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A Scan of National Development Finance Institutions in the SADC Region

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SADC DEVELOPMENT FINANCE RESOURCE CENTRE

FOR

SADC DEVELOPMENT FINANCE INSTITUTIONS NETWORK

A Scan of National Development Finance Institutions in the SADC Region

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Scan of Development Finance Institutions in the SADC Region

Part 1: Main Report

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TERMS OF REFERENCE

In accordance with the Terms of Reference (TOR) below, the Addendum to the Terms of Reference, and the approved Inception Report, the Consultants present the attached Draft Final Report to the SADC DFRC Secretariat and DFI Network in fulfilment of the Terms of Reference of the Project.

The Draft Final Report was adopted at a SADC DFI network meeting on 5 December 2014 with members of SADC.

TOR 1 - Chapter 4

Document the current state of development finance in the SADC region, relating in particular to the policy, regulatory and legal environments of national DFIs.

TOR 1 - Chapter 5

Identify and analyse the impediments and opportunities relating to cross-border activities by DFIs, and recommend measures at national and regional levels to address them.

TOR 1 - Chapter 6

Assess the Development Finance Institutions network mandate under the Protocol of Finance and Investment, taking into account other structures such as SADC Regional Development Fund, Project Preparation and Development Facility and Public Private Partnerships.

TOR 1 - Chapter 7

Propose policy options, framework and an action plan to aid the development of DFIs and enhance their creditworthiness.

Chapter 1
Background and Motivation of the Study

1.1 Background

Development Finance Institutions (DFIs)[1] are state-backed financial institutions that are concerned with the provision of long term loans not only to profitable projects but also to socially beneficial ones. The rapid industrialization in many countries in the 19th century was achieved by state provision of long-term loans to risky projects via DFIs (Diamond, 1957; Boskey, 1961). In countries such as Germany, Japan, France and Holland, DFIs were used extensively to meet the needs of growing industry (Diamond, 1957). During this period, DFIs provided technical support and cheap loans. They were also stakeholders in poor corporates and were very successful in accommodating entrepreneurship within those national economies.

Many advanced countries today finance development projects through DFIs. However, development banking activities only became widespread in less developed countries in the second half of the 20th century. Rapid industrialization had pushed less developed countries to use the development banking scheme increasingly during the second half of the 20th century. The development discourse at that time also rationalized state intervention in the financial sector. There was a strong belief that state regulation and intervention in finance would boost the real value of production and lead to a fairer allocation of resources. Interventionist state policies made development banking increasingly popular until the 1980s, although state involvement in the financial sector has gradually diminished since then in line with the neo-liberal shift in economic policies. Financial activities have been directed by free market dynamics rather than by regulated and directed markets.

Although the 1980s and 1990s witnessed financial liberalization in many parts of the world, the structure of development banking has not lost its value to the economy. After 1980, the decline in preferential credits to prioritized sectors and the backwardness in capital markets, particularly in developing countries, has exacerbated the need for financial intermediation for long-term financing. As will be discussed in chapter 2 of this study, development banking as a concept has evolved in various directions in different countries but has never lost its dynamism.

[1] In this study the term "Development Banks" (DBs) and "DFIs" will be used interchangeably.

Development banking in SADC member countries, in general, follows a single pattern for all the countries in the region. As a dynamic structure, development banking is supposed to play an important counter-cyclical role by providing long-term financing, technical and advisory services to entrepreneurs. A current challenge is to ensure that DFIs are able to do this effectively, which hinges on policy, while simultaneously guaranteeing that they play an active role in promoting financial access for those who cannot easily be assisted by commercial banks.

This is especially relevant for SADC, where general market failures in the provision of infrastructure finance, agriculture finance, housing finance and small and medium enterprise (SME) finance provide a strong rationale for an active developmental role to be played by DFIs. There are close to 50 DFIs in the SADC region, covering a wide range of institutions such as development banks, development corporations, development companies, export development funds, guarantee funds and so on. They have in common a policy mandate to foster economic development in the jurisdictions in which they operate. SADC DFIs can help to lengthen maturities in the financial sector and mobilize resources for underserved segments of the economy. In this regard, they can play a useful complementary role to that of international financial institutions, such as the World Bank, the African Development Bank (AfDB), and commercial banks.

Despite their importance, very little is known about SADC DFIs. Recent research either takes a cross-country perspective or focuses on case studies (see Thorne, 2011). To the best of our knowledge there is no specific assessment of the SADC DFI landscape. In particular, very little is known about their mandate, funding arrangements, financial performance, coordination arrangements, policy, legal and regulatory environment, risk management systems or corporate governance arrangements. This is important because existing studies which include Thorne (2011), Boskey (1961), and World Bank (1976) suggest that weaknesses in all these areas are the key determinants of the historically poor performance of DFIs.

1.2 The Overall Objectives of the Scan

The overall rationale of this Scan is to determine the landscape of the Development Finance Institutions in the Member States.

The specific objectives of the study are to:

a) Document the current state of development finance in the SADC region, in particular relating to the policy, regulatory and legal environments of national DFIs;
b) Identify and analyse the impediments and opportunities relating to cross-border activities by DFIs and recommend measures at national and regional level to address them;
c) Assess the DFI Network mandate under FIP taking into account other structures such as SADC RDF, PPDF and PPPs; and
d) Propose policy options, a framework and an action plan to aid the development of DFIs and enhance their creditworthiness

1.3 Structure of the Study

This study is divided into seven chapters. Chapter 1 is provides a general description of the aims and proposed method of the study. Chapter 2 presents a comprehensive survey of the literature on development finance institutions from the international perspective. This survey forms the basis for chapter 3, which covers the experience of DFIs in Africa. Within the framework of development finance in Africa, the issues of financial, legal and regulatory reforms are examined. Chapter 4 then documents the current state of development finance in the SADC region, in particular relating to the access to finance, size of DFIs, ownership, funding, business model, financial performance, mandate and so on. Chapter 5 discusses the challenges and opportunities related to the DFIs and Chapter 6 assesses the DFI Network mandate under FIP, taking into account other SADC development finance structures such as the SADC Development Fund (SADC DF), Project Preparation and Development Facility (PPDF) and Public Private Partnerships (PPPs). The concluding chapter, chapter 7, briefly discusses the policy options, the proposed action plan and recommendations for the future.

Chapter 2
Development Finance Institutions (DFI)
International Context

2.1 Introduction

It is first of all necessary to understand the nature of the development banking system, what exactly a development bank is, and how it differs from other types of banks. These differences help us to understand and to define the development bank concept. Generally, the most familiar types of bank are the commercial bank and the investment bank. Commercial banks have existed in almost all countries since the nineteenth century and have gradually replaced traditional moneylenders and other informal intermediaries. The basic function of banks has been to attract and assemble private sector savings and to provide short-term funding for the temporary needs of traders, artisans, commercial agriculture and, over time, for more sophisticated production and commerce. Typically, however, commercial banks have been less responsive to long-term credit needs, especially to those involving industrial sectors, because of risk aversion, tenor of investment, and so on.

Basically, long-term lending runs counter to the institutional habits, attitudes, criteria, and procedures of commercial banks. Most commercial bank loans involve the commitment of funds for no more than a few months, and they largely finance goods in import-export trade or inventories, which in themselves constitute reliable collateral. The loans usually go to firms with an established financial record, so that a reasonable evaluation requires merely ticking off a few standard indicators of security ratios and credit rating. The financing of industrial investment, by contrast, calls for a long-term commitment, often a decade or more (and the loan is based on collateral of uncertain saleability in case of default), perhaps to entrepreneurs with limited experience in the industry (often entirely new entrants). Furthermore, an industry's viability depends on numerous factors (technology, marketing, economic fluctuations, government policies, management) that can be assessed only over a span of several years, and with some expertise. This longer time frame and the expertise required are largely alien to traditional commercial banking, which specialises in short-term borrowing and lending for a period of not more than one year.

2.2 The Concept of Development Finance Institution

A Development Bank is a specialised financial institution whose functions and operations can be defined with regard to its hybrid financial development character. The field of "development banking" goes beyond the scope of the development bank proper. Development banking also covers the relations of development banks with national and local governments, with international agencies, and with policy-making and planning agencies. Development banks are institutional instruments of public policy whose performance is measured more than commercial banks in terms of social benefits generated, as measured by indicators of social accounting, than in standard profit and loss. The operations of these banks are linked with industrial, agricultural, social, governmental, institutional, and other development processes. Development banks are institutions organized to achieve the preparation, appraisal, financing, and implementation of investment projects and programmes. In addition, the work of development banks requires knowledge of financial markets, capital markets, financial intermediation, banking, resource mobilisation, human resource and technology development, marketing, technical assistance, development economics, and international economics and financial transactions.

In this context, the term "development bank" is used to denote the specialised financial intermediary which is also referred to as a "development finance institution" (DFI). However, since the world debt crisis in 1982, the "banking" aspect of these institutions has received greater emphasis, which has led to a more general use of the term "development bank" to reflect an important role these institutions play. "Development Finance Institution" is more precise for a public entity, because a "bank" normally tends to be privately owned institution, licenced by the central bank.

This brings us to the first dilemma confronting the development bank. It is a product of the marriage between a development financing institution and a commercial bank, each with their own operating strategies and investment objectives. Its main shareholder is the Government. Unless it is able to define its role and determine its playing field, it will always face problems of institutional identification and unwarranted competition from other financial institutions.

2.3 Objectives of Development Finance Institutions

Broadly speaking, the objectives of DFIs are twofold: (i) to increase the savings rate (which creates additional capital stock), and (ii) to increase the investment rate. The first objective

could be achieved by raising capital from capital markets abroad, inviting foreign direct investment, developing domestic financial markets, and mobilizing non-traditional sources of capital. Other than the initial capitalization provided by the government, development banks should not rely on the continued injection of government money but should instead raise capital from elsewhere. Receiving some government subsidy is different from relying entirely on government funding. If the bank were to rely entirely on government funding, it would not be increasing the savings rate since government money also comes from public savings.

The second objective could be achieved by investing in projects that commercial banks would be unwilling to support. These are the "development" projects that require substantial capital, are risky, need long-term financing, and are low in the bankability scale. Commercial banks will invest in these projects when they become "commercialized" or have been proven to be financially profitable. The DFIs can support projects that are not financially viable otherwise through the use of government financial funds. In theory, the development banks would not contribute to increasing the investment rate if they compete with commercial banks.

The two objectives above are mutually exclusive. The success of one does not depend on the other, although in the long run more savings would lead to more investment and more investment could result in more savings. Development banks and other non-bank development financing institutions work with government to achieve these objectives. An individual development bank pursues either one or both of these objectives depending on their operating charter. One bank might concentrate on channelling capital from traditional sources (such as government and the domestic capital market) to stimulate the manufacturing sector, as in the case of industrial development banks. Other banks would engage in attracting capital from non-traditional sources and at the same time invest in non-traditional investment activities, such as in rural development banking and micro-enterprise development banking. Some banks serve as saving and loan centres and raise capital through public debt (bonding) to finance housing projects. Import-export development banks help importers and exporters have access to foreign exchange. These development banks, in one way or another, are trying to increase the savings and investment rates.

2.4 Evolution of Development Finance Institutions

Development banking can be said to have evolved during the time of industrial expansion in countries now considered to be more developed. The 1930s and the years following the Second

World War saw the establishment of financial intermediaries engaged in development financing in many developing countries. During this period, the focus of development financing was industrial development, and industrial development banks can be considered the pioneers in development financing. This is consistent with the theory that development moves from agricultural to industrial development. Industrial development has been emphasized in the development plans of many developing countries and governments established industrial development banks as part of a plan to encourage industrial development. At the initial stage of industrialization, investments in manufacturing and processing are considered risky and untried. This type of investment also requires a large volume of capital and long-term financing. Industrial development banks were established to provide investment where the commercial banks were reluctant to do so.

Soon, the developing countries realized that industrialization could not be sustained without a concurrent development in agriculture and other sectors. This realization led to the establishment of other development banks and non-bank financing institutions. In less developed countries or 'pre-take off countries' (as referred to by some authors) multi-purpose development banks were formed. These development banks served various sectors of the economy needing assistance. As the country developed, more specialized development banks were established, such as agricultural development banks, micro-enterprise development banks, cooperative development banks, import-export banks, rural banks, housing development banks, and other sectoral development banks. Specialized industrial banks were established to serve specific industrial clients, such as manufacturing, technology, mining, steel, and energy supply.

According to Bruck (2003), there are over 550 development banks worldwide or an average of 3 development banks per country. There are 121 development banks in Asia and the Pacific region. In addition, there are 32 international, regional, and sub-regional development banks. Africa has over 147 development banks, and 47 development banks can be found in the Middle East. The rest are located in the South America and Europe.

Most development banks are government-owned, but some are privately owned. This is particularly true in developing countries. The government-owned development banks were established to support the development strategy of a particular developing country. During the 1960s, when industrial development was seen as the main road to development, many countries established industrial development banks to stimulate investment in manufacturing and

commerce. When linking agriculture to industrial activities emerged as a better strategy, agricultural development banks were established to increase agricultural production. Land banks were established to finance land reform. Cooperative banks were founded to stimulate investments in marketing and consumer cooperatives. Agro-Business banks were established to stimulate small to medium investments in food processing, transforming agricultural produce to commercial products, livestock feed processing, and commercial grain and livestock processing. Rural banks were established to connect the rural population to mainstream economic activity and to mobilize non-traditional sources of capital. Many developing countries established specialized development banks to support sectoral development, for example in tourism, import-export, marine production, micro-enterprises, rural development.

In countries that have attained a higher level of economic development, and as development projects become more bankable, commercial banks have played a greater role in providing private capital to development projects. In these countries, investment in industrial activities, transportation, communication, and energy generation has been taken over by commercial banks. Development banks have moved from being the initiator of these loans to being simply a participant in a loan package. The participation of a development bank in loan packaging is important as it demonstrates to commercial banks the viability of the investment. It also reduces the exposure of commercial banks to a more tolerable level.

A number of industrial banks that started as publicly-owned institutions have been privatized. In addition, many commercial banks started to invest in development projects together with development banks. This implies that the "business of development" is becoming profitable. The International Bank for Reconstruction and Development (IBRD) and the International Finance Corporation (IFC), both members of the World Bank Group, are profitable banks. Their surplus is channelled to the International Development Association (IDA), another member of the Group. IDA loans are targeted to less-developed countries. These loans have low interest rates and longer repayment periods than to IBRD and IFC loans.

2.5 Roles of Development Finance Institutions

The primary role of a development bank is to supply the "missing ingredients" needed to sustain the current level of economic development and to bring the country to a higher level of development. For many developing countries, the missing ingredients include capital, technology, foreign exchange, and entrepreneurship.

The production function of the economy is defined as:

$$\gamma = t(\mathrm{L}, \mathrm{LB}, \mathrm{K}, \mathrm{E}, \mathrm{T})$$

Where γ is the national output and is a function of land (L), labour (LB), capital (K), entrepreneur (E), and technology (T).

The entrepreneurs combine the other "factors" to reach a desired level of production. The entrepreneurs (E) are investors with the knowledge and skills to make sound investment decisions and who are able and willing to manage the risks. Depending on the size of the investment, they might be supported by managers who have the skills needed to manage the specific business. Together, they determine the right mix of the other factors of production, such as capital, land, labour, and technology.

In general, developing countries have favourable factor endowments or comparative advantage in land and labour. They have a comparative disadvantage in the supply of capital, entrepreneurship, and technology. These are usually the "missing ingredients" for developing countries. Comparative advantage means that a country can supply the factor of production at a lower cost than another country can. More developed countries have a comparative advantage in the areas of capital, entrepreneurship, and technology. Developing countries could wait until they increase capital formation, develop local entrepreneurial skills, and develop the needed technology on their own, but it is unlikely that they have an adequate economic base to do so on their own. In addition, many developing countries want to increase the rate of development in the shortest time possible. The developing countries therefore need the 'missing ingredients' to be supplied by, or sourced from, more developed countries.

The process of supplying the missing ingredients of capital, technology and entrepreneurship is continuous. As the development of a country gains impetus, demand for the missing factors will increase. Logically, it can be assumed that as a country develops, its capacity to absorb capital, technology and entrepreneurship will also increase. The continuous supply of these ingredients will lead to an increase in savings rate and investment rate, the two main objectives of DFIs.

In its quest to supply the ingredients needed for development, development banks will need to initiate action, build institutions, act as a catalyst for and advocate of development, and function as a bank of last resort.

2.5.1 Initiator

DFIs play a "supply-leading" role in the provision of the missing ingredients. Supply-leading occurs when institutions, such as DFIs, are created in advance or in anticipation of a demand for them. "Demand-following" is when institutions, such as commercial banks, are created in response to demand.[2] In the supply-leading role, DFIs should seek every opportunity to "stimulate" the demand for the missing ingredients and to create the capacity of the economy to absorb them. An example is technology transfer. If the private sector is not taking advantage of new or improved technologies, the DFIs should encourage their transfer through its lending activities to the entrepreneurs. Another example is in the development of entrepreneurial skills. The DFIs could make it a condition of a loan that the owner and managers of small-scale businesses attend business management seminars.

2.5.2 Institutional Builder

DFIs should develop new methodologies, techniques, and systems to raise capital and increase investments in non-traditional areas. One example is when a DFI develops a system of attracting capital from non-traditional sources such as farmers and small businessmen. Once the system is proved to be effective, formal guidelines could be developed for other banks to follow. When that happens, the system of raising capital from these sources is said to have been 'institutionalized'. Similarly, when a development bank successfully develops a new financing structure for a large industrial project, this can serve as a model which the private sector can use to finance similar projects. The pioneering activities of DFIs have also brought about the 'institutionalization' of microenterprise financing in both developing and developed countries.

2.5.3 Catalyst

Commercial banks might be reluctant to invest in development projects for a variety of reasons. These include the level of risk (because the project is a new venture), the amount of capital required and the long term over which repayment can be made, and the untested creditworthiness of prospective borrowers (as in microenterprise and agricultural financing). If the projects are vital to the process of economic development, DFIs should develop a financial package involving private investors and commercial banks. It should encourage the private

[2] Patrick, H.T (1966), 'Financial Development and Economic Growth in Underdeveloped Countries', Economic Development and Cultural Change.

sector to have confidence in the financial viability of the project. To do this, the DFIs could either provide a substantial portion of the required investment or offer guarantees on the repayment of the project's loans. For example, the Multilateral Investment Guarantee Agency (MIGA), a member of the World Bank Group, guarantees foreign investors against political risk[3]. This guarantee reduces the risk exposures of foreign investors as they will be participating in a financial structure prepared by the International Finance Corporation, another member of the World Bank Group, which gives loans to private sector investors in developing countries[4].

The development bank should be able to reduce its exposure as private investors and commercial banks gain more confidence in specific types of investment. In this context, the development bank serves as a "priming device" to draw the commercial banks into the project.

2.5.4 Development Advocate

The lending strategy of development banks should always treat development contributions as integral parts of the scheme. Development benefits include the generation of employment, the utilization of domestic resources, increasing the incomes of farmers and industrial workers, the saving and earning of foreign exchange, the transfer of new technology, and improving the entrepreneurial skills of non-traditional investors, as well as other benefits. If the lending activities of DFIs do not result in development benefits, and the DFI is concerned solely with recovering its loans, it can be considered to be operating just like any other commercial bank. In addition to development benefits, DFIs should also be "beneficiary-oriented", since development projects are targeted to specific beneficiaries. As a development advocate, the DFI should make sure that the intended beneficiaries receive the benefits. For example, if the agribusiness loan granted to a corporation was intended to increase the income of tomato farmers within the area of influence of the processing plant, the DFI should see to it that the intended beneficiaries (tomato farmers) actually benefited.

2.5.5 Bank of Last Resort

DFIs are expected to invest in areas where commercial banks are reluctant to get involved or have no previous involvement. This role is closely related to the other roles discussed above.

3 SADC DFIs could use this model as a reference point to develop a Regional Insurance Guarantee Scheme for the sub-region.

4 Which means that the IFC gives the loans, but the foreign investors provide the money, and are protected by doing it within the WB framework, and guaranteed by the MIGA.

In this role, the DFI provides financial resources to projects proposed by private investors which cannot be financed by commercial banks. The DFI is not an initiator because the project proposal comes from the potential private investor. The DFI should help the private investor design the project and devise techniques to minimize risk. This is especially true in projects with minimal financial return to the private investors but promising tremendous development benefits. In such a case, the private investors would seek to reduce their exposure by asking for a subsidized lending rate, or would seek the technical assistance of the DFI in designing the investment.

2.6 Experience of DFIs from International Perspective

For many years DFIs were considered to be "substitute" financial institutions necessary to provide impetus to industrial growth in underdeveloped countries during the "great spurt" phase of the industrialization process. This approach may explain why DFIs did so well in certain countries, in certain periods, and so poorly in others. A number of countries have never experienced the desired growth levels in the industrial sector. In a number of countries, and in a variety of economic contexts, DFIs have failed to perform because of poor financial management.

During the 1980s, the World Bank began to emphasize financial sector growth criteria and the DFI system was seen as an impediment to the development of a liberalized and commercially driven financial sector. The Bank continued to lend to the DFIs, while channelling an increasing share of funding through commercial banks, using a two-tier system with apex organizations to reach the small and medium enterprise (SMEs) sector which was previously serviced by the DFIs directly. Financial components of Sectoral Adjustment Loans (SALs) and Financial Sector Adjustment Loans (FSALs) became the major instruments for financial sector reform.

Reviewing the past forty years, the World Bank has conclude that DFIs did not contribute to development, adding that they sometimes hinder rather than help. They can, however, assist real-sector growth when the financial sector is generally underdeveloped, provided that they are used in to achieve specific goals, within clearly-defined parameters, and their true financial costs are presented accurately and transparently in the national accounts.

In the past two decades, the World Bank has advocated that DFIs be considered and analysed in the context of the whole financial sector (accepting that this sector will demonstrate different

characteristics in different countries). It has also argued that negative real interest rates and excessive use of directed credits adversely affect the mobilization of savings and the efficient allocation of credit, and that the success of SME lending projects depends on the policy framework in effect. It is now understood and accepted that DFIs can play an important developmental role in SME lending, agricultural-based rural financing, and specialized credit, in those markets where commercial banks cannot be expected to undertake undue risks, and where there is a well-defined market niche for DFIs.

Any discussion of DFIs is necessarily related to the concept of directed credit and specialized "target markets". When directed credit schemes are accepted as a useful part of a country's developmental policies, the issue becomes whether or not the commercially driven and established financial markets fail to provide access to the levels of credit necessary to sustain proper economic growth to certain segments of the market, i.e. the micro, small, and medium enterprises. When the use of directed credit to the SME sector is justified, assistance can be directed either through existing financial institutions or through specialized DFI structures.

Furthermore, it has been argued that establishing or continuing to subsidize a DFI may have negative effects on the development of the commercial banking sector if special concessions or subsidies are granted to the DFI.[5] In general, it appears that the use of directed credits and concessionary terms for DFIs as financial intermediaries is to be preferred only if the government has made a real-sector decision that such development financing is required by economic conditions and a realistic allocation of government resources has been made in the budget process.[6] In addition, the commercial banking sector must be unable, or unwilling, for logical credit risk management and profitability reasons, to provide the required types of directed credits to specific target groups.

2.7 Lessons for SADC

There is a strong belief that modem DFIs can only become sustainable and continue their specialized role in a country's economic development if they are independent from excessive government influence and control. The key element in this equation is ownership, and an

[5] As a result of this, DFIs may operate at a sub-optimal level and this may cause financial instability.
[6] This alludes to the complementary role of the DFIs to the commercial banks.

independent bank supervisory system, with powers to supervise DFIs on the same basis as it supervises the commercial banking system.

DFIs that are privately owned and independently managed are seen to be the most successful, with a mixture of government and multinational development agency ownership considered the most desirable. It is also generally agreed that DFIs should complement other financial institutions such as commercial banks, capital markets and non-bank financial institutions. However, if the services of the DFIs are available from other institutions, such as commercial banks or finance companies, then it is difficult to defend or justify government-operated or supported DFIs in these areas. These institutions should only be continued if they fill a particular gap and service a particular need in the financial markets.

Chapter 3
Development Finance Institutions (DFIs): The African Context

3.1 Introduction

Up to the end of the 1980s, development finance was provided nearly exclusively by Development Banks (DB). In this period, African DFIs, as in other developing countries, operated within a protected environment. They benefited from having privileged access to the financial resources of the state and maintained a special relationship with international donor institutions. Furthermore, they operated outside of the normal regulatory framework for banks, which meant that they were not constricted by financial management protocols imposed on commercial banks. Though these institutions were called "banks," strictly speaking they were not, as they did not accept deposits, and therefore did not have the capacity, as normal banks do, to create money. This task was reserved for institutions registered with the Central Bank and operating under its supervision.

3.2 The African Experience

During this pre-1990 period, Development Banks were public institutions created by the state, with equity capital frequently provided by international cooperating partners (ICPs). According to the needs and the specific context of the country, these institutions could play a number of roles. They could be involved in the promotion and evaluation of development projects, the financing of specific sectoral policies, or the implementation of governmental policies and projects (World Bank, 1976). Their principal objective was to provide long-term finance to economic agents, since commercial banks did not have sufficient resources.[7] DFIs not only financed development-oriented projects, but also provided technical assistance for project preparation, implementation, and follow-up, services which commercial banks could not supply.

DFI operations were based on a financial analysis of the project that calculated its expected economic rate of return (ERR), which differed fundamentally from the financial analysis used by commercial banks. Whereas banks evaluate the capacity of the potential borrower to repay

[7] As commercial banks generally deal short-term deposits and short-term lending.

his or her debts, DFIs chose a project by calculating its long-term profitability.[8] Since DFIs did not provide short-term finance, companies often had to open accounts at both commercial banks and development banks to meet all their financial needs, each institution managing its account according to its own internal logic.[9] However, because of the lack of inter-institutional relationships between banks and DFIs, any financial difficulty faced by a project or company, while it would be detected by a commercial bank, would only become known to the DFI much later, often when it was already too late to intervene.[10] The informational dissymmetry created by the lack of communication between severely handicapped the DFIs' effectiveness.

Development Banks were chosen as the principal means of providing development finance because of the notion that development had a "direct linear relationship with the amount of capital made available to local economic agents" (Bruck, 1999, p.1). In countries characterized by a lack of national savings and low export revenues, capital for development-oriented activities needed to come from external sources. This was achieved through the creation of national Development Banks. These institutions, modelled after international institutions like the World Bank, would channel donor funds into the country to finance long-term development projects. Similarly, this type of economic approach urged local banks to implement directed credit programs, in order to encourage lending towards certain sectors – agriculture, industry, craftsmanship, etc. – to meet national development objectives.

At the same time, governments implemented import-substitution policies as well as capped interest rates, in the hopes that lower rates would facilitate lending. This approach to financing development therefore excluded the financial sector from the development process. One economic growth theory at the time postulated that financial sector development followed, rather than preceded, the expansion of economic activity, specifying that economic growth through the increased activity of productive companies would come before the demand for financial services (Robinson, 1952). Robinson's analysis was based, in part, on the theories of Keynes, which affirmed that the financial sector played a neutral role in the economy as a simple channel of transmission for resources. For this reason, the concept of Development

[8] The main difference between the analyses used by Commercial Banks and DBs concerns the way in which each deals with risk. DBs based their approach on the potential success of the project itself as opposed to making the borrower (the project's promoter) responsible for the loan's reimbursement, as banks do. This can lead to a lack of accountability for the project's promoter.

[9] Certain DBs provided both long-term and short-term finance, like the Banque Camerounaise de Développement or the Crédit de la Côte d'Ivoire, but the majority of DBs only provided term finance and/or venture capital (World Bank, 1976).

[10] This is because commercial banks are more aggressive in following up the loans.

Banks was that they were responsible for transmitting resources obtained through external sources to domestic development projects, while banks followed the same policy, lending resources through directed credit programs.

However, the Development Banks' privileged position gradually began to disappear as economic theories evolved. At the same time that the theoretical framework was changing, DFIs had also begun facing internal difficulties as domestic economic situations deteriorated and financial management challenges grew. By the end of the 1980s, it was clear that African states needed to re-examine their methodology for promoting national development critically. In fact, questions concerning development finance and financial sectors in general were brought up during the preparation and implementation of Structural Adjustment Programs (SAP).

3.2.1 Impact on Financial Sector (SAP-Financial Reforms)

The conclusions published in the works of two economists, McKinnon and Shaw, in 1973 radically changed the approach to financial sectors and, in particular, their role in development. Based on research concerning the financial sector reforms in Taiwan during the 1950s and Korea during the 1960s, McKinnon and Shaw formulated a theory that went against that established earlier by Keynes. Their recommendations for financial sector liberalisation reforms were eventually accepted by the Bretton Woods institutions, particularly the International Bank for Reconstruction and Development (IBRD) and the International Monetary Fund (IMF), which incorporated them into Structural Adjustment Programmes or made them conditions in loan or grant agreements. Towards the end of the 1980s, African countries began to see the first consequences of this change in approach.

Prompted by the situations in Latin America and Asia, where strict financial controls seemed to have had negative effects on the economy – provoking capital flight in the former case and an increase in the informal economies and inflation in the latter (McPherson and Rakovski 1999) – McKinnon and Shaw recommended the elimination, or at least a sharp decrease, in what they termed "financial repression"[11] or government interference in the financial sector. The two economists indicated that the liberalization of the financial sector, especially with

[11] Financial repression denotes measures by which governments channel funds to themselves as a form of debt reduction. This concept was introduced in 1973 by Shaw and McKinnon. It include such measures as direct lending to the government, caps on interest rates, regulation of capital movement between countries and a tighter association between government and banks.

regard to interest rates, would have a positive effect on the economic growth rate, as higher interest rates would incite economic actors to save more, mobilizing greater domestic savings for investment.

To eliminate financial repression, the economists called for the removal of interest-rate ceilings, which they asserted were reducing national savings and the accumulation of capital, by allowing nominal interest rates not to be determined by the market. Previously, common practice had been to maintain low interest rates in order to encourage borrowing for investment.

The primary difference between the two approaches was the role of money. In the Keynesian approach money was neutral but for McKinnon and Shaw it was not. They argued that weak interest rates provided little or no return and caused economic agents to keep their money out of banks. On the other hand, positive real interest rates mobilized more savings. With greater mobilization of savings, banks could finance more, both quantitatively and qualitatively (see below), and therefore increase economic development. Economic agents who did not wish to see their assets attacked by inflation directed their surplus resources towards additional consumption instead of saving.

As a consequence of McKinnon and Shaw's recommendations for financial liberalization, banks fundamentally changed their operations and policies. In a directed credit system with capped interest rates, banks did not need to assess the projects that they would finance (as they often did not have the choice) or develop tools to cover the associated risks. In a liberalized financial system, banks set up a true credit policy using financial analysis to assess risks instead of allocating credit through government-directed credit programs. They also uncapped interest rates to cover those risks.

Financial liberalization also increased the quality of investments. Because of higher interest rates, entrepreneurs could no longer launch projects with little or no profitability, Instead, they had to ensure that their projects had high rates of returns in order to reimburse their loan capital and interest. Financial liberalization therefore had a positive effect on the selection of projects, encouraging quality investment in the country.

Finally, financial liberalization in theory allowed for a more nuanced approach to monetary policy management, using interest rates as opposed to legal reserves. Such reserves could be removed or lowered by the Central Bank because they had a strong negative impact on bank profitability.

At the end of the 1980s, the World Bank and the IMF began to implement many of the recommendations of McKinnon and Shaw and others (Feldstein and Horioka, 1980, Krugman 1979). Significant restructuring of financial sectors began in countries across the Continent, as SAPs and other liberalization programs were put into place. As part of these reforms, the banking laws changed, central banks and banking commissions were reinforced, and new management standards were imposed on banks. Non-performing loans in banking institutions' portfolios were identified and separated.

3.2.2 Impact of SAP (Financial Reforms) on Development Banks

The theoretical basis on which Development Banks had been built was seriously weakened after the implementation of liberalization programs. Before liberalization, the inability of commercial banks to provide finance for national development projects allowed the government to direct financial flows towards separate specialized institutions, such as Development Banks. The new approach, based on the theories of McKinnon and Shaw, opposed this sort of financial sector partitioning, contending that once the uncapped interest rates served to mobilize national savings, banks would be in a position to finance projects adequately themselves. The elimination of financial repression enabled banks to finance development activities. There was no more need for ad hoc DFIs, such as Development Banks with fixed interest rates, to mobilize national savings.

The gradual disappearance of Development Banks was therefore linked not only to their bad management, but more importantly to the new economic framework in which they worked. Liberalization policies contested the compartmentalization of financial sectors, and established neutral and more effective market-based mechanisms to determine interest rates. These mechanisms allowed institutions to replace the discretionary decisions of economic agents (governments, CEOs of DFIs, international donors, etc.), whose limitations had been revealed. Thus, while this approach did not directly oppose institutions like national DFIs, its objective to "de-compartmentalize" financial sectors caused DFIs to lose their particular status and placed them on the same level as banks. As a result, the Development Bank concept that had prevailed in previous decades began to disappear; the result was that DFIs as financial institutions had to either reform or face being shut down.

3.3 Diminishing Role of DFIs

The reforms in favour of liberalization were implemented during difficult economic conditions for the majority of African countries. In such sub-optimal conditions, liberalization often exacerbated inflationary trends and led to increased government borrowing and spending (Pill and Pradhan, 1995). For the commercial banks and the DFIs which had not previously made lending and credit allocation decisions according to traditional banking criteria (risk, etc.), the new deregulated environment posed a great challenge (Pill and Pradhan, 1997).

New and more rigorous banking laws were introduced (Dhumale 2000). These laws also called for the establishment of Banking Commissions to supervise the banking sector and all institutions receiving deposits from the public. These guidelines were especially concerned with short-term finance.

Thus, in "de-compartmentalizing" the financial sectors, the new approach structurally linked development finance to the newly liberalized financial sector. This linking served to place the entire issue of development finance under the control of the banking sector authorities (Central Bank, Banking Laws, and Banking Commissions), which were primarily interested in monitoring and ensuring short-term savings and credit operations. The problems of development finance – essentially long-term finance – were therefore handled by the banking sector, whose experience primarily focused on managing short-term funds.[12]

The situation of DFIs worsened when they were authorized, and often encouraged, to mobilize savings or to lend short-term funds in order to diversify their portfolios and to ensure their survival (Epstein, 1996). DFIs had no previous experience with short-term risks and did not possess the needed institutional organization to mobilize deposits or to allocate short-term loans. Thus, the DFIs accepting deposits automatically came under the supervision of the state's banking authorities, which created new constraints and caused them to lose their specificity vis-à-vis banks, and their performance was to be evaluated in future according to short-term criteria, despite their original mission to provide medium and long-term finance.

At their inception, Development Banks in Africa were not regulated by banking laws, or in some countries received special dispensations from banking laws. In the new approach, the DFIs could choose not to comply with Banking Laws, in which case they would disappear as

[12] This introduced weak regulation for DFIs.

‘banks’. As a result, their role in development finance through the provision of term finance would sharply decline. The difference in the evolutions of Development Banks between countries was thus related to the degree to which new banking laws were applied.

Another important difference in the evolution of DFIs across the continent depends partly on whether the country’s judicial framework was based on the Continental European model or on common law (Tsuru, 2000). In the former, the financial system is not very diversified, but is primarily centred on banking institutions, whose activities are more or less limited to savings and loans. During the reforms, therefore, the DFIs in these countries did not have a choice, and were forced to transform into commercial banks or be eliminated. In countries based on the British legal system, the financial system was more diversified. Banks had to comply with banking regulations, and other non-bank financial institutions operating in parallel provided credit as well as technical assistance when necessary. Thus, in the majority of countries based on the common-law framework, non-bank institutions, such as Development Corporations, were often already involved in providing development finance or could be created to replace former Development Banks.

3.4 Points of Reference for DFIs

Today the principal point of reference for development finance is banking law. For an institution that provides development finance, the fundamental question is whether or not it must comply with banking laws. Is the institution approved as a bank? If so, to what extent must it comply with banking regulations and ratios such as capital adequacy ratio, liquidity ratio etc.? Compliance necessarily limits the range of activities the institution can carry out in favour of development-oriented activities. If it is not registered as a bank (meaning that it does not collect deposits and, usually, does not have the word “bank” in its title) the institution is generally free to set its own prices and make financial decisions, which allow it to intervene in national development projects on commercial basis. However, in this second case, without external supervision, the institution’s financial health and stability may be put into question.

Setting banking law as the primary point of reference meant that the reforms of the 1990s focused almost exclusively on the short-term aspect of banking. The banking laws were adopted during a time of financial distress across the Continent. The severity of their provisions and the strictness of their application can be understood in light of significant abuses that forced governments to close numerous commercial banks, in addition to development banks,

throughout the continent. The banking laws were reformed in order to provide a solid base for financial systems. However, they did not provide specific provisions relating to long-term financing needs for national development.

3.5 Specific Definition of DFIs

The discussion above shows the importance of adopting a precise definition of institutions providing development finance in order to avoid any confusion as to their status and hence their managerial constraints.

First, the use of the term "bank" must be reserved for institutions registered with the Central Bank as such, regardless of whether or not they finance development.[13] In the majority of countries, African banking laws recognize one single type of bank, or a "universal bank," and have eliminated other classifications, such as "development bank."

Secondly, non-bank financial institutions which play a role in financing development projects, are called Development Finance Institutions (DFIs). From a monetary policy point of view, banks can create money, collect deposits, and use the interbank money market to raise funds, whereas DFIs generally do not create money, do not collect public deposits, and do not use interbank money markets.

Thirdly, non-bank financial institutions that specialize in providing specific services, either commercially or developmentally oriented (leasing, venture capital, etc.) will be called "specialized finance companies."

3.6 The African Experience

The financial sector reforms in favour of economic liberalization adopted throughout Africa did not have the same consequences in each country. The majority of DFIs in operation when SAPs were first implemented and financial liberalization measures were put into place attempted to adapt in order to survive. To do so, they developed new activities, primarily savings programs, to mobilize new resources, as well as engaging in short-term lending. These activities caused the institutions to be placed under the supervision of Central Banks and Banking Commissions and forced them to comply with the new banking laws. DFI portfolios,

[13] Most banking laws actually prohibit the use of the word "bank" for institutions which have not been approved by Banking Authorities. However, certain DFIs in Africa have kept the word "bank" in their title despite the fact that they are not regulated as banks.

which had often been weakened by large numbers of non-performing loans, were then inspected by the Commissions.

Shortly after the implementation of the reforms, the traditional DFIs began to disappear. Some were declared bankrupt or were completely reorganized, while others were converted into banks.

The landscape of financial sectors throughout Africa, particularly in regard to institutions providing development finance, is highly varied. Development-oriented institutions can take several forms. For instance:

- Non-bank financial institutions (NBFIs) can finance development through Development Corporations, which have often taken over the function of Development Banks.[14] These will be referred to as Development Finance Institutions or DFIs;
- Newly created financial institutions modeled on former Development Banks, based on similar ideologies with similar missions, will also be referred to as DFIs; and
- Development-oriented banks, which are usually former development banks that have maintained certain development objectives after their transformation into commercial banks.

It is important to note that, in the SADC region, there has been an increase in the number of DFIs with the latest being the Development Bank of Angola and the National Investment Bank of Mozambique.

The differences in the evolution of the financial landscapes in sub-Saharan Africa can be partly understood by examining the specifics of the multi-national Banking Commission that exist in Africa.

In sub-Saharan Africa, SAPs served to reform and restructure the financial sectors, strengthening the Banking Authorities. These multinational Banking Commissions were national institutions, and had greater latitude in evaluating the effectiveness of institutions such as DFIs, using broader criteria (i.e., not limited to pure financial analysis). They thus became more flexible in their analyses, and allowed, among other things, certain institutions facing severe financial difficulties to survive (Morocco), or permitted national legislatures to create

[14] However, DFIs and former DBs do have a fundamental difference in approach, which will be discussed in the following chapters.

new public financial institutions that would neither be under the supervision of the banking laws nor of the Banking Authorities (Namibia, Angola or Zambia).

3.6.1 Financial Reforms

Nearly two decades have passed since the first financial sector reforms in Africa were implemented. The liberalization of financial sectors had a positive influence on growth (Mkandawire and Soludo, 2002). At the same time, it seems clear that liberalization did not provide a viable solution for development finance needs.

Criticisms related to financial sector reforms of the 1990s focus on two main points. First, the underlying theoretical analyses of McKinnon and Shaw have been re-examined in light of the financial crises, notably in Latin America, which seemed to have been triggered by economic liberalization reforms. In 1993, in reaction to these adverse consequences, McKinnon wrote "The Order of Economic Liberalization", in which he identified the proper order and pre-conditions necessary for the successful implementation of liberalization measures, in order to avoid situations such as hyperinflation. Secondly, other critiques pointed to economic success cases where reforms favouring economic liberalization were not instituted. Some governments, such as South Korea and Taiwan, maintained interventionist policies and succeeded in promoting investment and industry before beginning to liberalize their economies (Harris, 1998; Rodrik, 1999; Lagging, 1990; Amsden 1989). In addition, there was debate over whether it was necessary to liberalize the financial sectors entirely or to leave room for other, complementary, approaches that could be used to target certain economic sectors for support.

3.6.2 Reform Issues

Financial reforms implemented by the Bretton Woods Institutions did not always generate positive results. The elimination or lowering of interest rate ceilings, for example, often drove banks to raise lending rates drastically, which greatly reduced the number of clients able to borrow, and which made credit reimbursement much more difficult. In certain countries banks faced greater difficulties as default rates increased.

The post-reform situation in many countries led some analysts to criticize McKinnon and Shaw for having founded their recommendations on seemingly typical case studies. Others remarked that recommendations concerning financial sectors had been established on models for political liberation from the 1960s. The latter suggested that eliminating financial repression from the

financial sectors had used the same model as that proposed to eliminate political oppression from the political systems.

3.6.3 Results of the Reforms

Financial reforms in Africa have changed the Continent, situating it somewhere between Asia and Latin America economically. Because of the strong donor presence, African countries have been obliged to continue restructuring national financial and monetary policies. This has created a relatively favourable context for financial sector reform. However, at the same time, financial sector reforms have not led to the simplification or rationalization of the institutional landscape as they did in Korea.

The policy reforms had different results across the Continent. In each country, the operations carried out by former DFIs were to a greater or lesser extent taken over by other actors operating in the new financial landscape. As has already been stated, certain sectors would nevertheless remain without access to finance.

3.6.4 The Post-Reform Financial Landscape

The post-reform financial landscape of Africa was characterized by the arrival of new actors and the redistribution of operations formerly carried out by DFIs, among other institutions.

The primary outcome of financial sector reforms in Africa was the division of the financial sectors into two sub-sections:

- A first sub-section of "banks" regulated by the Banking Laws, which underwent many subsequent reforms that supplemented the initiatives undertaken in the 1990s; and
- A second sub-section of various "non-bank financial institutions", focused primarily on providing development finance, but not recognized by Governments because of their heterogeneity.

One of the effects of the financial sectors reforms was failure to merge non-bank financial institutions and commercial banks so as to avoid financial instability in the financial sector system.

After two decades of reform, the new financial landscape in African countries has the following appearance:

- Sub-Section 1: Banks:

    1) Traditional commercial banks or "universal banks:" these can participate in development-oriented projects, provided they have a sufficient return;
    2) Development-oriented commercial banks: within this category are former DFIs that have maintained certain development objectives despite having been converted into universal banks regulated by Banking Laws. These banks are characterized by an exclusively public shareholding and are willing to take on more risk in regard to development projects than commercial banks, in order to achieve their social objectives e.g., BPC Angola/SME Banking of Namibia.

- Sub-Section 2: "Non-Banks:"

    1) Multiple types of finance companies that specialize in providing development finance are collectively considered DFIs: Industrial Corporations, Housing Corporations, new "development banks", etc. These institutions have maintained their organization since their creation. One of their main characteristics is that they are not compelled to comply with Banking Laws;
    2) Finance companies, which are generally created by or are in partnership with commercial banks: these provide venture capital, leasing, consumer credit, etc.;
    3) Microfinance institutions (MFI), which began to appear in the middle of the 1990s; and
    4) Stock Exchange Markets: these are also important as they provide long-term finance.

3.6.5 Redistribution of Former DFI Operations

The quasi-disappearance of traditional DFIs deeply affected national capacity to achieve economic and social development objectives. The tasks and operations formerly undertaken by DFIs were not entirely redistributed to other institutions after the reforms.

3.7 Functions of Development Finance Institutions

DFIs had five fundamental functions, which can be classified under two main categories: financial functions and non-financial services.

3.7.1 Financial Functions

a) Term liquidity

DFIs were the principal source of term finance. Typically, long-term funds were received at concessionary rates from international donors and then on-lent to clients. At the time, commercial banks did not have the financial structure needed to provide term finance, and therefore did not compete with DFIs on this product. After the 1990s, with the disappearance of DFIs, universal banks became the sole providers of term finance. These were not able to meet national needs completely, nor to do so on a sustainable basis, despite donors' willingness to open medium to long-term lines of credit as they had done with DFIs. The reason for the failure was two-fold:

- Even development-oriented banks did not concentrate their activities on meeting development needs, as the former DFIs had done. Lines that were opened were only useful in so far as these banks had an interested client base, which was not often the case;
- The question of the sustainable provision of term finance by universal banks was not posed in the same manner as it had been for former DFIs. For a bank, the fundamental consideration is its capacity for transformation, as opposed to its on-lending of external lines. Transformation is the process through which banks finance medium or long-term commitments with short-term resources. This process requires banks to be able to identify short-term resources that are stable enough to be used to cover longer-term commitments. A bank's capacity for transformation is built up over time as it develops its capacity to mobilize resources in order to create a stable core of short-term funds. Until this process is well underway, the bank will not be able to lend on the medium or long-term.

b) Medium and Long-Term Risk Coverage

Medium- and long-term risk coverage includes providing credit for new entrepreneurs or economic agents that did not previously have access to finance, assisting economic agents in the initial stages of new projects (providing venture capital and equity), and providing

assistance in the restructuring or reorganization of projects already underway. These types of activities, which entail covering higher risks for longer periods of time, are fundamental for development promotion, and therefore are some of the most important aspects of former DFIs. With the dismantling of DFIs, these functions were not completely taken up by other institutions. Given the state of public finances today, even the successors of DFIs – development-oriented commercial banks and DFIs, which both have the state as a majority shareholder – cannot by nature assume development risks as high as their predecessor DFIs.

3.7.2 Non-financial services

a) Feasibility studies, project promotion, brokering partnerships

These activities relate to the initial stages of project formulation, including the formation of the project's basic concept, brokering the deal, and searching for suitable domestic and foreign capital investors**.**

b) Post-Implementation Technical Assistance

Once the project has begun, technical assistance is provided to project promoters throughout the life of the project by offering and pooling expertise.

c) Project management, coordination of operations during crisis

These activities relate to DFIs' role as catalysts for multinational projects or in crisis situations where the coordination of different actors is necessary.

3.8 Redistribution of Operations and Services after Reforms

In general, the operations and services formerly provided by DFIs were not entirely ensured by commercial banks in the post-reform period.

Table 1 below shows how the operations and services were redistributed in sub-Saharan countries.

Table 1: Distribution of Operations and Services

DB Functions and Services	Type of DFI
Medium to Long-Term Liquidity	• DFI • Development-Oriented CBs • Stock Exchange Markets
Medium to Long-Term Risk	• DFIs • Specialized Companies • Stock Exchange Markets
Financial Engineering for Development Projects	• DFIs • NGOs
Feasibility Studies	DFIs
Project Promotion, Partnership	• DFIs • NGOs
Technical Assistance, Project	• DFIs • NGOs
Project Management,	• DFIs

The medium to long-term liquidity function was primarily taken over by DFIs, such as Development Corporations. Development-oriented commercial banks play a secondary role in this regard. Medium to long-term liquidity continues to be problematic even today as DFIs must work with external resources that are not always granted because they lack financial stability, and many banks have not yet built up the capacity to provide much term finance through transformation.

Medium to long-term risk coverage became the responsibility of DFIs, Specialized Companies and the financial market through the creation of guarantee funds. DFIs have, however, continued to perform their historic role of providing non-financial services.

3.9 Finance Gap

Financial sector reforms generally encouraged the stabilization of financial portfolios through the identification and removal of non-performing loans. However, the process also left certain economic and social sectors without sufficient access to finance, such as:

- Financing for customers with particular risks: MSMEs, artisans, women, etc.;

- Financing for low-income housing, from construction to the renting or sale of residences;
- Financing for infrastructure, especially at the local level;
- Financing for the production and consumption of renewable energy and financing for environmental protection;
- Financing for sectors of the social economy: associations, mutual insurance companies, etc.;
- Rural finance; and
- Financing for agricultural-related projects.

The financing needs listed above are not easily satisfied by banks, including those that are development-oriented, or by DFIs because of the inherent difficulties related to the medium to long-term nature of these projects such as: (i) liquidity shortages; (ii) risk-covering difficulties; and (iii) the relative inexperience of these institutions in financial engineering.

3.10 Conclusion

The assessment of the reforms of Africa's financial sectors can be summarized in the following four main points:

1) The specificity of development finance was not recognized and therefore not taken into account in the reforms. Instead, the working hypothesis was that banks, as "universal" financial institutions, had both the vocation and the capacity to finance every type of project. Today, the specificity of development finance must be fully understood so that development policies can be based on a solid conceptual foundation. In particular, questions pertaining to long-term liquidity and risk need to be further discussed.
2) The reforms of the 1990s left bank portfolios stabilized and stronger as the banks identified and removed non-performing loans. However, the reforms did not address the non-bank components of the financial sectors, nor did they take into account the non-bank, non-financial institutions providing development finance, although these organizations were already playing an increasingly important role in providing development finance and support. In order to strengthen and stabilize these institutions as well, it may be advisable to include these sectors in future reforms.
3) The products and services provided by former DFIs were only partially redistributed to the remaining financial and non-financial institutions. Therefore, certain deficiencies

exist, which differ according to the particular national financial landscape of a given country. The way in which today's actors can widen their intervention in financing development should be reconsidered in order to identify possible solutions.

4) Several key sectors for national development, especially those concerned with poverty and job creation, still suffer from limited access to finance despite the presence of new actors specializing in development finance. Reflection is needed to develop an overall strategy that can facilitate access to finance in these sectors, particularly with regard to liquidity and risk coverage issues.

Future development policies need to take into consideration these four points in order to respond properly to development finance needs and promote sustainable development projects.

Chapter 4
Development Finance Institutions (DFI)
In the SADC Region

4.1 Introduction

The Southern African Development Community Region (SADC) member states have a diverse financial landscape. Different types of DFIs play important roles in providing development finance. This chapter will therefore:

- review the status of DFIs in SADC region; and
- identify and analyse the impediments and opportunities relating to cross-border activities by DFIs and recommend measures that can be taken at national and regional levels to address them.

4.2 Sample and Methodology Employed

The sample used in this Scan is based on the 48 DFIs identified in the region.[15] The data was collected using a questionnaire, annual reports and interviews with officials from relevant Ministries and Central Banks. The rest of this chapter discusses the results, starting with the countries which the study covered.

4.3 Scan Sample

Twenty-one members of the SADC Development Financial network completed the questionnaire. The diversity of DFIs that participated in the survey, in terms of size, type and performance, suggests that the sampled DFIs will likely give a true representation of the development finance landscape in the SADC region.

In addition, the consultant[16] managed to find data on additional DFIs through their annual reports. The list in Table 2 below indicates the countries from which full data was available and these form the basis of the main report.

[15] See Annex 2: Institutional Structure and Nature of DFIs.
[16] Dr. Lufeyo Banda.

Table 2. Scan Respondents by Member States

	Country
1	Botswana
2	Lesotho
3	Mozambique
4	Namibia
5	South Africa
6	Swaziland
7	Tanzania
8	Zambia
9	Zimbabwe

4.4 Results of the Scan

Historically, DFIs have been used by governments to promote economic development in practically all countries around the world regardless of their stage of development. DFIs have been established in many countries to finance the construction of roads, highways, energy plants, dams, and telecommunication infrastructure, to foster embryonic industries and small and medium enterprises (SMEs), and to provide financial services to low-income households through the provision of housing etc.

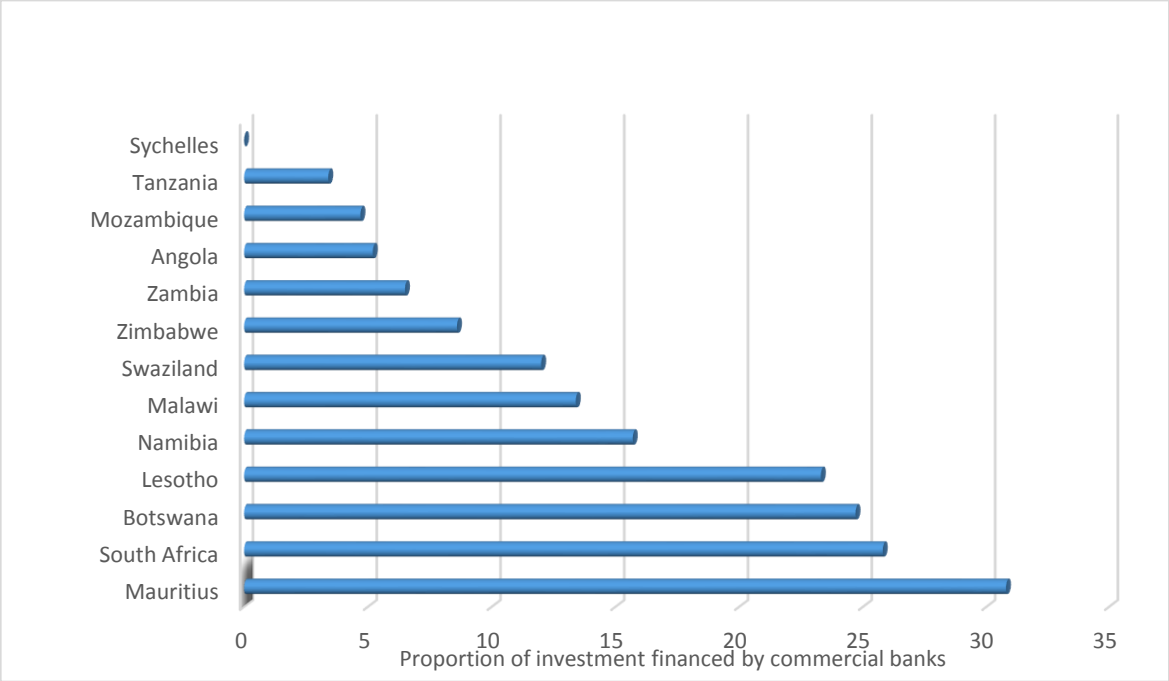
DFIs in SADC countries usually constitute the main source of long-term credit, loan guarantees, and other financial services in the infrastructure, industry, housing and agricultural sectors. Even in some advanced economies, where private financial institutions and capital markets satisfy the financial needs of firms and individuals, several DFIs continue to play an active role in providing financial services to the so-called strategic sectors of the economy.

4.4.1 Access to Finance

Access to finance is one of the most important issues developing countries, including SADC member states face today. Indeed, the effectiveness of financial markets is one of the biggest differentiating factors between developed and developing countries. As has been noted in development economics literature, in developed countries 'the vast majority of firms and entrepreneurs have access to sources of capital for funding a business', while in developing countries, including SADC countries, this is not the case. Figure 1 below illustrates this point.

Figure 1 shows that there is a huge gap in access to finance by the entrepreneurs and firms in the SADC region and such financing gaps must be filled by specialised financial institutions such as the Development Finance Institutions.

Figure 1: Access to Finance by Firms



Source: Enterprise Surveys (http://www.enterprisesurveys.org), The World Bank 2010

4.4.1.1 Implications of the access to finance

The lack of financial access limits the range of services and credit for household and enterprises. To this end, individuals and enterprises need to rely on their personal wealth or internal resources to invest in their businesses, and this limits their full potential and inevitably leads to the cycle of persistent inequality and diminished growth or sub-optimal growth.

For the reasons outlined in the preceding section, shareholders need to ensure that the DFIs are developed, well capitalised, and their mandates well defined so that they are in line with the National Strategic Plans.

4.4.2 DFIs by Year of Establishment

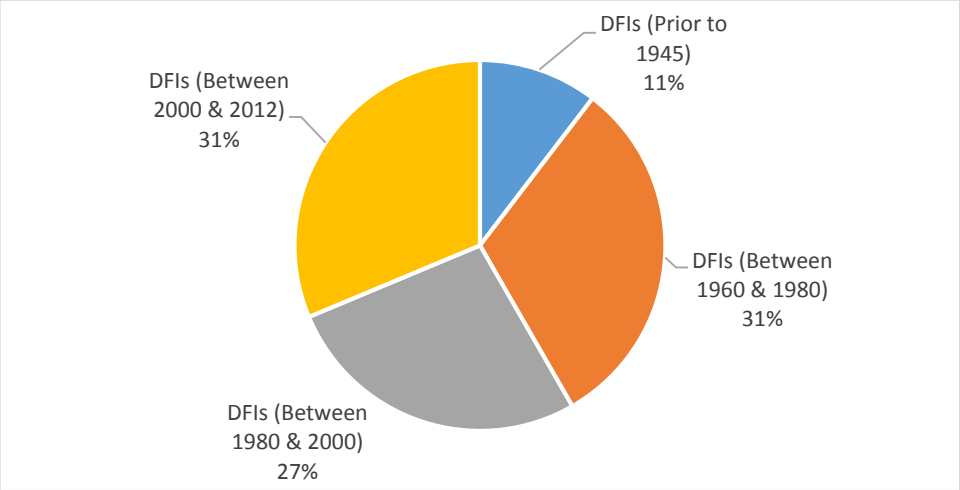
As illustrated in Figure 2 and Annex 2 of the Scan, 10.4% of DFIs examined in the Scan were established before 1945, 31.3% between 1960 and 1980 (during the time most SADC countries

became independent), 37% of DFIs between 1980 and 2000, and 31.3% between 2000 and 2012.

These figures reveal two interesting features of DFIs. First, a large number of the surveyed DFIs were established more than three decades ago and are currently still in operation, despite the strong criticism of DFIs in the 1980s and 1990s. This suggests that most governments still see the value of the role DFIs play in promoting economic growth and reducing poverty.

Secondly, during the past 30 years, as governments around the world were privatizing state-owned financial institutions, several countries were establishing new DFIs. Examples of DFIs established in the recent past include the Development Bank of Angola, the SME Development Bank of Namibia, the Development Bank of Mozambique and the Export Development Fund of Malawi. As this report is being written, new DFIs are proposed for Malawi, and Zambia, among other countries.

Figure 2: Year of Establishment of DFIs



4.4.2.1 Implications of the Period DFIs were established

Three issues can be deduced from the results in Figure 2:

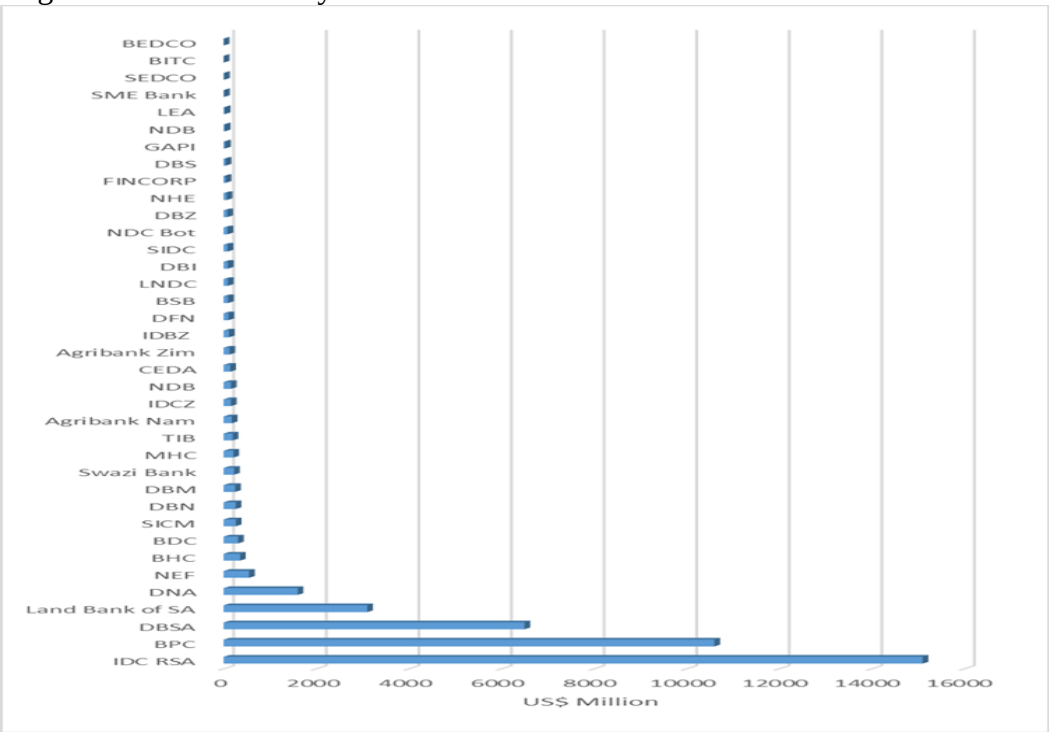
- The analysis of the period during which the SADC DFIs were created shows an upward trend in the growth of DFIs despite the international institutions objections to these institutions.
- This trend also seems to indicate great political will on the part of SADC member states to preserve these institutions and it also shows that member states in the region still value the contribution these institutions make to various sectors of their economies.

- There is therefore need on the part of the DFI Network to ensure that their institutions are strengthened so that they can both enhance development and protect their shareholders.
- The long survival of DFIs and the ongoing political goodwill towards them means that SADC DFIs should be able to develop further and contribute to both national development and regional integration.

4.4.3 Size of DFIs

At the end of 2012, the DFIs in the Scan reported total assets amounting to US $40.9 billion dollars. As shown in Figure 3, the largest share of the assets was held by South African and Angolan DFIs (Industrial Development Corporation of RSA- US$15 billion, BPC –US$9.6 billion, Development Bank of Southern Africa- US$6.5 billion, Land and Agriculture Development Bank of South Africa- US$3.1 billion and Development Bank of Angola- US$1.6 billion).[17] The lowest ranked DFI in terms of asset value is BEDCO with assets of roughly US$3 million. This trend in asset values partly reflects the success of some of the DFIs in terms of sustainability.

Figure 3: SADC DFIs by Assert Size



Sources: Various Annual Reports of DFIs for 2012

[17] For more details on the asset size of DFIs see Annex 2, Institutional Structure and Funding of DFIs in SADC.

4.4.3.1 Implications of Asset Size

The fact that most of the DFIs in the SADC region are relatively small by asset size has a number of implications for SADC DFIs and the region. These include:

1) The volume of resources that most DFIs can mobilise from the market could be very small. This is premised on the understanding that for most DFIs raising funds on the market is based on the 1:3 leveraging ratio. Thus, given the asset values of most DFIs in region, it would be difficult for most of them to raise sufficient resources to cover their wider mandates.
2) There is a need for both the Government and DFIs to examine the possibility of merging some of the DFIs so that they can create a critical mass and make sure that the few resources available are most advantageously used.
3) DFIs also need to prove their value in order to persuade to invest in DFIs more and to use them for developmental projects. Failure to demonstrate their importance may lead to governments creating parallel institutions, thereby reducing the asset values of DFIs, making it difficult for them to provide the services they are mandated to.

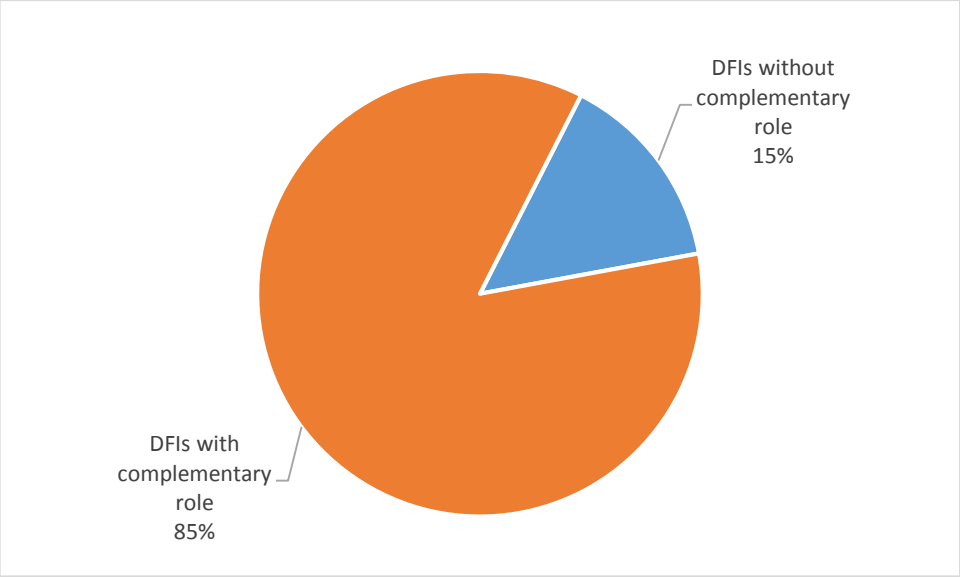
4.4.4 Complementary Role of DFIs

Another interesting finding of the scan is that most DFIs, approximately 90%, assumed a complementary role by increasing their supply of credit to private firms in their jurisdictions.

The study has also found that seven DFIs (14.6%) in the sample do not play any complementary role.[18] These are BEDCO of Lesotho, LEA of Botswana, BTIC of Botswana, LNDC of Lesotho, the Lesotho Housing Corporation, Sepha of Seychelles, and the Zambia Building Society. These institutions can mostly be categorised as agents of the government and play a critical role of attracting Foreign Direct Investment (FDI) and supporting the development of SMEs. Although BEDCO and LNDC are DFIs, poor lending and loan recovery systems over the past twenty years has led to a mandate drift in the two institutions.

[18] Annex 2 on the institutional structure and funding of DFIs.

Figure 4: DFIs and their Complementary Role



4.4.4.1 Implication of the Complementarity Issue

There are a number of implications which can be deduced from this result and these include:

1) Complementarity of the DFIs will lead to less competition between the DFIs and commercial banks, a situation which can be categorised as healthy;[19]
2) The complementary role of DFIs may lead to more innovations on the part of the DFIs and the creation of space for the commercial banks to take over some of the activities previously dominated by the DFIs; and
3) Complementarity could also lead to the development of more financial products, such as guarantee schemes, for DFIs.

4.4.5 Ownership and Funding

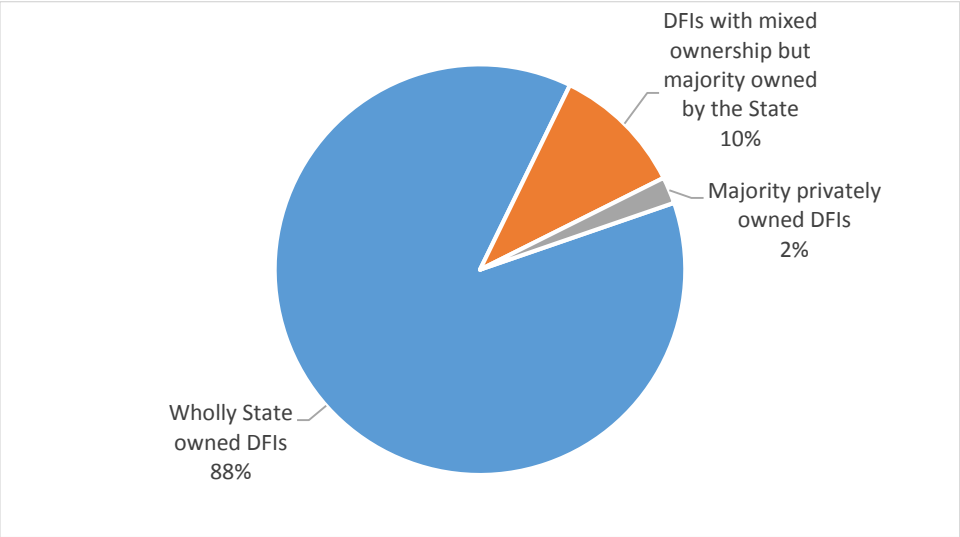
Characteristically, DFIs are institutions owned, administered, and controlled by the Government (State), which provides the strategic direction of the DFI and appoints their senior management and board members. The extent of government ownership in DFIs, however, can vary. As illustrated in Figure 5 and Annex 3, while 87.5% of the DFIs surveyed are entirely government owned and controlled, the private sector participates as a minority shareholder in 10.4% of DFIs, and 2.1% are majority-owned by the private sector (e.g. Gapi-SI).[20] The other

[19] This situation may also lead to the DFIs focusing more on niche markets, a situation which may lead to the best use of scarce long-term resources.
[20] For more information on the shareholding structures of DFIs, see Annex 2, Table 1.

striking feature about the DFIs in the SADC region is that these institutions also include Development Funds such as the Export Development Fund of Malawi and the Namibian Development Fund which in many cases can only be treated as accounts held at the Ministry of Finance or Central Bank and not as development finance institutions.

The Scan also finds that at least one National Development Bank has been established in nearly all the SADC member states. These include the Development Bank of Southern Africa, the Development Bank of Zambia, and the Development Bank of Namibia, amongst others. There are also a number of Development Corporations in the region. These include IDC of South Africa, the Botswana Development Corporation, the Lesotho National Development Corporation, and the State Investment Corporation of Mauritius.

Figure 5: SADC DFIs Structure Ownership[21]



Another feature about the Development Banks and Corporations operating in the SADC region is that these two types of institutions offer both loans and equity to their clients. According to development finance theory, equity financing is supposed to be only offered by a Development Finance Corporation like IDC-South Africa or IDC Zimbabwe, while long-term loans should only be offered by Development Banks.

[21] For more information see Annex 3.

4.4.5.1 Implications of Ownership Structure

In the SADC region, most of the DFIs were established by Act of Parliament. However, over time some of these DFIs have changed their legal persona by being incorporated under the Companies Act.

The fact that 98% of the SADC DFIs are majority owned by Government (i.e., 87.5% wholly owned and 10.4% majority State owned) may imply the following:

1) The lack of strategic partners for most SADC DFIs may lead to a lack of adequate resources and this in itself may defeat one of the key objectives of the DFI, which is to increase the savings rate. This will also mean failure to raise capital from capital markets, developing domestic capital markets, and mobilising non-traditional resources;
2) The failure on the part of DFIs to invest in projects that commercial banks would be unwilling to invest in could lead to an increasing of the gap which these institutions were intended to fill.

4.4.6 Capitalisation of DFIs

Development Finance Institutions have different options for funding their business operations, including (i) taking savings and deposits from the public, (ii) borrowing from other financial institutions, (iii) raising money in the domestic or international capital markets, (iv) using their own equity, and (v) receiving budget allocations from the government. Most DFIs use a combination of all these funding options.

Except in situations where the mandate of the DFI is to promote savings, some authors, such as Rudolph (2007) argue that it is undesirable for DFIs to take deposits from the general public, as it could lead them to compete with commercial banks and drift from their original purpose of offering long-term credit. Moreover, if DFIs were allowed to offer savings and deposit accounts to the general public, the distinction between a development bank and a commercial bank might become blurred.

Most of the DFIs in the SADC region use a combination of funding options: 89.6% are by their respective governments, 10.4% are funded by DFIs such as IDC South Africa and DBSA, 25% are allowed to collect deposits, while 64.6% of the DFIs have access to capital market

resources. In addition, the Scan also finds that most of those DFIs had business models which are not sustainable because most of the external resources were short-term. This finding is particularly worrying when one considers the role these institutions are supposed to play in terms of long-term investment and the kind of external resources they mobilise from the market. The fact that only 43.8% of the SADC DFIs are able to mobilise more long-term than short-term external resources shows that most of the DFIs in the SADC region have business models which are not sustainable and that most of the business models introduce a liquidity risk which in turn creates a funding risk for the DFIs.[22]

4.4.6.1 Implications of the Business Model

As can be seen from the preceding section, DFIs in the SADC region depend heavily on government support and this has serious implications for the operations of these institutions. For instance, the fact that almost all of the resources come from government in most DFIs may lead to:

- Sustainability problems for the business model, which introduces liquidity or funding risks;
- Depending on time and season, the government may choose to either give more or fewer financial resources. As government resources are always limited, it is more likely that less money, rather than more, will be available from the government budget; and
- Markets in the region or member country may be undercapitalised because of the failure of the DFIs to use these markets.

4.4.7 Deposit taking by DFIs

Except in situations where the mandate of the DFI is to promote savings (e.g. Post Office Banks), the literature postulates that it is undesirable for DFIs to take deposits from the general public. Avoiding this allows the DFIs to focus on their lending operations and avoid competition with private banks, and at the same time to limit taxpayers' potential exposure to loss.

[22] For more details, see the business models for each DFI in the country reports.

Table 3: Deposit Taking Institution

1	Banco de Poupança e Crédito (BPC)
2	Botswana Savings Bank
3	Lesotho Post Bank
4	Development Bank of Mauritius
5	Mauritius Housing Corporation
6	Mauritius Post and Corporative Bank
7	National Housing Enterprise of Namibia
8	SME Bank
9	Swaziland Development and Savings Bank (Swazi Bank)
10	Tanzania Investment Bank
11	Zambia National Savings and Credit Bank
12	Agribank Zimbabwe
13	Infrastructure Development Bank of Zimbabwe

Source: Annual DFI reports

Table 3 shows that 13 (27.1%) of DFIs take deposits from the public while the other 35 (72.9%) do not. All deposit-taking DFIs in the survey are retail lenders, that is, they lend directly to customers; no second-tier institution (DFIs that lend through other private financial institutions to reach end customers) takes deposits from the general public. The taking of deposits by these institutions has been attributed to a lack of long-term resources from the shareholders and capital markets, a situation which has led to mandate drift for most of these institutions.

That relatively few DFIs source funds from the capital market could be attributed to factors such as: (i) a lack of understanding of how to leverage DFI capital, particularly when using callable capital, (ii) a lack of willingness on the part of the government to offer guarantees, and weak balance sheets of the DFIs themselves.

4.4.7.1 Implications of Deposit Taking

DFIs are unique in being created to provide long-term funding. This can be best understood by the law of large numbers and the risk from the maturity transformation of assets. It must be pointed out that the financial institution cannot borrow short and lend long. This will not only create liquidity problems but may also lead to bank failure. The key implications of DFIs using deposits as the source of funds are:

- Failure to service the economic sectors for which DFIs were created (due mainly to a mismatch of assets and liabilities); and
- Mandate drift, a situation which may lead to government creating similar institutions to fill the gap not serviced by commercial banks.

It is therefore important to note that as DFIs which are specialised institutions for long-term financing, they should seek to attract more long-term resources than short-term external resources. In the event that more of their resources are short-term and external, the DFIs need to manage the risk of maturity transformation carefully, as it might ultimately result in funding or liquidity risk.

4.4.8 Financial Performance and Sustainability

Financial sustainability refers to a Development Finance Institution's capability to generate sufficient income from its operations to enable it to continue with its operations at a stable and increasing rate. For this reason, DFIs are expected to be profitable and financially self-sustainable, and not dependent on government subsidies or transfers to (partially) fund their operations. The Scan found that 89% of institutions receive government transfers that partially fund their operations. It should be noted that receiving direct transfers from the government does not necessarily mean dependence on government funds. Sometimes even the most successful DFIs in the SADC region receive transfers from their respective governments to fund interest rate subsidies to a particular type of borrower.

However, some DFIs have become highly dependent on government transfers to operate. Their financial products are pegged at lower than the rate of Treasury Bills. As a result, these institutions operate with a negative interest rate spread, making it difficult for them to survive without government subsidies. The survey shows that 18% of the DFIs that receive government subvention claimed that if transfers were cancelled, they would not be able to operate on a sustainable basis. Furthermore, according to the financial analysis of the DFIs, 51% could not cover their total operational cost and impairments with their operating income.[23] This suggests that the majority of the DFIs in the region are not sustainable as the percentage of the operating income of most of these institutions can not cover the costs of running the business.

89.6% of all DFIs enjoy the support of their governments, which explicitly guarantee their debt and other liabilities. A fairly large percentage of DFIs (64.6%) can borrow from other financial institutions or issue debt. This indicates a failure on the part of the remaining 35.4% of DFIs to capitalise on the shareholders' guarantees, which come in the form of callable capital. The result seems to suggest that the provision of guarantees is not regarded as effective by most

[23] For more details see the section on financial performance in the country studies.

SADC DFIs when it comes to resource mobilisation, and this could partly explain why the cost of most products is higher for DFIs than for commercial banks in the region.

4.4.8.1 Implications of Sustainability

As shown above, the majority of DFIs in the SADC region are not financially sustainable and depend on government subvention for their operational survival. If the Government withdrew their financial support, these institutions would fail. Furthermore, the DFIs should not only think of profitability as a means to sustainability. The disciplined application of pricing and financial ratios, such as return on equity and return on assets, are crucial to the survival of these institutions. SADC DFIs need to balance financial viability and developmental impact; failure to do so could lead to the failure of the DFI. Success, on the other hand, should not be at the expense of neglecting the DFIs' core developmental mandate. DFIs need to develop pricing models that will ensure that their products are competitive, rather than overpriced as they currently are in some cases. Furthermore, in order to ensure that DFIs have a strong balance sheet which they can use to leverage external resources, they should ensure that resources for government social projects are ring-fenced, so as to avoid weakening their balance sheets.

The implication of this is that government needs to strengthen the balance sheets of the DFIs to enable them to borrow from the market. The money obtained from the market should be priced in such a way as that DFIs can cover the cost of the capital and other operational costs. DFIs always need to ensure that funds for social projects are ring fenced and, for a revolving fund, the funds should be priced equal to or above the treasury bill rate.

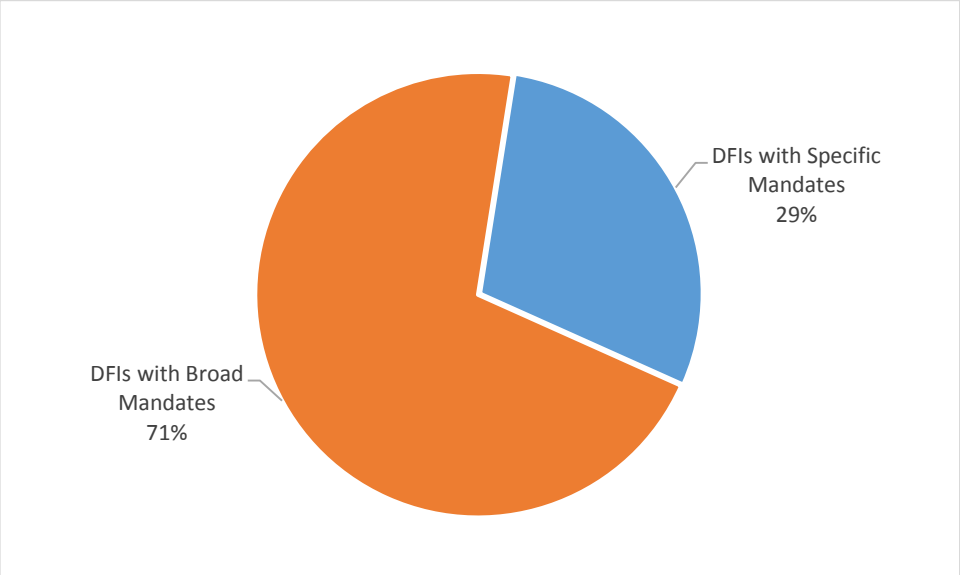
4.5 Mandates, Business Models and Financial Products

4.5.1 SADC DFIs' Mandates

DFIs have been established with a wide range of policy or developmental mandates. DFIs can be divided into two groups on the basis of their mandates: (i) institutions with a narrow and specific mandate, which explicitly refers to the sector(s), type of customers or activities that a DFI is expected to support, and (ii) institutions with broad mandates that are formulated in general terms without reference to any particular sector or activity. Examples of the second type of mandate are '…to promote the country's economic development' or to "reduce unemployment".

As shown in Figure 6 and Annex 3, 29% of DFIs surveyed are institutions with specific policy mandates. They include institutions that were specifically designed to support the agriculture, housing, and SME sectors through lending, guarantee or advisory services, and the support of housing and infrastructure projects. Examples of this group are: the Botswana Housing Corporation, Agri Bank Namibia, and the Land and Agriculture Development Bank of South Africa.[24]

Figure 6. Mandates of DFIs



The other 71% of DFIs have broader legal mandates and are expected to support a broader range of activities and sectors. Examples of these institutions include the Development Bank of Zambia (DBZ), which was established under the Development Bank of Zambia Act in 1972, but which has been reorganized 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.

Another example of a DFI in the region with a broad legal mandate is the Development Bank of Mauritius (DBM) which is a publicly-owned limited liability company. It finances projects involving the modernisation and diversification of agriculture and manufacturing, the promotion of small/medium enterprises, the dissemination of information technology and the promotion of a 'computer culture'. It makes equity investments in associated companies and

[24] For more details see Annex 3 on the Institutional Structure and Sector Focus of DFIs.

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 Industrial Development Corporation of South Africa (IDC) is another example of the DFI with a broad legal mandate. This institution is a self-financing, state-owned national development corporation established in 1940, whose mandate is to facilitate, promote, guide and assist in the financing of new industries and industrial undertakings, and of schemes for the expansion, better organization and modernization of existing industries and industrial undertakings.

4.5.1.1 Pros and Cons of Specific and Broad Mandates

There are advantages and disadvantages to both narrow and broad mandates. On one hand, narrow mandates encourage institutions to adhere to their mandates as stipulated in their founding documents (Acts or Decree). Monitoring and performance evaluation is easier in DFIs with a narrow rather than a broad focus. However, institutions with narrow mandates do not have the flexibility to target various sectors, in some cases limiting their ability to manage risk through diversification.

On the other hand, institutions with broad mandates provide flexibility to DFIs to finance a wide range of activities and sectors deemed important by the government. However, if not properly managed, DFIs might quickly lose focus and effectiveness, be subject to different and competing demands from different ministries and government institutions, or simply drift into diffuse tasks and activities. There is also a danger that such DFIs will primarily undertake activities that can easily be achieved. There are many examples of this in the region, such as Agri Bank of Zimbabwe, the Swaziland Development and Savings Bank and IDC South Africa.

4.5.1.2 Implications of Mandates

Most SADC DFIs in the region have broad mandates with few resources available to them. This could lead to failure on the part of DFIs to fulfil their developmental mandates as available resources may not make it feasible for them to cover all sectors of the economy. Another danger is government interference in the operation of the DFIs. This could arise from DFI management failing to interpret their mandate correctly and asking government officials for clarity, with a

resulting drifting and shrinking of the original mandate, and ultimately a failure to monitor and evaluate these DFIs.

4.5.2 Economic Sectors and Clients Targeted by DFIs

The DFIs surveyed operate in several sectors of the economy and serve different types of clients, creating a wide range of intervention modes through which governments provide credit and other financial services in the economy. Table 4 below shows different economic sectors covered by SADC DFIs. For instance, a DFI specializing in SME lending may target a wide range of sectors in the economy as long as its clients remain SMEs. A specialized agriculture bank may target all types of clients (smallholder farmers, SMEs, large private corporations, and even other state-owned enterprises) but is geared specifically to agriculture sector.

Table 4: Economic Sectors Targeted by DFIs (% of DFIs targeting each sector in Investment)

DFI	**Economic Sector Mandated**	**%**
Agri Bank Namibia Land and Agri Bank RSA IDC South Africa	Agriculture Agriculture Industry & Manufacturing	14
BITC Botswana LNDC Lesotho BEDCO Lesotho LEA Botswana CEDA Botswana	No Sector of the economy	19
MDB Mauritius DBN Namibia SME Bank Namibia SIDC Swaziland IDCZ Zimbabwe DBZ Zambia SDSB Swaziland	All Sectors of the economy	44
NHE DBSA FINCORP Gapi-SI SEDCO	Some Sectors of the economy	23

The DFIs sampled were asked to select the economic sectors they target from a list of nine sectors: services and trade, industry and manufacturing, agriculture, housing and construction, infrastructure, energy, health, mining, and education. As shown in Table 4 above, 14% of DFIs in the SADC region targeted specific sectors such as Agriculture and Industry. 38% of DFIs targeted all the economic sectors and 23.8% of DFIs also targeted a broad range of sectors with

the exclusion of only a few sectors listed in the questionnaire. The scan also found that about 19% of the DFIs did not target any of the sectors indicated in the questionnaire. This was owing to the fact that some DFIs are not lending institutions but investment institutions, and others have stopped lending because of financial problems.

Similarly, DFIs were asked which type of clients they target: 92% of DFIs responded that they targeted small and medium enterprises, 60% large private corporations, 55% individuals and households, 54% other state-owned enterprises (SOEs) and 46% private financial intermediaries. It is interesting to note that for most DFIs, regardless of their size or mandate, SMEs constitute the type of client they are trying to serve and support. This is not surprising as, for most SADC countries, access to finance by SMEs still poses a challenge to the financial sector and DFIs are better placed institutions to assist these SMEs.

4.5.2.1 Implications of Economic Sectors and Clients Targeted

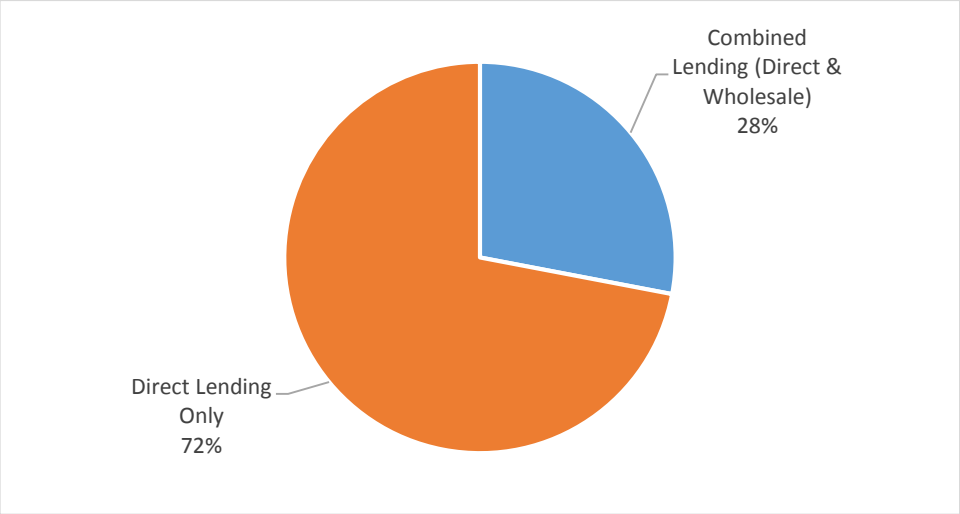
The types of sectors and clients targeted by SADC DFIs seem to show that the market of the DFIs is broad though inclined more towards the SMEs. The implication of this is that there is a need for DFIs in the SADC region to prioritise their support for this sector.

4.5.3 Lending Models: First-Tier and Second-Tier Lending

In practice, DFIs have developed and adopted different business models to carry out their lending operations. Figure 7 below shows that 28% of DFIs lend through a combination of first-tier (lending directly to end customers) and second-tier operations (lending to other private financial institutions which subsequently on-lend to end customers), while 72% of DFIs in the survey only lend through first-tier (or retail) operations.

Examples of “first-tier-only” DFIs include BPC Angola, the Mauritius Development Bank, SME Bank of Namibia, the Seychelles Development Bank and Land and the Agriculture Bank of South Africa.

Figure 7. DFIs' lending models



4.5.3.1 Advantages and Disadvantages of 1st and 2nd Tier Lending

There are various advantages and disadvantages to first and second-tier lending. Under the first-tier (retail) lending model, DFIs deal directly with the end customers. Often, this requires the DFI to have a large number of branches to access its target customers. This can put great pressure on agriculture, housing, and SME banks whose clientele is usually large and geographically dispersed throughout a country. In this model, the interest rate offered to end customers can be lower, other things being equal, because resources are not intermediated through other financial institutions. In addition, the credit risk stays completely with the DFI.

Under the second-tier (or wholesale) lending model, DFIs tend to have lower operating costs because financing is provided by the DFI to private financial institutions which subsequently select and assess the loan applications of end customers. Under this model, the DFI can reach more end customers and cover more locations without incurring high operating costs. This model also promotes the growth of private financial intermediaries that become the arms of DFIs and reach under-served sectors and clients. Moreover, the credit risk is partially absorbed by the private financial institution that intermediates the DFIs' funds. As discussed below, second-tier DFIs tend to report lower non-performing loan ratios than first-tier DFIs. However, interest rates for end customers tend to be higher because private financial institutions pass on to them their financial costs.

4.5.3.2 Implications of Lending Models

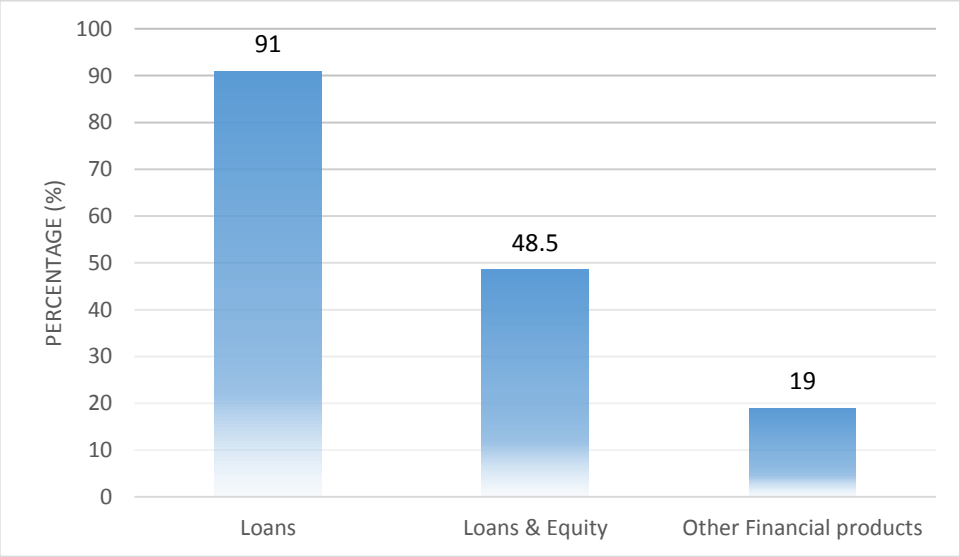
If SADC DFIs continue providing direct funding to its clients, there are three possible implications:

1) Lending through other financial intermediaries may reduce costs to DFIs; and
2) The gradual change from the traditional model of DFIs lending directly to clients to one where they lend through other financial intermediaries is considered to be cost-effective.

4.5.4 Financial Products of DFIs

The survey also inquired about the types of lending products that DFIs offer to their customers, particularly loans and equity. Chart 1 shows that the majority of the DFIs sampled offer long-term loans (91%) and 48.5% of DFIs offer both equity and loans. Only a few DFIs in the region offer syndicated loans, unsecured loans and working capital. Overall, the study found that the financial products offered by the DFIs were narrow and mostly focused on loans and equity.

Chart 1: Financial Products by % Distribution



The scan also examined the maximum maturity of the long-term loans that DFIs offer to their customers. Often, the lack or limited availability of long-term financing in developing countries has been used to justify the existence of DFIs. The study found that the terms of the loans vary widely, with maturity from 5 to 35 years.

Analysing both the sources of funding and loans provided by the DFIs also revealed the interesting fact that some DFIs were able to borrow short and lend long. This poses a risk of maturity transformation as such DFIs can easily experience liquidity problems.

4.5.4.1 Implications of Financial Products

The implication of this result is twofold:

- DFIs will experience a high risk concentration in their portfolio; and
- There will be low liquidity as most of resources will be in long-term assets.

4.5.5 Use of subsidized interest rates

The provision of credit at subsidized interest rates by DFIs has been controversial. Some economists warn that this practice might undermine the solvency and profitability of DFIs and distort the competitive environment. Others consider the use of subsidized interest rates justifiable to support nascent enterprises, provided that subsidies are transparent and used for their intended purposes.

The provision of credit at subsidized interest rates is a practice adopted by 50% of DFIs covered in the Scan. Most of these DFIs fund the subsidies using transfers from their respective governments. In some countries, however, this practice has become unsustainable because of the pressures it places on the fiscal position of their respective Governments. Other means of funding subsidies include cross-subsidization from profitable areas of business and access to cheaper funds from large international financial institutions, such as regional and international development banks.

The scan also found that the remaining 50% of the DFIs sampled either offered their products at the same or higher rates than offered by the commercial banks. It was interesting to note that DFIs offering financial products at a relatively higher price than that offered by commercial banks. This clearly indicates two things: (i) that the government guarantee was not being used to the advantage of the DFIs, and (ii) that the pricing models followed by these DFIs could be wrong, a situation which warrants further investigation.

4.5.5.1 Implications on Subsidised Interest Rates

Providing DFI products at subsidized interest rates has implications for the way DFIs mobilize their resources and how their products are priced. For this reason, SADC DFIs will need to:

- develop a funding model;
- capitalise on their shareholders' guarantees to raise cheap money; and
- develop a pricing model for the products

4.5.6 Risk Management and Asset Quality

4.5.6.1 Risk Management

Risk Management is essential for every financial institution and encompasses all the activities that affect its risk profile. It involves the identification, measurement, monitoring and controlling of risks to ensure that:

- The individuals who take or manage risks clearly understand it;
- The organization's risk exposure is within the limits established by Board of Directors;
- Risk-taking decisions are in line with the business strategy and objectives set by Board;
- The expected payoffs compensate for the risks taken;
- Risk-taking decisions are explicit and clear; and
- Sufficient capital as a buffer is available to take risk.

Risk management in DFIs involves the ability to adopt instruments, policies, and procedures that can help to control the risk and make projects bankable that might otherwise not have been.

In addition, the study found that:

- Many of the DFIs in the SADC region tend to embrace weak risk management, loan follow-up and collection systems. This has led to poor project selection and poor identification of weak or non-productive assets, which in turn has led to the manifestation of poor quality portfolios, characterized by a high number of non-performing loans;
- There is no common risk framework for the DFI. Even in a single country DFIs can adopt or adhere to different risk frameworks. For instance, one might follow King III

corporate governance codes while another followed the Companies Act or an Enterprise Risk Management Framework.

- There is no common approach to institutional risk oversight. In some DFIs, overall responsibility for risk management rests with the Board, or Board Risk Management Committee. In other institutions, responsibilities for the risk management lies with the CEO or the Chief Financial Officer.

4.5.6.2 Implications of Risk Management

Lack of a proper risk management framework will lead to the following:

- Failure or inadequate internal processes to mitigate various risks;
- Low levels of risk awareness in the DFIs; and
- High levels of NPLs or impairments;

4.5.6.3 Net Provision for Losses

A common criticism of DFIs is that they are prone to experience asset quality problems. DFIs are often portrayed as having a limited capacity to assess borrowers' capability and willingness to repay their loans. They are also portrayed as having a limited capacity for debt collection on loans, resulting in a high number of non-performing loans, debt forgiveness programs, and financial losses that are ultimately borne by taxpayers.

The scan collected data on the non-performing loan (NPL) ratios of DFIs. At the end of 2012, 37.8% of DFIs reported NPL ratios of less than 15%. This is shows poor performance on loan management by the DFIs as most of these institutions appear to show a poor loan book with over 62% of DFIs recording NPL above an acceptable average of 15%.[25]

4.5.6.4 Return on Equity and Assets

Given that profit maximization is not the main objective of DFIs, their returns tend to underperform the average return of the banking system. Results for 2012 show that 40% of the sampled DFIs had an ROE greater than the 3% which is the average for commercial banks. Similarly, only 24% of DFIs in the sample had an average ROA greater than 3%. From this, one could conclude that most of the DFIs in the SADC region have a weak asset base.

[25] See PSGRS for the acceptable rating.

4.5.6.5 Implications of Quality of Assets

If, as indicated in the preceding two sections, most of the DFIs in the SADC region have a weak asset base, the consequences would likely be:

- A decline in Government support;
- Limited opportunities to raise Funds on capital market; and
- A higher probability of the institution being closed or changed into a commercial bank.

4.6 Corporate Governance Arrangements

Good corporate governance is critical to the success of DFIs. In broad terms, corporate governance according to Nova Scotia Liquor Corporation (www.mynsic.com) refers to "…the process and structure for overseeing the direction and management of a corporation so that it carries out its mandate and objectives effectively".

Governance of a DFI can be more challenging than it is for private financial intermediaries. To begin with, the structure of DFI ownership and control can be more complex, involving a large number of governmental institutions (ministries of finance, agriculture, housing, trade, labor, etc.), and sometimes even the legislature. These entities all have their own legitimate (and sometimes conflicting) expectations of what the DFI should accomplish.

When the mandate of the DFI is stated only in general and broad terms, senior government officials or elected politicians have more room to influence the direction and activities of the DFI. Unless the institutional framework of a DFI is strong enough and the mandate clear enough to withstand undue political pressure, a DFI can become vulnerable to political interference or be captured by interest groups exerting pressure on it to take excessive credit risks, causing future financial losses for the DFI. Furthermore, as government-owned institutions, lack of a sound monitoring and evaluation framework can cause the board and management of DFIs to become progressively tolerant of DFIs' inefficiencies and weak performance.

Many of the problems that commonly afflict state financial institutions, such as weak performance, financial problems, broad and not–so-clear mandates, unfair competition with the private sector, and capture by interest groups, can be associated with, if not attributed directly to, weaknesses in corporate governance.

The scan attempted to examine a few characteristics of the corporate governance framework of DFIs, keeping in mind that an extensive review of this topic is beyond the scope of this survey. Sampled DFIs were asked about the size and composition of their boards. The results show that, on average, the boards of SADC DFIs are composed of at least 8 members. It should be noted, however, that while the composition of the board in terms of the number of board members appears to be in line with the international best practice, a closer look reveals that there is no standard practice with regard to shareholding representation on the boards of DFIs, and many of the DFIs also lack board charters and shareholders' compacts. The results also show that most of these boards consist of government representatives, including members representing ministries of finance, labor, trade, housing, social affairs, and even the central bank.

Examining governance issues in DFIs raises the question of whether public servants should serve on the boards of DFIs. Arguments can be made for and against this practice. The main argument in favour of it is that as representatives of the government, public servants can provide strategic direction and ensure that the DFI fulfils its mandate in an efficient and effective manner. The main argument against it is that public servants might be in a position to influence the decisions and direction of the board inappropriately. While the issue remains unresolved, there is a general consensus that the number of public servants appointed to the board should be limited, they should meet the necessary qualifications and they should have the same obligations and roles as any other board member. In addition, proper guidelines should be put in place which all members of the board should follow.

The scan found that a large percentage of DFIs have adopted a series of minimum requirements for board members in order to mitigate some of the problems mentioned above. As many as 67% of DFIs require that board members have a minimum level of education, 70% require minimum technical qualifications in the banking field, and 65% require that board members have record of bankruptcy. In many of the DFIs sampled the government as the main shareholder retains the ultimate power to appoint and remove board members and CEOs. This could be a source of concern for DFIs as it might lead to political interference in the way the DFIs are managed. For this reason, PSGRS and King III could serve as a basis for dealing with corporate governance issues.

4.6.1 Transparency

Effective corporate governance depends on the flow of accurate, timely and relevant information within the DFI, and externally to the government, legislature and the public. The survey looked at the transparency of DFIs with regard to the information disclosed to the public in select areas. Table 5 shows that 90% of DFIs prepare and publish their annual reports, most of which are available online on their own websites, and 90% also disclose their audited financial statements. However, only 65% of DFIs disclose off-balance sheet items, when applicable. 75% of DFIs disclose their governance and risk management framework, and only 25% comply with regulatory capital and capital adequacy ratio (CAR).

Table 5: Transparency of DBs

Disclosed Information Percentage of	Percentage of DFIs (%)
Annual report	90
Audited financial statements	90
Off-balance sheet items	65
Governance and risk management framework	75
Regulatory capital and capital adequacy ratio	25

Overall results in Table 5 seem to show that the DFIs in the SADC region are reasonably transparent. This is a positive development for SADC DFIs as their levels of transparency and disclosure should be comparable with those of publicly listed companies. Timely financial statements and annual reports are essential in order to make DFIs accountable to Parliament and the public in general for their actions. Conflicts of interest of the board members and senior management need to be publicly disclosed, including transactions with related parties.

4.6.1.1 Problems caused by Lack of Corporate Governance

As has been pointed out, corporate governance is critical to the success of the DFIs. If the board and management of DFIs fail to adhere to the code of corporate governance, the following problems may occur:

- Government officials, acting in the capacity of owners (the minister to whom the DFI is accountable, or other individuals), directly intervene in day-to-day operational decisions, such as to whom to lend, on what terms to lend, and when to forgive indebtedness;

- Executive managers, acting with near autonomy, pursue unintended objectives, and operate in a manner contrary to sound commercial business and public financial management principles;
- Board members lack the independence, professional skills and experience necessary to properly undertake their duties;
- Internal and external financial and non-financial reporting is incomplete and inaccurate, does not provide an adequate basis for decision-making by boards and executive managers, and misleads government owners, legislatures and the public.

4.6.1.2 Implications of Corporate Governance

The consequence of the types of problems cited above can be not only loss-making, inefficient and/or ineffective DFIs, but also a weakened financial system. Poor governance may lead SADC DFIs to under-price risks and otherwise engage in business practices that displace the provision of commercial financial services by the private sector, impede new private entry, and undermine competition. The result can be to retard financial market development, to diminish access to financial services, and to weaken the stability of the financial system, often the opposite of the stated rationale for government ownership of financial institutions in the first place.

In contrast, good corporate governance can help to ensure that SADC DFIs are conceived and managed with a clear vision of how they can overcome existing weaknesses or problems in the provision of needed financial services without becoming part of the problem themselves. It can ensure that DFIs pursue the objectives for which they were established, avoiding the dangers of 'mission creep' and an institutional tendency to grow in size and expand in scope. It can increase the confidence of clients and business partners, and lower DFIs' cost of funds. It can facilitate the ability of the government to attract private capital for eventual ownership diversification.

4.7 Coordination of DFIs in SADC Member States

Arguments for coordinating DFIs at national level fall into two categories. The first concerns arguments for inter-institutional coordination in principle; the second comprises rationales for organizing such coordination specifically on an ex ante rather than an ad hoc basis. The general principles of coordination are fairly broadly understood, but the case for organizing it on an ex

ante basis is not yet accepted in the SADC region and deserves greater appreciation. This section considers arguments for the coordination of DFIs.

The case for coordination in principle between national development financial arrangements rests on three points. First, the coordination is necessary to prevent different shareholders (Ministries) from attaching conflicting conditions to their financial support. Secondly, while some redundancy might be desirable in the national financial architecture, duplication should be deliberate and minimized. Thirdly, multiplicity of reporting lines raises the possibility of duplication and inefficiency in the way public resources are utilised. Institutional coordination is therefore necessary to ensure that resources provided by the Government to various national DFIs are efficiently utilised. For more information see Annex 3 on the coordination and regulation of DFIs in the SADC region.

The scan's key findings on the coordination of DFIs in annex 4 shows that:

- 67% of the DFIs in the SADC member states are coordinated by their line ministries; and as a result
- There is lack of an overarching coordinating policy framework with many of the national DFIs reporting to different line ministries; and
- The above issues introduce elements of mandate overlap and duplication.

4.8 Regulation and Supervision of DFIs

There is a broad international consensus that DFIs and other financial institutions owned or controlled by the government or state should have the regulation and supervisory standards of private financial institutions with a soft touch on capital adequacy ratios.[26] In this way, DFIs will be subjected to the same solvency, liquidity, governance, accounting, and transparency standards as private sector institutions, whenever applicable. Moreover, in the event of financial problems in DFIs, the regulator is expected to act and take the same preventive or remedial actions normally undertaken for private financial institutions.

The scan found that 33% of DFI in the region were in fact regulated and supervised by the same institution that supervises private commercial banks, such as the central bank or the non-bank supervisory agency. The other 67% were supervised by the same ministries and

[26] This is because of systemic risk which the fall of DFIs may introduce in the financial sector system.

government agencies providing their strategic direction, such as the Ministries of Finance, Industry, Trade, Housing, Agriculture, etc. Examples of DFIs supervised by ministries include BDC of Botswana, LNDC of Lesotho, the Mauritius Development Bank, and DBSA.[27]

Prudential supervision by the ministry providing the strategic direction for the DFI raises multiple problems. First, the ministry or agency exercising the supervisory function usually does not have the same expertise to monitor and assess the risks associated with the business of the DFIs under their umbrella as a central bank or bank supervisory agency does. Secondly, conflicts of interest frequently arise, and the supervising institution deploys withholding tactics, thereby delaying prompt corrective action or even the simple recognition and disclosure of problems.

From the results of the scan, one can conclude that DFIs should be regulated and supervised as a financial institution or a bank would be, though with a caveat on certain ratios such as capital adequacy ratio. The regulatory framework should provide for a level playing field between DFIs and other financial institutions that perform the same or similar functions. By treating DFIs as banks, a number of problems are avoided, including predatory pricing and crowding out of the commercial banks; such treatment promotes a fair relationship between the DFIs and the commercial banks. The influence of the supervisory agency will depend on the supervisor's degree of independence as well as the independence of the chairperson of the board. A DFI subject to bank regulation is more likely to develop proper systems of risk management, which may increase its overall efficiency.

4.8.1 Prudential Standards and Guidelines Rating System (PSGRS)

In the absence of a proper regulatory policy framework, DFIs in Africa have developed the guidelines known as Prudential Standards and Guidelines Rating System (PSGRS), which were adopted in 2008 by AADFI in collaboration with the AfDB after consultations with various stakeholders. Its main objective is to assess compliance with a set of internationally accepted corporate governance, financial and operational standards and to provide stakeholders, including shareholders, regulators and donors, with useful benchmarks to assist in their respective involvements. The PSGRS is based on a survey containing 100 questions grouped into three specific categories: governance standards, financial prudential standards and operational standards. Compliance is assessed for each category and sub-category based on

[27] For more details see annex 4.

three criteria: full compliance, partial compliance and no compliance. A weighted score is ultimately produced to rank institutions.

In November 2013, a peer review assessment was carried out for African DFIs under the auspices of the Association of African Development Finance Institutions (AADFI). Table 6 below shows some results of top rated DFIs on the African continent.

Table 6: Top Rated African Development Finance Institutions

	Result %	Rating
African Export and Import Bank (Egypt)	94	
East African Development Bank (Uganda)	93	
Credit Agricole du Maroc (Morocco)	93	AA
Odu'a Investment Company, Ltd. (Nigeria)	92	
Banque Nationale pour le Développement Economique (Burundi)	91	
Eximguaranty Co (GH) Limited (Ghana)	91	
Banque Rwandaise de Développement (Rwanda)	89	
SwaziBank (Swaziland)	89	
Industrial Development Corporation (South Africa)	88	
National Investment Bank(NIB)-(Ghana)	87	A +
Swaziland Development Finance Corporation (Swaziland)	87	
Development Bank of Namibia (Namibia)	86	
Citizen Entrepreneurial Development Agency (Botswana)	84	
PTA Bank (Kenya)	84	
Nigerian Export-Import Bank (Nigeria)	83	
ECOWAS Bank (EBID) (Togo)	82	
Botswana Development Corporation (Botswana)	81	A
Agricultural Development Bank	80	
Banque de l'Habitat de Cote d'Ivoire(BHCI) (Côte d'Ivoire)	80	
Banque de Développement des Etats de l'Afrique Centrale(BDEAC) (Congo)	80	

Source: AADFI Consultant Report on the 3rd Peer Review – November 2013

These results show that seven (7) of the top 20 DFIs in Africa were from the SADC region, and members of the SADC DFI Network. This number is small, given that there are roughly 50 DFIs operating in the region.

Furthermore, the scan found only one country in which PSGRS has been incorporated in the regulatory policy framework by the Central Bank.

4.8.1.1 Implications of Regulation and Supervision

The consequences of a lack of, or a poor, regulatory framework could include:

- Poor performance of the DFIs;

- Failure to take corrective measures for erring DFIs;
- Failure to secure a credit rating from credit agencies; and ultimately
- Failure to access resources from the markets.

Chapter 5
DFI Network Mandate under FIP[28]

5.1 Introduction

The SADC DFI Network is one of the SADC structures which fall under the protocol of finance and investment. The genesis of this institution lies in the 1998 FISCU study on development finance institution in the SADC region, which recommended the establishment of a development finance system encompassing three pillars: a SADC DFI Network, a SADC Development Finance Resource Centre (DFRC), and a SADC Development Fund (SDF). The first two have since been established. The SADC DF is still to be put in place.

The development finance system therefore provides a framework within which SADC DFIs could contribute effectively to regional development and integration under the RISDP. In this model, activities at all three levels not only reinforce each other, but derive directly from the RISDP. The remaining part of this chapter therefore gives a brief background on each of the structures associated with the network.

5.2 SADC DFI Network

The SADC DFI Network is an institution which was established under the SADC Finance and Investment Protocol (FIP) in 2000 to contribute to the SADC agenda of regional integration. It promotes collaboration and cooperation between the national development finance institutions in such areas as pooling resources for regional projects, taking equity in each other's institutions, investing jointly in new regional structures and collaborating on projects, as well as cooperation in capacity building, policy research and strengthening information technology. The Network falls under the DFI sub-committee that is accountable to the Ministers of Finance and Investment through the senior Treasury officials.

Respondents were asked whether their DFIs were members of the network and what benefits they got from being members. The response from all 21 respondents was that they had benefited from sharing of information, capacity building initiatives and indeed technical assistance.

[28] FIP stands for protocol of finance and investment.

The responses clearly showed that the network is a valuable asset to its members as it has contributed positively to the development of the SADC DFIs in the region. This has also been shown by the growth in the network's membership, which has increased from 18 in 2004 to 32 members in 2014.

5.2.1 Implications on SADC DFI Network

Notwithstanding the good performance by the network so far, a lot still need to be done especially in the areas of resource mobilization, cross-border mandates and cooperation, and strengthening of the DFIs in member states. All this affects the following issues:

- resources for regional projects;
- the regulatory environment for DFIs;
- the mandate of the network; and
- the plan for the network on key issues affecting the members.

5.3 SADC DFRC

Following the creation of the network, Ministers of Finance and Investment also agreed to the setting up and recognition of the SADC DFRC as the secretariat of the DFI network in July 2003, following the SADC principle of subsidiarity. As the institutional hub of the DFI network, the DFRC is mandated to render critical support to the DFI network as coordinator and catalyst to improve the operational efficiency of its members, and their effectiveness as development finance institutions.

The study found that during the past ten years in which the DFRC has been in existence, DFIs have forged partnerships and collaborated on various projects and activities, including taking equity and lending to each other. The DFRC has also facilitated joint support to projects and to capacity building (with 112 training programmes carried out so far, reaching 3,086 personnel) as well as technical assistance to DFIs. Progress has also been made by the DFRC in facilitating collaboration initiatives on consensus building through entities such as CEO forums.

The DFRC has also played a critical role in establishing the PPDF, PPP Network and Regional Development Fund. These three key institutions will enable SADC DFIs to (a) mobilize intra- & extra-regional funds for development projects; (b) prepare regional projects up to bankability stage, and (c) crowd in private sector capital.

5.3.1 Implications of the SADC DFRC

While the response from network members has been positive on the role of the SADC DFRC, it is clear that there is a need for the SADC DFRC to go beyond capacity-building initiatives. This will affect the resources of the secretariat and require the SADC DFRC to do the following:

- Carry out more in-house training and advisory programmes which deal with specific issues affecting DFIs;
- Develop model legal and regulatory frameworks;
- Undertake research on policy issues to inform the decision-making of SADC governments and institutions;
- Facilitate consensus on issues of common interest; and
- Get approvals from the Ministers of Finance and Investment on the issues which require member states' endorsement.

5.4 The SADC Project Preparation and Development Facility (PPDF)

In the same year in which the secretariat of the DFI network was established, SADC member states also agreed to establish a Project Preparation and Development Facility to finance the preparation and development of projects by providing technical assistance on project identification, project selection and feasibility studies and to participate in the financing of selected projects.

The role of this facility is to:

- Provide funding for the preparation and development of regional projects, primarily infrastructure, to the point of bankability; and through this to; and
- Establish a pipeline of projects needing financing for potential investors.

5.4.1 Implications of the PPDF

Once the PPDF starts to operate, it is expected that this facility will be used by the SADC DFIs to identify and prepare projects for the market because of their expertise in thes areas.

It is also expected that once the SADC DF is put into effect, the PPDF will be subsumed under the infrastructure window of the Fund which will make it easy for SADC DFIs to use the facility.

5.5 The PPP-network

Article 4 of the Finance and Investment Protocol also recognizes Public Private Partnerships (PPPs) as an effective financing mechanism for both national and regional development initiatives. SADC Member States have prioritized PPPs as a potentially significant vehicle which can be used to support infrastructure development projects in member states and the region.

In 2011, following a conference in Johannesburg, South Africa, it was agreed by the stakeholders, including government, DFIs and other SoEs, to set up a PPP network for SADC, to be hosted by the SADC DFRC. The main objectives of the PPP network is to facilitate cooperation on policies and practices, and other related issues, that will encourage and facilitate the use of PPPs to ensure the development of infrastructure in the region.

As with the PPP, it is expected that once the SADC DF is fully operational, the PPPs will be used as a vehicle to package infrastructure projects proposals for public and private sector players.

5.5.1 Implications of PPPs

It is expected that DFIs would be able to use PPP projects for leverage, and that the PPP network would play a complementary role in preparing PPP projects. It must be noted that PPPs, like the PPPD, should aim to ensure that projects are prepared and ready for private sector support.

5.6 The SADC Development Fund

The SADC RDF, which is currently at an advanced stage of preparation, will be an apex institution for resource mobilization in the SADC region and will fall under the development finance system of the region. The resources to be mobilized through this Fund will be channelled to finance projects in the areas of infrastructure, industry, trade and adjustment and social development.

Once fully operational, the Fund is likely to have at least four windows, namely infrastructure, trade and adjustment, industrial and social development. Furthermore, it is expected that the three facilities already established under the development finance institutions system will complement the SADC DF by way of (i) the PPDF and PPPs assisting with the project preparation and the crowding in of private sector investment, and (ii) the SADC DFRC coordinating all the various activities affecting all SADC development finance institutions at a regional level. This will include all activities described in Article 3 of Annex 9 of the FIP "Cooperation in Respect of Development Finance".

5.6.1 Implications of the SADC DF

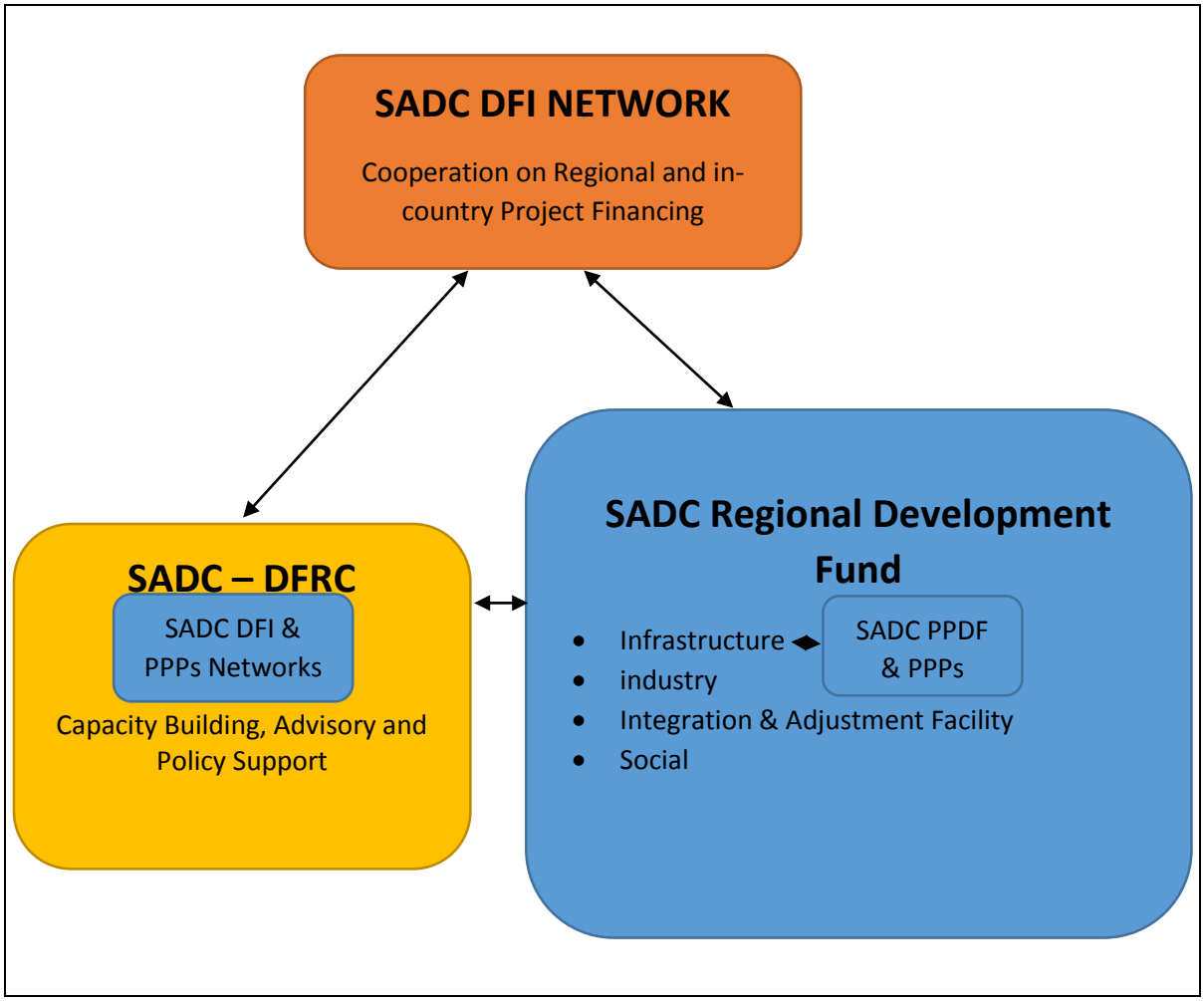
As indicated in the preceding chapter, the SADC DF will be the main instrument through which SADC member states will mobilize resources for regional projects. This will have a great impact on the SADC DFIs, especially when it comes to resource mobilization for cross-border projects. Some of the implications this will have for DFIs include:

- The SADC DF will take equity and supply resources for projects development in which national DFIs will be directly involved; and
- SADC DFIs may be required to comply with international standards on governance and regulation to qualify for resources.

5.7 SADC Development Finance System

Based on the results given in Figure 8 below, it is expected that the DFRC, as a secretariat, will provide services such as the monitoring of progress and challenges in Development Finance System, and will on an ongoing basis formulate and recommend interventions which will enhance the efficiency of the system and its regional institutions in order to achieve the development and integration goals of SADC.

Figure 8: The SADC Development Finance System



DFIs under the network will be expected to work with the SADC DF to raise resources and structure projects, using best practice methods within the overall framework of the SADC development system. The PPDF will prepare projects for investors while the PPP network will provide a platform for cooperation between the public and private sectors on policies. This development finance system will also work closely with the SADC Secretariat (Trade Investment Finance and Investment and Infrastructure departments). At the ministerial level, the development finance network outlined in Figure 8 will work closely with senior Treasury officials and ministers of finance and investment.

As indicated earlier in this chapter, the SADC DFI system has done exceedingly well with capacity building initiatives over a short period, and has exceeded their targets in the provision of technical assistance. The development finance system has also played an important role in ensuring that the PPDF, PPPs Unit and the SADC DF are fully operationalized.

Notwithstanding these achievements, the following matters still need to be dealt with by the SADC DFI system:

1) the participation of DFIs in regional development projects through cooperation in pooling funds (resource mobilization), project identification and project management;
2) the establishment of a regional insurance guarantee scheme;
3) legal regulatory policies for DFIs;
4) the harmonisation of mandates and the coordination of DFIs at a national level; and
5) capacity building

Chapter 6
Challenges and opportunities

6.1 Introduction

This section briefly reviews the challenges and opportunities for development finance institutions in the SADC region. Although not exhaustive, the lists below shed some light on what the major challenges for DFIs in the SADC region are, and what opportunities are available to them.

6.2 Challenges

In the field of development banking, it has become increasingly commonplace to question what the role of DFIs is and whether indeed they still have one. This, however, fails to recognize the achievements of DFIs in the past, and risks ignoring important lessons that can be learned from their experience and which are applicable to a broader range of financial institutions. The following challenges particularly affect DFIs throughout the SADC region:

a) Ownership Structure

The study found that the governments of SADC member states have in the past exerted control over the management of DFIs by appointing board members and chief executives. The appointments have often been based on political considerations rather than merit, making it difficult to take action against non-performing managers. This has made these institutions prone to political interference in both management and investment decisions, thereby preventing them from developing into viable development finance entities.

b) Poor Management and Political Interference

DFIs have long been used by their governments as instruments to pursue development objectives, mainly in sectors such as agriculture, infrastructure and industry, but also in education and housing. While this is in line with the mandate of development finance, the problem has been that, over time, the funding and policy support needed for the type of lending mandated has dwindled. It is also common knowledge that given the significant government ownership structure of these institutions, many have suffered from political interference, to support political gains rather than any genuine development cause. Examples in the SADC region abound of problems faced by the Development Finance Institutions being caused by uneconomical projects that were funded by the government through these institutions. This

ultimately led to the governments having to restructure the institutions and try to reschedule the unsustainable debt that accumulated.

c) Poor Business Models

On the funding side, SADC DFIs have had to endure the declining trend in the level of concessionary assistance they receive from traditional sources, both external and domestic, the emergence of international capital markets, the deregulation of national financial systems and ultimately the increased competition for funding from new players in the financial system. The fact that DFIs are not usually deposit-taking institutions has compounded this problem. Coupled with this, the majority of DFIs have serious problems mobilizing external resources. These include the failure to mobilize adequate long-term external resources, which inevitably leads to high risk for liquidity or a risk of risk of being funded.

On the lending side, the DFIs have had to face increased competition from commercial banks and non-bank financial institutions that have, in some measure, developed strategies and products to enter the long-term financing market space that was hitherto exclusively occupied by development institutions.

Again, the above issue is a generic problem faced by DFIs the world over and examples abound in the SADC member states. This only underscores the need to track the environment on an ongoing basis, adapt the business model and make the necessary changes to the organization, including skill development, in order to sustain a viable business model.

d) Failure to balance Social and Commercial Interests

As government institutions, DFIs have traditionally been perceived as the poor man's financial institution with a benign approach to lending. Political influences and development objectives have got mixed up over time, and with DFIs rarely pursuing hard recovery measures, this has served to create a situation where loans by DFIs are treated almost like grants, with borrowers attaching no priority to their debt servicing. An analysis of those DFIs that have provided education loans underscores this point. Over time, many SADC DFIs have almost developed a culture of poor commercial focus in the name of development financing, manifesting in adverse loan selection and lax monitoring and controls, leading to asset losses and capital losses.

Even where DFIs have tried to follow reasonably good lending practices, a development mandate which has driven them to lend to segments which are inherently unviable, without adequate continuing support from the government has led to balance sheet problems. For

instance, many DFIs that lend to the agricultural sector in SADC member states have provided loans and advances to subsistence farmers and borrowers who under normal circumstances would not survive without the institution's assistance, and who have limited scope to develop beyond their current level of operations. This has impacted the loan portfolio quality of these institutions and in many instances has necessitated a shift in focus.

e) Weak Risk Management Systems and Practices

As is the case with many DFIs in the emerging world, SADC DFIs, have historically tended to embrace weak risk management, loan follow-up and collection systems. This has led to poor project selection and poor identification of weak or non-productive assets, which in turn has led to poor quality portfolios, characterized by a high rate of non-performing loans. The lending practices, technology and information systems and the research capabilities, though not explicitly covered in this study, have in most cases not kept pace with changes in the business environment. While a very few DFIs, such as the Development Bank of Southern Africa, the Land Bank, and the Industrial Development Corporation of South Africa have, with support from shareholders, restructured operations to become commercially focused and viable, the majority of the other DFIs in the region still lag behind and are constantly buffeted by the competitive pressures of the market.

f) Coordination of DFIs

Development Finance Institutions in SADC member states have been established through various Acts of Parliament and are answerable to their parent ministries, which creates a coordination problem. The fact that these DFIs report to parent miniseries leads to multiplicity of reporting and bureaucracy, and slows down the decision-making process. Furthermore, the Acts establishing DFIs in specific countries or across the region differ in terms of detail on operational issues and areas of emphasis.

g) Lack of or Weak Regulation of DFIs

In the SADC region, the majority of the DFIs are not regulated at all. The few that are regulated by the Central Bank or other regulatory authority face challenges such as inappropriate or weak regulatory policy frameworks which are not suitable for development finance institutions. Thus, a lack of an overarching legal regulatory framework for DFIs in all SADC member states makes it difficult for authorities to monitor, control, or remedy the situation.

6.3 Opportunities

As well as the challenges discussed in the preceding section, the scan shows that a combination of exogenous and endogenous factors present a number of opportunities to Development Finance Institutions. Table 7 below gives the exogenous and endogenous factors and opportunities for DFIs. For instance, exogenous factors like GDP growth may lead to more creditworthy borrowers and more lending opportunities in productive sectors for the DFIs. Also, factors such as natural resources based sectors may offer DFIs opportunities to finance supporting infrastructure such as roads, houses for workers, office space, and agriculture.

The short-term orientation of the banking system and shortages of long-term funds also create opportunities for DFIs to develop local sources of steady and inexpensive long-term funds. An example on endogenous factors is bank failure, which may also present an opportunity for DFIs to be self-sustaining by being commercially viable.

Table 7: Opportunities for DFIs

Exogenous and Endogenous Factors	Opportunities
1) GDP growth in the medium term is likely to be higher than in the recent past 2) Natural resources based sectors offer relatively high growth potential 3) Poorly developed physical infrastructure 4) Weak human development in the region 5) Impact of political instability on foreign capital flows. 6) Short-term orientation of banking system and shortages of long-term funds 7) Bank failures 8) High interest cost and high level of non-performing assets (NPAs). 9) Capital markets in embryonic stage. 10) Absence of supportive institutional framework in the financial sector. 11) Poor financial position of governments.	1) More creditworthy borrowers and more lending opportunities due to productive sectors 2) Opportunities for DFIs to be self-sustaining by being commercially viable 3) Opportunity to develop local sources of steady and inexpensive long-term funds 4) Potential to influence the government policy and creation of an enabling environment 5) High business potential from financing of infrastructure projects 6) Good potential for agriculture, and natural resource based industries 7) Privatization process/limited competition provide good business opportunities for DFIs

12) Privatization of state-owned enterprises underway.	

Chapter 7
Conclusion and Policy Implications

7.1 Conclusions

At the current pace of economic growth, it is clear that the majority of SADC countries have little chance of catching up with developed world. For SADC countries to achieve and sustain higher growth rates, they need to establish strategies for increasing efficiency of the financial system in mobilizing and allocating resources to long-term investment, especially to unlock the potential of the SME, industrial and infrastructure sectors. To achieve this objective, development finance institutions which are very important specialised financial institutions must play a larger and more effective role in bridging the financing gap faced by the key sources of potential growth and employment creation, especially small and medium enterprises, industry and infrastructure.

Despite the importance of development finance institutions, little is known about these institutions and the role they play in the economy. The scan's results show that the development finance institutions in the SADC region are heterogeneous. These development finance institutions differ among themselves in areas such as: i) Ownership structure, ii) Mandate, iii) Business models, iv) Financial performance, v) Economic areas supported, vi) Pricing and lending products, vii) Regulation and supervision, and viii) Corporate governance.

The scan also finds that financial viability of development finance institutions must feature prominently in the DFI strategy to maximize the impact of development finance on national and regional development. To achieve this goal, development finance institutions need to operate in an environment characterized by appropriate governance mechanisms, especially with minimal interference by political leaders into lending operations. Managers of DFIs in turn need to establish efficient operating procedures, effective mechanisms for cost recovery, and innovative strategies for mobilization of long-term funds. Moreover establishing development finance institutions will maximize resource mobilization and facilitate the financing of national development plans, including regional infrastructure. These financing mechanisms will enhance national development and regional trade and investment, important factors for increasing growth prospects in the SADC region.

7.2 Policy Options

DFIs were created primarily to supply financial services that are not normally provided by commercial banking institutions. Such development institutions generally specialize in providing medium and long-term financing for projects which require specialized skills and focus, and may carry higher credit risks or market risks due to the longer investment tenures. In some cases, the mandated roles of the DFIs include the promotion and achievement of a government's specific social and economic objectives.

Furthermore, while some SADC DFIs have expanded the specific roles for which they were originally established, others have evolved to engage in commercial activities that are less developmental in nature. Although this expansion into commercial activities was undertaken to complement the earnings potential of the DFIs, it has placed a strain on the resources of these institutions, putting pressure on their organizational capacity, management capability and technical expertise. In addition, the multiplicity of the DFIs in each member state has resulted in inadequate coordination among DFIs and the relevant authorities in areas such as policy formulation, strategic planning and funding requirements. These have to some extent affected the DFIs ability to perform effectively.

A number of recommendations, focusing on measures to increase the capabilities of DFIs and to improve the supervisory framework, as part of an overall strategy to improve the efficiency and effectiveness of DFIs in the SADC region.

7.3 Policy Recommendation 1:

7.3.1 Mandate clarity and role of the DFIs

To ensure that the DFIs complement the existing banking institutions effectively, by providing financial services to projects not serviced by the banking institutions, the mandate of the DFIs should be clearly outlined and defined. The focus of the DFIs should be as follows:

- As development institutions, DFIs should continue to meet the socioeconomic and developmental goals set by the government while at the same time remaining financially viable;
- As financial intermediaries, the DFIs should not be involved in sectors that have matured and are able to obtain financing on their own from the commercial banking

system or the capital market. DFIs should complement the banking sector through extension of credit in:

a) Priority and/or new growth areas specified and identified by the government, such as information technology and high technology ventures, infrastructure development, services and agriculture;
b) Sectors which banking institutions do not have the expertise to appraise, including projects involving complex industrial and agricultural technology;
c) Sectors or projects which require lenders to assume venture-type risks which should not be funded from depositors' funds; and
d) Projects requiring longer-term funding which is not normally provided by the banking institutions.

- As specialised institutions, the DFIs should enhance their range of facilities through product and service innovation in order to sustain growth in specialized areas. Emphasis should also be placed on providing value-added advisory, consultancy and technical assistance, supported by strong research capabilities.

7.3.2 Focus on core competences of the DFIs

One of the problems identified in this study is that many of the DFIs have lost business focus, and compounded this problem by blindly attempting to emulate the seemingly successful practices of commercial banks, without creating the requisite systems and processes. For this reason it is important that DFIs identify their core competencies and focus their development on their areas of expertise. They need to examine their own operating environment and identify areas where they can add value.

Privatization for the sake of privatization can be counter-productive. It is not enough simply to be another player in the market, particularly if the DFI does not have the necessary competencies and if there are other institutions in the market who can do the job better. DFIs therefore need to adopt a business approach with a clear eye to sustainability even as they serve to channel much-needed finance into areas needing development. Often, it is not only the accessibility of finance which counts for development, but also the cost of finance.

7.4 Policy Recommendation 2:

7.4.1 Enhance institutional capacities and operational structure

In order to achieve their mandates and meet challenges successfully, the DFIs' operational capabilities and capacities need to be further strengthened and improved by the following measures:

- Formulate comprehensive policies and operational procedures in line with organizational objectives. DFIs' financing policies should ensure that loans and investments are given proper viability studies, credit evaluations and risk assessments;
- Address credit risk needs appropriately. A comprehensive risk management system with appropriate management oversight to identify, measure, monitor and control risks needs to be established. Stress tests would be useful to provide an indication of capital requirements in alternative economic scenarios and business strategies;
- Incorporate adequate organizational controls with strong checks and balances. To minimise management and operational risk, clear lines of responsibilities and management structures need to be established, and both internal and external audit procedures need to be instituted;
- Identify human resource requirements and develop an appropriate recruitment policy for the selection and placement of competent personnel. Professional training should be conducted in a systematic way in order to enhance staff skills and competencies, especially in the area of financing;
- Increase the use of technology to enable the efficient dissemination of information and to improve consumer access to financial services and facilities, e.g. through a financial service portal. Manual processing and procedures should be automated to enhance operational efficiency. A comprehensive management information system should also be developed.
- Set up a research and development department to help DFIs provide consultancy and advisory services to targeted groups;
- Establish an international network of DFIs that will enable sharing of information on activities and developments in the field; and

- Set up a unit to oversee the coordination of DFIs with relevant ministries, authorities and agencies, and to facilitate the assessment and achievement of government objectives.

7.5 Policy Recommendation 3:

7.5.1 Enhance performance measurement

A comprehensive performance measurement framework to gauge DFIs' ability to meet government policies, goals and targets should be put in place. Because of the unique role of DFIs, the framework should not be solely based on financial performance indicators. The performance measurement of DFIs should include the following:

- Quantitative and qualitative indicators that evaluate the economic and social contributions arising from DFIs' activities;
- A quantitative operational programme or budget set annually or on a periodic basis; and
- Financial performance indicators.

7.5.2 Action Plan

The following action plan can be used to facilitate the assessment of the performance of DFIs:

- Formalise an annual performance plan for DFIs based on their primary developmental roles and objectives;
- Establish appropriate measures and benchmarks to determine the efficiency and effectiveness of DFIs in achieving these objectives; and
- Report performance results to the government and the public.

7.6 Policy Recommendation 4:

7.6.1 Cleaning of the Balance sheet and Introduction of a Systematic framework for Mobilizing Resources from the Market & Strategic Partners

A legacy of substantive accumulated non-performing loans or accumulated losses tends to weigh down any restructuring effort. To address this problem, it would be preferable for the governments in the SADC region to facilitate the cleansing of the balance sheet by separating

the performing assets from the chronic bad assets in the portfolio of the DFI, and recapitalising the institution adequately. This can be done by placing the bad assets into a Special Purpose Vehicle. The DFI will then look for other special means of recovery on a commission basis. This will clean up the DFI's balance sheet, placing it on a more solid footing. It is important that such cleansing support be accompanied by inviolable operational covenants and governance structures which will sustain healthy operations.

Further, a systematic framework to ensure adequate funding for DFIs' operations should be introduced. The framework should consist of the following elements:

- Funds obtained from the government for development and social programmes should be allocated and accounted for in the government's annual budget;
- The government funds intended for development and social programmes should be kept separate from the DFIs' own funds and administered separately in the manner of trust funds;
- Government support should be given to help DFIs to raise funds from the capital market for the DFIs' own lending activities; and
- DFIs should be encouraged to mobilize more long-term external funds from the market for their own lending activities.

7.6.2 Resources from Government for Specific Projects

Government funding support for development and social programmes should be protected with a system of close supervision and controls, together with strong corporate governance, to ensure that these funds are used for their stated purposes. DFIs should also make sure that fees covering the cost of administering these funds are collected.

7.6.3 DFI Access to Capital Markets

DFIs' access to the capital market needs to be enhanced to provide an efficient means of financing capital-intensive and long-gestation projects. Government support may be needed to enable DFIs to obtain favourable funding rates, which ultimately would make the projects more viable. Such assistance could be given through changing the laws governing investment in pension funds and insurance.

7.7 Policy Recommendation 5:

7.7.1 Continue Government's support to the DFIs

In order for SADC DFIs to meet their objectives successfully, government support and an effective coordination of DFIs with relevant ministries is essential. This can be achieved through the following measures:

- Adopt a consultative approach in order to facilitate coordination and communication among the regulatory and supervisory authorities, the government, the DFIs and industry experts. Regular meetings and consultation should be used to ensure a smooth transmission and implementation of government policies;
- Have relevant ministries clearly specify the role and objectives of DFIs in line with the changing needs of the nation and developments in the economy;
- Apply annual budgetary allocation processes as tools to determine DFIs' scope of activities and funding sources;
- Establish measures to address ad-hoc development and social projects which are not budgeted for in government allocation to DFIs and incorporate performance review and accountability criteria; and
- Formulate and agree on the performance plan, targets, benchmarks and measurement criteria for DFIs' operations.

7.8 Policy Recommendation 6:

7.8.1 Strengthen corporate governance

The governance architecture of DFIs in the SADC region needs to be strengthened to minimise or even eliminate government influence on operations. For this reason it would be progressive to appoint a chairman of the board who:

- Has professional and relevant experience;
- Has a reputation for integrity; and
- Is independent enough to resist any political influence.

The board also should have a reasonable number of independent directors. While government appointments to the board may be unavoidable if there is significant government ownership,

appointments to the board and top management of the DFIs should be transparent and based on professional merit. These independent directors should include professionals who have relevant experience in areas such as banking, investment analysis, law, industry, tourism etc. The loan approval powers of the board may also be delegated to a sub-committee of the board, which is comprised mostly of independent directors with relevant credit experience. This may serve structurally to minimise political influence on lending decisions. Structural improvements notwithstanding, real operational autonomy will depend to a large extent on government's intentions and the political will to allow such progressive measures. Operationally, within the context of the DFIs' risk management framework, project selection should be based primarily on commercial viability, unless there is specific subvention/subsidy available from the government linked with lending to inherently unviable sectors or projects which have mainly only social benefits. This will help to ensure that loans of this type do not compromise the financial performance of the institution.

7.8.2 Strengthen Risk Management and Capital Base

A more prudent approach to risk management and risk assessment is needed to ensure that over time both loan portfolio quality, which has been found to be general poor in many SADC DFIs, and overall financial performance are improved. For this reason, risk assessment must be used for risk mitigation and risk management. All this must be done within the framework of well-developed risk management systems and practices which are consistent across the development finance system.

It is also critical for DFIs to maintain a high level of capital adequacy, since DFI operations are inherently risky. Adequate capital will also enable the DFI to mobilize external resources and explore innovative loan products such as partial guarantees. An analysis of successful development finance institutions internationally would reveal that all high-rated banks tend to keep a very high level of capital.

7.9 Policy Recommendation 7:

7.9.1 Establish a legal framework to provide for regulation and supervision of DFIs

It is proposed that a legal and regulatory framework be established for the DFIs. A single legislation to regulate the DFIs in every SADC country with due consideration of the unique roles and function of each individual DFI. The new legislation will ensure that DFIs' policies

and objectives are consistent with the Government initiatives and direction and that Government policies are implemented effectively. The regulatory framework should take into account that DFIs are expected to serve public purposes and as such should be given special benefits and privileges to do so to achieve the national interest and the socio-economic agenda. The envisaged regulatory framework should be concerned with the safety and soundness of the DFIs so as to minimise the need for financial assistance from the Government. The legislation should also incorporate prudential rules, disclosure and reporting requirements, rules on corporate governance (as indicated in the PSGRS), as well as powers to be granted to the regulatory and supervisory authority in the case of mismanagement or malpractice in the DFIs.

7.10 Policy Recommendation 8:

7.10.1 Single Independent Regulatory and Supervisory Body (SIRSB)

In the event that it's not feasible for DFIs to be regulated and supervised by the Central Banks, the DFI Network should propose to Ministers of Finance to establish a single Independent Regulatory and Supervisory Body (SIRSB) in each SADC country to strengthen the supervision of DFIs.

The SIRSB should have the following attributes:

- Ability to regulate and supervise activities of DFIs in meeting their strategic focus towards achievement of Government developmental objectives and goals;
- Ability and capacity in terms of manpower, skills, knowledge and expertise, and system capabilities to implement regulatory and supervisory measures to ensure the safety and soundness of DFIs. This includes capacity for ongoing supervisory efforts, both off-site supervision and on-site examination;
- Competency in evaluating and measuring the performance and impact of DFIs' activities and in assessing DFIs' achievement of the Government developmental goals;
- Formulate sufficient reporting requirements for DFIs to facilitate supervision as well as coordinate overall DFIs performance reporting to Government and public; and
- Facilitate effective coordination and communication among policy makers and the DFIs.

The IRSB will play a strong coordination role in the overall supervision by carrying out the supervision process. In supervising the DFIs, efforts will be focused on enhancing the corporate governance practices supported by strong commitment and active participation of the relevant ministries. In addition, external checks and balances from external auditors and the budgetary process can be incorporated as part and parcel of the supervisory process. The IRSB should address the safety and soundness of the DFIs, individually and collectively, as well as public purpose and the economic implications of the activities of the DFIs on the financial system and economy.

7.11 Conclusions and Way Forward

Historically, DFIs have been an important instrument for governments to promote economic growth by providing credit, loan guarantees, other financial services and a wide range of advisory and capacity building programs to low-income households, SMEs, and even large corporations whose financial needs are not sufficiently served by private commercial banks or local capital markets.

Even in advanced economies, where private financial institutions and capital markets cover the financial needs of households and enterprises, DFIs continue to play an active role in the economy by providing credit to select sectors and fostering new investments in priority sectors such as Agriculture, infrastructure, SME development and Industry and energy.

Despite the importance of DFIs, little is known about the role they played by DFIs. The Scan's results reveal that the space of DFIs is heterogeneous in all SADC countries and, as a result, they cannot and should not be treated as a uniform group of institutions. DFIs in the SADC Member States differ among themselves in various areas, such as[29]:

- Ownership structure (fully vs. partially owned by government)
- Policy mandates (narrow vs. broad mandates)
- Funding mechanisms (deposit taking vs. non-deposit taking institutions)
- Target sectors and clients (narrow vs. wide focus)
- Lending models (first-tier vs. second-tier)
- Pricing of lending products (subsidized vs. market interest rates)

[29] See Annex 1 Table for an exhaustive list of the findings of the Scan

- Regulation and supervision (special regime vs. same regime applicable to private banks)
- Corporate governance (independent vs. government controlled boards)
- Transparency standards (wide vs. limited disclosure)

The scan found that across SADC Member States, DFIs display various differences and patterns. Specialized and profitable DFIs with a strong commercial orientation such as IDC South Africa coexist with other DFIs that are highly dependent on government subsidies. They pursue multiple and sometimes conflicting economic and social objectives.

Some DFIs were also found to have high standards of transparency, accountability, and operational autonomy with institutions that continue to operate under the powerful influence and interference of single individuals and politicians. Deposit-taking DFIs with large branch networks coexist with DFIs that are only funded through capital markets and lend only through second-tier operations.

In practice, the different institutional features and modalities adopted by individual DFIs as discussed in the earlier sections of this study do matter, because they can determine to a large extent a DFI's ability to become financially-self-sustainable and, more importantly, fulfil their objectives and policy mandates in an efficient manner.

Thus adopting the best possible institutional design for DFIs is important since they operate in difficult and challenging environments. DFIs are expected to serve clients and segments of the market with a high risk profile that are usually not being served by private financial institutions. At the same time, as government-owned and controlled institutions, DFIs could be vulnerable to undue political pressure, unless strong safeguards in the form of guidelines are put in place.

It must be emphasised that empirical findings from the international perspective have revealed that only DFIs with clearly defined mandates, high corporate governance standards, strong risk management capability, proper regulation and supervision, and a strong management team have been successful. In fact, in the past several DFIs around the world have failed due to poor lending decisions, high amount of non-performing loans, undue political interference, capture by interest groups, and lack of well-defined mandates.

Finally, it must be pointed out that the work and findings from this Scan are by no means exhaustive as further work need to be done on a number of issues such: developing model

frameworks for legal and regulatory policy for DFIs, facilitating the harmonisation of the mandates in SADC Member countries, establishment of regional insurance guarantee schemes, capacity building etc.

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Annexure 1

SADC Development Finance Resource Centre (SADC DFRC)

Questionnaire for Evaluation of SADC Development Financial Institutions (DFIs)

All requested information is to be provided as of the end of the last four fiscal years, or otherwise as specified in the question.

I	**General Information**		
1	Name of your institution		
2	Address		
3	Country		
4	Website		
5	When was your institution established?	Year [ ]	
II	**Classification of your institution**		
	Question	**Answer**	**Comments/ Explanations**
6	Indicate your institution's ownership structure at the end of 2012	Indicate shares in % in the appropriate box below	
6.1	Proportion of total held by State/Government (%)		
6.2	Proportion of total held by Multilateral Financial		

	Institutions and Foreign Governments (%) (specify)		
6.3	Proportion of total held by Domestic private sector (%)		
6.4	Proportions of total held by Foreign private sector (%)		
6.5	Proportions of total held by Other (specify) (%)		
7	Under which Act or Law is your institution incorporated?		
8	What is your institution's mission or policy mandate, as defined by your law? (Specify)		
9	Does your institution have public and private policy mandate, i.e., allowed to finance sustainable development projects in partnership with the public and private sectors?	Yes [ ] No [ ]	If yes specify these projects.
10	Does your institutional have SADC policy mandate i.e., allowed to fund development projects in SADC Member States?	Yes [ ] No [ ]	If yes specify these projects.
11	Does your institution Manage, Monitor and Evaluate Policy Activities and Performance of the following?	Please answer "Yes" or "No" in the appropriate box below	Provide more detailed Specification for each policy target below
11.1	Policy targets (e.g contribution to economic	Yes [ ]	

	development and employment created by sectors supported by institution	No [ ]	
11.2	Financial targets (e.g. adequate initial capitalisation, profit and losses allowed to be made by your institution)	Yes [ ] No [ ]	
11.3	Operational targets (e.g. how much of your budget is marked for each sector supported by your institution.)	Yes [ ] No [ ]	
12	Is term finance of your institution provided through commercial banks	Yes [ ] No [ ]	
13	Is the provision of macro-directed development finance channelled through your institution?	Yes [ ] No [ ]	
II	**Size and Quality**		
14	Total assets of your institution at the end of:	Specify in US$	
14.1	2009		
14.2	2010		
14.3	2011		
14.4	2012		
15			

	Market share of your institution in terms of total assets in the banking system in 2012 (specify in %)		
16	Total equity at the end of:	Specify in US$	
16.1	2009		
16.2	2010		
16.3	2011		
16.4	2012		
17	Total gross loan portfolio at the end of:	Specify in US$	
17.1	2009		
17.2	2010		
17.3	2011		
17.4	2012		
18	What proportion of loans and equity investment is external/cross border?	Specify in US$	
18.1	2009		
18.2	2010		
18.3	2011		

18.4	2012		
19	Total assets excluding subsidiaries	Specify in US$	
19.1	2009		
19.2	2010		
19.3	2011		
19.4	2012		
20	What was the % provisions for bad debts to total loans and advances outstanding in	Specify in %	
20.1	2009		
20.2	2010		
20.3	2011		
20.4	2012		
21	Number of branches at the end of 2012		
22	Number of subsidiaries at the end of 2012		
23	Number of staff at the end of 2012		

III	**Funding**		
24	Does your institution take deposits from the general public?	Yes [ ] No [ ]	
25	What was the number of deposits accounts and total value at your institution at the end of? ("Not applicable" if your institution does not take deposits)		
25.1	2009		
25.2	2010		
25.3	2011		
25.4	2012		
26	What was the outstanding amount of deposits at the end of? ("Not applicable" if your institution does not take deposits)		
26.1	2009		
26.2	2010		
26.3	2011		
26.4	2012		
27	Can your institution borrow from other financial	Yes [ ] No [ ]	

	institutions or issue debt in local markets?		
28	Does your institution receive direct budget transfers from the Government? What proportion is this of your operational budget?	Yes [ ] No [ ]	
29	If Government transfers were canceled, would your institution be able operate on a sustainable basis with its own generated income and profits? (indicate "Not applicable" if your institution does not receive budget transfers)	Yes [ ] No [ ] N/A [ ]	
30	Has your institution received government funds, subsidies, or transfers to cover losses or strengthen its financial situation in the past five years?	Yes [ ] No [ ]	
31	Does the government guarantee your institution's debt?	Yes [ ] No [ ]	
32	Does your institutions mobilise resources from international market? What proportion is this of your total funds raised?	Yes [ ] No [ ]	
IV	**Business Model and Products**		
33	How does your institution lend?	Please answer "Yes" or "No" in the appropriate box below	Supporting explanations
33.1	Wholesale (through other financial institutions)	Yes [ ] No [ ]	

33.2	Retail (directly to final customers)	Yes [ ] No [ ]	
33.3	Both wholesale and retail	Yes [ ] No [ ]	
34	To which subsectors does your institution lend?	Please answer "Yes" or "No" in the appropriate box below	Indicate distribution in % and any relevant trends
34.1	Agribusiness	Yes [ ] No [ ]	
34.2	Construction	Yes [ ] No [ ]	
34.3	Industry/Manufacturing	Yes [ ] No [ ]	
34.4	Services	Yes [ ] No [ ]	
34.5	Mining	Yes [ ] No [ ]	
33.6	Infrastructure	Yes [ ] No [ ]	
34.7	Energy	Yes [ ] No [ ]	
34.8	Education	Yes [ ] No [ ]	
34.9	Health	Yes [ ] No [ ]	

34.10	SME	Yes [ ] No [ ]	
34.11	Does your institution carry out projects on behalf of governments, and what are the terms of such arrangements?	Yes [ ] No [ ]	
34.12	Other (please specify)		
35	What is your institution's target market?	Please answer "Yes" or "No" in the appropriate box below	Indicate distribution in % and any relevant trends
35.1	Individuals and households	Yes [ ] No [ ]	
35.2	Start-ups	Yes [ ] No [ ]	
35.3	Micro, small and medium enterprises	Yes [ ] No [ ]	
35.4	Large private corporations	Yes [ ] No [ ]	
35.5	Other financial institutions	Yes [ ] No [ ]	
35.6	Other state-owned enterprises	Yes [ ] No [ ]	
35.7	Other (Please specify)		
36	What lending products does your institution offer?	Please answer "Yes" or "No" in the appropriate box below	Indicate distribution in % and any relevant trends

36.1	Loans for start-up activities	Yes [ ] No [ ]	
36.2	Loans for working capital	Yes [ ] No [ ]	
36.3	Bridge or short-term loans	Yes [ ] No [ ]	
36.4	Loans for new product launch activities	Yes [ ] No [ ]	
36.5	Unsecured loans (for intangible assets)	Yes [ ] No [ ]	
36.6	Long-term loans	Yes [ ] No [ ]	
36.7	Syndicated loans	Yes [ ] No [ ]	
36.8	Equity financing	Yes [ ] No [ ]	
36.9	Other (please specify)		
37	Interest rates on loans	Indicate answer in % in the appropriate box below	
37.1	What is your average annual interest rate on loans?		
37.2	What is the average annual lending rate of Commercial Banks in your country		

38	Does your institution provide loans at subsidized interest rates (below the market interest rates)?	Yes [ ] No [ ]	
39	If subsidized interest rates are offered, how are they funded?	Indicate Yes or No or Not applicable in the appropriate box below; "Not applicable" if your institution does not provide loans at subsidized interest rates)	
39.1	Government transfers	Yes [ ] No [ ] N/A [ ]	
39.2	Cross-subsidization (using profits from profitable business lines).	Yes [ ] No [ ] N/A [ ]	
39.3	Other (please explain)		
40	What is the maximum loan term (maturity) offered by your institution?	In years [ ]	
41	What was the average loan amount granted by your institution in 2012?	In US$ [ ]	
42	What other financial products/services does your institution offer?	Indicate Yes or No in the appropriate box below	
42.1	Loan Guarantees	Yes [ ] No [ ]	

42.2	Trust Services	Yes [ ] No [ ]	
42.3	Money Transfers	Yes [ ] No [ ]	
42.4	Micro-insurance	Yes [ ] No [ ]	
42.5	Savings Accounts	Yes [ ] No [ ]	
42.6	Deposit accounts	Yes [ ] No [ ]	
43	What non-financial services does your institution offer?	Indicate Yes or No in the appropriate box below	
43.1	Consulting	Yes [ ] No [ ]	
43.2	Networking / business matching	Yes [ ] No [ ]	
43.3	Training	Yes [ ] No [ ]	
43.4	Advisory services	Yes [ ] No [ ]	
43.5	Other (please specify)		
V	**Profitability and asset quality**		
44	What was your institution's Return on Assets (ROA)	Indicate your answer in % in the box below.	
44.1	2009		
44.2			

	2010		
44.3	2011		
44.4	2012		
45	What was your institution's Return on Equity (ROE)	Indicate your answer in % in the box below	
45.1	2009		
45.2	2010		
45.3	2011		
45.4	2012		
46	What was your institutions gross non-performing loan ratio (in %) at the end of?	Indicate your answer in % in the box below	
46.1	2009		
46.2	2010		
46.3	2011		
46.4	2012		
47	Is your institution required to comply with a minimum Capital Adequacy Ratio	Yes [ ] No [ ]	

	(CAR) like commercial banks?)		
48	If your answer in question 43 is yes, what then was your CAR at the end of 2012?		
49	Is your institution required by the State/Government to achieve a minimum rate of return on your capital or equity?	Yes [ ] No [ ]	
50	If so, what is the minimum rate of return (in %) you are required to achieve? ("Not applicable" if your institution is not required to achieve minimum return)		
VI	**Corporate Governance**		
51	How many members compose your institution's board?	Indicate number [ ]	
52	How many board members are independent (not affiliated with government agencies)?	Indicate number [ ]	
53	How many board members are non-executive, i.e. not involved in the daily management of the institution?	Indicate number [ ]	
54	Who chairs the board of directors?		
55	How many times does the board of directors meet per year?	Indicate number [ ]	

56	Who appoints the members of the board?		
57	Who appoints the Chairman of your institution's board of directors?		
58	For how long are board members appointed?	Indicate Yes or No in the appropriate box below	Indicate the number of years in the appropriate box below
58.1	Is it for fixed terms	Yes [ ] No [ ]	Years [ ]
58.2	Is it indefinite	Yes [ ] No [ ]	
59	Who has the power to remove the Chairman of the board?		
60	Who appoints the Chief Executive Officer of your institution-legally?	Indicate Yes or No in the appropriate box below	
60.1	The President of your country	Yes [ ] No [ ]	
60.2	The relevant Minister	Yes [ ] No [ ]	
60.3	The relevant Minister and with the advice of the Board	Yes [ ] No [ ]	
60.4	Other, please explain		
61	Does the legal framework governing your institution include the following	Indicate Yes or No in the appropriate box below	

	qualifications for the Chief Operating Officer of your institution?		
61.1	Minimum level of education or technical qualifications	Yes [ ] No [ ]	
61.2	Minimum level of financial or banking experience	Yes [ ] No [ ]	
61.3	No bankruptcy record	Yes [ ] No [ ]	
61.4	Lack of conflict of interests	Yes [ ] No [ ]	
62	Is the Chief Executive Officer appointment for a fixed term? (Yes/No)	Yes [ ] No [ ]	
63	If so, for how many years is the appointment? ("Not applicable" if the appointment is not for a fixed period)	Years [ ] N/A[ ]	
64	Does your institution publish its annual report?	Yes [ ] No [ ]	
65	Does your institution disclose to the public, at least once a year, the following information?	Indicate Yes or No in the appropriate box below	
65.1	Audited financial statements	Yes [ ] No [ ]	
65.2	Off-balance sheet items	Yes [ ] No [ ]	

65.3	Governance and risk management framework	Yes [ ] No [ ]	
65.4	Regulatory capital and capital adequacy ratio	Yes [ ] No [ ]	
66	Is your institution subject to specific state-owned enterprises/financial institutions corporate governance guidelines or requirements?	Yes [ ] No [ ]	If Yes, specify which one [ ]
67	Which ministry/government entity represents the state/government as a shareholder in your institution?		
68	Is the policy ministry represented on the Board?	Yes [ ] No [ ]	
69	Does your institution have a risk management unit, or equivalent unit, responsible for identifying, monitoring, managing and mitigating risks faced by your institution?	Yes [ ] No [ ]	
70	If yes, to whom does the chief risk officer report to? (Please answer "Yes" or "No" in the appropriate box)	Indicate Yes or No in the appropriate box below	
70.1	Board or Board Committee	Yes [ ] No [ ]	
70.2	Chief Executive Officer	Yes [ ] No [ ]	

70.3	Other senior official in your institution	Yes [ ] No [ ]	
VII	**Regulation and Supervision**		
71	Who supervises your institution?	Please answer "Yes" or "No" in the appropriate box below	
71.1	Central Bank	Yes [ ] No [ ]	
71.2	Ministry of Finance	Yes [ ] No [ ]	
71.3	If other, specify, please explain in the last column		
72	Does your institution comply with the same prudential rules (capital adequacy ratio, loan classification, loan provisioning, etc.) as commercial banks?	Yes [ ] No [ ]	
73	If your answered is "no" to question number 62, please explain existing differences in column 3		
74	Is your institution rated by an international rating agency?	Yes [ ] No [ ]	
75	If rated, what is your institution's latest rating?		
76	Is your institution legally required to be audited by a professional external auditor?	Yes [ ] No [ ]	

77	Does your institution have an internal audit department or a qualified external audit company that reports directly to the Board of Directors?	Yes [ ] No [ ]	
78	AADFI	Please answer "Yes" or "No" in the appropriate box below	
78.1	Is your institution a member of AADFI?	Yes [ ] No [ ]	
78.2	Is your institution certified by AADFI	Yes [ ] No [ ]	
VIII	**FIP Related Issues (Regional Integration Agenda)**		
79	Does your institution collaborate with other SADC Member States on the following areas?	Please answer "Yes" or "No" in the appropriate box below	Number of projects, staff involved
79.1	Participation in regional/ cross-border Projects	Yes [ ] No [ ]	
79.2	Mobilise intra- and extra-regional funds for development projects	Yes [ ] No [ ]	
79.3	Taking equity in each other's institutions	Yes [ ] No [ ]	
79.4	Investing jointly in new structures where necessary	Yes [ ] No [ ]	
79.5	capacity building, including exchange of personnel	Yes [ ] No [ ]	

79.6	Are you a member of SADC DFI Network? If not, why not?	Yes [ ] No [ ]	
79.7	If you are a member of the SADC DFI Network, what major benefits do you derive from being part of the Network and the DFRC?		
IX	**Challenges**		
80	In your view, what are the most important challenges for your institution going forward? (Please answer	Please answer "Yes" or "No" in the appropriate box below	Explain nature of challenges
80.1	Become financially self-sustainable	Yes [ ] No [ ]	
80.2	Improve corporate governance and transparency	Yes [ ] No [ ]	
80.3	Managing undue political interference	Yes [ ] No [ ]	
80.4	Improve risk-management capacity	Yes [ ] No [ ]	
80.5	Improve loan recovery ratio	Yes [ ] No [ ]	
80.6	Acquire more flexibility to hire and retain highly qualified staff (clarify)	Yes [ ] No [ ]	
80.7	Diversify business operations (please explain)	Yes [ ] No [ ]	

80.8	Entering regional and international markets	Yes [ ] No [ ]	
80.9	Mobilising financial resources from internal and external sources	Yes [ ] No [ ]	
80.10	Staff skills	Yes [ ] No [ ]	
80.11	Government oversight as owner	Yes [ ] No [ ]	
80.12	Management of government-sponsored/ subsidised project	Yes [ ] No [ ]	
80.13	Other (please explain)		
x	**PPPs Related Matters**		
81	Does your PPP Unit collaborate with other SADC Member States on the following areas?	Please answer "Yes" or "No" in the appropriate box below	Number of projects, staff involved
81.1	capacity building, including exchange of personnel and sharing expertise and experiences with other PPP Units	Yes [ ] No [ ]	
81.2	Is you Unit a member of SADC PPP- Network? If not, why not?	Yes [ ] No [ ]	

81.3	If you are a member of the SADC PPP Network, what major benefits do you derive from being part of the Network and the DFRC?		
81.4	Is your PPP Unit involved in any projects?	Yes [ ] No [ ]	If answer is yes, name the projects
81.5	If your PPP Unit is not involved in any projects, state the reasons.		

Annexure 2

Institutional Structure & Funding of DFIs in SADC

Country and Institutions	Year Est.	Asset Size US$ Million	Complementary Role	Funding
Angola				
1. Banco de Poupança e Crédito (BPC)	1991	9, 600	Yes	• Deposits • DBA • Govt
2. Development Bank of Angola	2006	1,578	Yes	• Govt
Botswana				
3. National Development Bank	1963	156	Yes	• Govt • CM Loans
4. Botswana Development Corporation	1970	312	Yes	• Govt • CM Loans • Equity
5. Botswana Housing Corporation (BHC)	1970	352	Yes	• Loans • Income
6. Botswana Investment Trade Centre	2011	38	No	• Govt

7. Local Enterprise Authority	2004	24	No	• Govt
8. Citizen Entrepreneurial Development Agency	2001	141	Yes	• Govt
9. **Botswana Savings Bank**	1992	95	Yes	• Govt • Deposits
Lesotho				
10. Basotho Enterprise Development Corporation	1980	3	No	• Govt
11. Lesotho National Development Corporation	1967	91	No	• Govt • ICP • Dev Banks
12. Lesotho Postbank	2004	-	Yes	• Govt • ICP • Deposits
13. Lesotho House Corporation	1989	-	No	• Income

Malawi				
14. Export Development Fund	2012	3.9	Yes	• Govt
Mauritius				
15. Development Bank of Mauritius	1964	246	Yes	• Govt. • Deposit • Loans
16. State Investment Corporation	1984	264	Yes	• Govt. • Loans • Income
17. Mauritius Housing Corporation	1963	208	Yes	• Govt. • Loan • Deposit
18. Mauritius Post Bank	2003	487	Yes	• Deposit
Mozambique				

19. BNI	2010	91	Yes	• Govt
20. Gabinete de Consultoria e Apoi à PequenaIndustria (GAPI)- No SADC Policy	1990	31	Yes	• From ICPs • Loans
Namibia				
21. National Development Corporation	1993	25	Yes	• Govt • Loans (DBSA)
22. EFN	2003	103	Yes	• Govt
23. National Housing Enterprise	1993	67	Yes	• Deposit • Loan • Govt
24. Agribank of Namibia	1944	175	Yes	• Loans • Govt
25. SME Bank	1912	10	Yes	• Deposit • Govt
26. Development Bank of Namibia	2002	258	Yes	• Govt

Seychelles				
27. Development Bank of Seychelles	1977	42	Yes	• Govt • Loan
28. Sepha	2004	-	No	• Govt
29. SME Bank	2013	-	Yes	• Govt • Loans
30. Seychelles Housing Finance Corporation	2003	95.3	Yes	• Govt • Loans
South Africa				
31. Development Bank of Southern Africa- SADC Mandate	1983	6, 500	Yes	• Govt • Loan • ICPs
32. Industrial Development Corporation	1940	15,100	Yes	• Govt • Loans
33. Land and Agriculture Bank of SA- SADC Mandate	1912	3, 100	Yes	• Govt • Loan
34. **NHFC**	1996	-	Yes	• Govt

35. National Empowerment Fund	1998	550	Yes	• Govt
Swaziland				
36. Swaziland Industrial Development Company	1987	86	Yes	• Govt • Loan
37. Swaziland Development and Savings Bank (Swazi Bank)	1973	224	Yes	• Deposit • Loan
38. Swaziland Development Finance Corporation (FINCORP) **No SADC Mandate**	1996	45	Yes	• Govt • Loans
Tanzania				
39. Tanzania Investment Bank	1971	209	Yes	• Govt • Deposits
40. National Development Corporation **No SADC Mandate**	1962	US$84	Yes	• Govt • Income

Zambia				
41. Development Bank of Zambia	1972	US$76	Yes	• Govt • Loan from other (DFIs)
42. Zambia National Savings and Credit Bank	1972	-	Yes	• Govt • Deposits
43. Zambia Building Society	1968	-	-	• Govt
44. CEEF	2006	-	Yes	• Govt
Zimbabwe				
45. Industrial Development Corporation of Zimbabwe	1963	158	Yes	• Govt
46. SEDCO	1983	9.6	Yes	• Govt • ICPs
47. Agribank Zimbabwe	1924	127	Yes	• Govt • Deposits • Loan

48. Infrastructure Development Bank of Zimbabwe	2005	115.5	Yes	• Deposits • Loans

Notes

Period under which DFIs were established

- Five DFIs were established prior to 1945 and this translates to 10.4% of DFIs;
- Fifteen DFIs were established between 1960 and 1980 which translates to 31.3%;
- Thirteen DFIs were established between 1980 and 2000, which translates to 27.0%; and
- Fifteen DFIs were established during the period of 2000 and 2012, and this translates to 31.3%

Funding

- Forty three DFIs are funded by the Government, and this translates to 89.6%;
- Thirty one DFIs (64.6%) have access to loans from capital markets;
- Fourteen DFIs (29.2%) collect deposits; and
- Five DFIs (10.4%) had access to resources from other DFIs

Complementarity

- seven DFIs (14.6%) were found not to play any complementary role to commercial banks (this is specifically related to lending)

Annexure 3

Institutional Structure and Sector Focus of DFIs in SADC

	Country/institutions			Nature of institution		
Country and Institutions	**Ownership**	**Statutory Institution**	**Corporate Entity**	**Single Sector/Focus**	**Multi-Sector/ Focus**	**Other Financial Service**
Angola						
1. Banco de Poupança e Crédito (BPC)	Government	x			SME Development in: • Agricultural; • Industrial; & • Commercial and services	
2. Development Bank of Angola	Government	x			• Industrial; • Agriculture, & • Wholesale and Trade	
Botswana						
3. National Development Bank	Government	x			• Agricultural; • Commercial; • Property development (commercial, industrial and residential commercial property); &	

					• Industrial and tourism projects.	
4. Botswana Development Corporation	Government		x		• Agribusiness and services; • Industry; & • Property development	
5. Botswana Housing Corporation (BHC)	Government		x	• Housing		
6. Botswana Investment Trade Centre	Government	x			• All Economic Sectors	• Investment promotion & • Export development
7. Local Enterprise Authority	Government	x		• SMMES		• Development and support services to the local industry needs of SMMEs
8. Citizen Entrepreneurial Development Agency	Government	x			• Agribusiness; • Property; • Manufacturing, & • Services	
9. Botswana Savings Bank	Government	x			• Parastatal • Local Government • Individuals	

Lesotho						
10. Basotho Enterprise Development Corporation	Government	x		• SMEs		• Development and support services to the local industry needs of SMMEs
11. Lesotho National Development Corporation	Government	x			• Manufacturing; • Processing Industries; & • Mining and Commerce etc.	
12. Lesotho Postbank	Government	x			• SME development including other sectors of the economic	
13. Lesotho House Corporation	Government	x		• Housing		
Malawi						
14. Export Development Fund	Government		x		• Agriculture & all other sectors of the economy	

Mauritius						
15. Development Bank of Mauritius	Government		x		• All Sectors of the Economy	
16. State Investment Corporation	Government		x		• Transport and communication; • ICT; • Agro industry; • Manufacturing; • Property; • Entertainment and tourism	
17. Mauritius Housing Corporation	Government		x	• Housing		
18. Mauritius Post Bank	Government		x		• SME development and all other sectors of the economy	
Mozambique						
19. Development Bank of Mozambique	Government	x			• SMEs Infrastructure, natural resources, Energy, Industry, Transport	
20. Gabinete de Consultoria e Apoi à	• Government 30%	x			• SMEs, Agri, Transport, Trade, Construction	

PequenaIndustria (GAPI)	• Pvt Sector 40% • Civil Soc 30%					
Namibia						
21. National Development Corporation	Government	x			• All sectors	
22. Development Fund of Namibia	Government	x			• Industry; • Infrastructure; & • SMEs	
23. National Housing Enterprise	Government	x		• Housing		
24. Agribank of Namibia	Government		x		• Agriculture; & • Agriculture industry	• Facilitate Black Economic Empowerment
25. SME Bank	Government/Pvt Sector	x			• SMEs; & • Micro-enterprise sector • All other sectors of the economy	Commercial banking
26. Development Bank of Namibia	Government	x			• All Sectors of the Economy	Micro SMEs Corporate
Seychelles						

27. Development Bank of Seychelles	Government	x			• Housing and commercial facilities; • Tourism industry; & • Fisheries and Agriculture	
28. Sepha	Government	x		• SMEs		
29. SBFA	Government	x		• SMEs		
30. Seychelles Housing Finance Corporation	Government		x	• Housing		
South Africa						
31. Development Bank of Southern Africa	Government	x		• Infrastructure		
32. Industrial Development Corporation	Government	x			Industrial development in the following areas: • Manufacturing activities; • Infrastructure; • Tourism; • Mining; & • Agricultural activities	

33. Land and Agriculture Bank of SA	Government	x		• Agriculture		
34. **NHFC**	Government	x		• Housing		
35. National Empowerment Fund	Government	x			• All sectors of the economy	• Facilitate Black Economic Empowerment
Swaziland						
36. Swaziland Industrial Development Company	Government/ Foreign financial institutions	x			• Agriculture • SMEs • Microfinance	
37. Swaziland Development and Savings Bank (Swazi Bank)	Government		x		• Agriculture • Industry • SMEs	• Commercial banking
38. Swaziland Development Finance Corporation (FINCORP)	Government/ /Private Sector		x		• Agriculture • SMEs • Microfinance • Trade	
Tanzania						

39. TIB Development Bank	Government /Private Sector		x		• Agriculture; • Manufacturing, processing; • Construction; • Transport; Tourism & • Mining sectors	• Commercial Banking
40. National Development Corporation	Government	x			• Mining; • Industry and Export Processing Zones; • Energy; • Infrastructure; & • Development Corridors (SDIs)	
Zambia						
41. Development Bank of Zambia	Government	x			• Agriculture, • Processing industries; • Manufacturing; • Tourism; • Transport and haulage; • Fisheries; & • Infrastructure	
42. Zambia National Savings and Credit Bank	Government	x			• Agriculture • Including all sectors of the economy	• Commercial banking

43. Zambia Building Society	Government	x		• Housing		
44. CEEF	Government	x			All sectors of the economy	• Empowerment services
Zimbabwe						
45. Industrial Development Corporation of Zimbabwe	Government		x		• All sectors of the economy	
46. SEDCO	Government	x		• SMEs		
47. Agribank Zimbabwe	Government	x			• Agriculture • Manufacturing • Mining etc.	• Commercial banking
48. Infrastructure Development Bank of Zimbabwe	• Government • Pvt Sector • Reserve Bank	x			• Manufacturing • Agro • Tourism • ITC • Construction • Energy	

1. Submission:

- 48 DFIs were identified;
- 21 DFIs submitted the questionnaires; and
- Consultant also managed to find information on the other 21 DFIs.

2. Ownership

- Out of the total of 48 DFIs, 42 are wholly owned by the States which translates to 87.5%;
- One DFI is majority owned by the Private Sector which is 2.1%; and
- Five DFIs have mixed ownership structure though majority owned by the State and this translates to 10.4%.

3. Mandate

- Fourteen DFIs have specific mandate and this translates to 29.2%; and
- Thirty four DFIs have broad mandates which translates to 70.8%

4. Legal Persona

- Thirteen DFIs have been incorporated under the Companies Act; and
- Thirty five of the total DFIs identified still fall under the Acts of Parliament or decree

Annexure 4

Regulation and Supervision of DFIs

Country and Institutions	Central Bank	Line Ministry
Angola		
1. Banco de Poupança e Crédito (BPC)	✓	
2. Development Bank of Angola	✓	
Botswana		
3. National Development Bank	✓	
4. Botswana Development Corporation		✓
5. Botswana Housing Corporation (BHC)		✓
6. Botswana Investment Trade Centre		✓
7. Local Enterprise Authority		✓
8. Citizen Entrepreneurial Development Agency		✓
9. **Botswana Savings Bank**	✓	
Lesotho		
10. Basotho Enterprise Development Corporation		✓

11. **Lesotho National Development Corporation**		✓
12. Lesotho Postbank	✓	
13. Lesotho House Corporation		✓
Malawi		
14. Export Development Fund		✓
Mauritius		
15. Development Bank of Mauritius		✓
16. State Investment Corporation		✓
17. Mauritius Housing Corporation		✓
18. **Mauritius Post Bank**		✓
Mozambique		
19. Development Bank of Mozambique	✓	
20. Gabinete de Consultoria e Apoi à PequenaIndustria (GAPI)	✓	
Namibia		
21. National Development Corporation		✓

22. Development Fund of Namibia		✓
23. National Housing Enterprise		✓
24. Agribank of Namibia		✓
25. SME Bank	✓	
26. Development Bank of Namibia		✓
Seychelles		
27. Development Bank of Seychelles	✓	
28. Sepha		✓
29. SME Bank		✓
30. Seychelles Housing Finance Corporation	✓	
South Africa		
31. Development Bank of Southern Africa		✓
32. Industrial Development Corporation		✓
33. Land and Agriculture Bank of SA		✓
34. **NHFC**		✓
35. National Empowerment Fund		✓

Swaziland		
36. Swaziland Industrial Development Company		✓
37. Swaziland Development and Savings Bank (Swazi Bank)	✓	
38. **Swaziland Development Finance Corporation (FINCORP)**		✓
Tanzania		
39. Tanzania Investment Bank	✓	
40. National Development Corporation		✓
Zambia		
41. Development Bank of Zambia	✓	
42. Zambia National Savings and Credit Bank		✓
43. Zambia Building Society		
44. CEEF		✓
Zimbabwe		
45. Industrial Development Corporation of Zimbabwe		✓
46. SEDCO		✓

47. Agribank Zimbabwe	✓	
48. Infrastructure Development Bank of Zimbabwe		✓

Source: DFI Annual Reports **16 DFIs= 33%** **32 DFI = 67%**

Scan of Development Finance Institutions in the SADC Region

Part 2: Country Reports

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TERMS OF REFERENCE

This study sets out to investigate and document the current state of Development Finance Institutions in the SADC region, with particular reference to the policy, regulatory and legal environments of national DFIs, and present country reports for each of the member states. The study focused on the following areas:

1. The status of the DFIs, their functions and operational environments;
2. The impediments and opportunities relating to the activities of the DFIs; and
3. The DFI Network mandate under FIP, taking into account other structures such as SADC RDF, PPDF and PPPs.

COUNTRY STUDY I: ANGOLA

The SADC DFRC Project Team of Dr. Lufeyo Banda, Dr. Herrick Mpuku, and Mr Stewart Kufeni held discussions in Angola on 17-18 January 2014 for the SADC DFI Scan study. The following review is based on the information collected and the discussions with representatives from the Ministério das Finanças, Banco National de Angola (BNA), Banco de Desenvolvimento de Angola (BDA) and Banco de Poupança e Crédito (BPC).

1 Background on Angola

As a result of Angola's status as Africa's second biggest oil producer, the Angolan economy grew by 3.6% in 2012 and 5.1% in 2013 respectively. Angola's domestic product (GDP) growth came mostly from the non-oil energy, agriculture, fisheries, manufacturing and construction sectors. Growth is projected to reach 7.9% in 2014 and 8.8% in 2015 as the country increases its investment spending in the economy, especially in the area of public infrastructure.

Despite this good economic performance, indicators are that social development has not kept pace with the strong economy. About 68.0% of the population live below the poverty line and unemployment remains high at 25.2% (World Bank's World Development Indicators 2012). In addition, the Gini coefficient, which is a measure of inequality, stands at 58.6.

Table 1: Key Figures for Angola

Capital	Luanda
Exchange Rate: 1 US$ =	96.03 Angolan Kwanza (Kz)
Population ^	20 820 525
Population growth rate (%) ^	3.12
Urban population (% of total) ^	59.91
Urbanisation rate (%) ^	4.41
GDP per capita (US$) ^	5 484.83
GDP growth rate (%, real) ^	3.55
GNI per capita, Atlas method (current US$) ^	4580
Population less than US$2 per day~	67.42
Population below national poverty line *	68.0
Gini co-efficient ~	42.66
HDI (Global Ranking)"	148
HDI (Country Index Score) "	0.508
Unemployment rate (%) *	25.20
Bank branches per 100 000 ^	10.51
Lending Interest Rate ^	16.93
Deposit Interest Rate ^	3.60
Credit % of GDP ^	17.46
Inflation	9
Ease of Doing Business Ranking (out of 185 countries)	172

Sources: ^ World Bank's WDI (2012), ~ World Bank PovcalNet: an online poverty analysis tool, various years; = www.coinmill.com on 26 August 2013; " UNDP's International HDIs (2012); * African Economic Outlook, various years;! World Bank's Doing Business Survey Data (2013)

Notwithstanding this gloomy picture, the government has taken steps to improve living conditions. Major investment has been planned to expand access to electricity, water and transport. To boost business, government has revised financial sector policies and introduced new foreign exchange currency laws in the oil and mining sectors. Though the structural

policies are positive, Angola needs to accelerate economic diversification and reduce dependence on oil, which accounts for about 46% of GDP, 80% of government revenues and 95% of Angola's exports.

On the monetary side of the economy, Angola's monetary policy focus has been on ensuring inflation and exchange rate stabilisation and resilience to external shocks. The National Bank of Angola (BNA) cut its main interest rate by 25 basis points three times in 2012. It ended 2013 with a policy rate of 9.25%. Favourable monetary policy trends led to an annual expansion of credit-to-the-economy, which averaged 21.13% on an annual basis, though this was down from the 2012 level of 30%. Most of the credit growth occurred on commercial activities. Consumer price inflation fell from 9% in 2012 to 7.7% at the end of 2013, the lowest figure in two decades. Inflation remains high and is mostly driven by consumer goods and logistical services. In the short term inflation will remain within the BNA target of 7-9%. Despite the declining trend of inflation, the cost of living in Angola remains high compared to neighbouring countries.

2. Access to finance in Angola

According to an AfDB 2014 report, Angola's financial sector is highly concentrated. The top five banks account for 77% of total assets. Banking coverage expanded from 22% in 2010 to 51% of the country's area in 2012 though it is still concentrated in Luanda. The percentage of adults with access to formal banking services increased from 13.5% in 2011 to 22% in 2012 as the bank network expanded through public campaigns. Further increase in access to banking has been mainly due to the government's decision to pay civil service salaries only through commercial banks and this has forced employees to open bank accounts. In support of the government initiative, in 2012 the National Bank of Angola also launched the Bankita programme in an effort to increase access to finance in Angola.

Table 2: Access to Finance - Angola

#	Indicator	%	SSA Region
1	% of firms using banks to finance investment	13.1	18.0
2	Proportion of investment financed internally (%)	89.0	78.4
3	Proportion of investment financed by banks (%)	5.2	9.9
4	Proportion of investment financed by suppliers of credit (%)	2.2	3.8
5	Proportion of investment finance by equity or stock sale (%)	1.8	3.7
6	% of firms identifying access to finance as a major constraint	38.5	41.9

Source: Enterprise Surveys (http://www.enterprisesurveys.org), The World Bank.

Table 2 indicates that despite the effort put in place by the government and NBA, access to finance by entrepreneurs still remains very low. For instance, only 13.1% of entrepreneurs use banks to finance their investments. Table 2 also shows that out of the total investment required by entrepreneurs, only a marginal 5.2% is provided by the banks, 2.2% by suppliers of credit, 1.8% by capital markets, while the largest portion (89%) of investment is internally financed by entrepreneurs. Furthermore, 38.5% of entrepreneurs in Angola report access to finance as the second biggest obstacle to their operations.

This report reveals that Angola has a development financial gap which commercial banks cannot fill at the moment. To address this problem, the Angolan government has set up two development finance institutions. These include Banco de Poupança e Crédito (BPC, formerly BPA) and Banco de Desenvolvimento de Angola (English: Development Bank of Angola) (BDA).

3 Analysis of Angolan Development Finance Institutions

Having just emerged from a long civil war, Angola has the task of repairing the country's socio-economic and infrastructure which had been destroyed. The Government of Angola has identified six priority sectors which it seeks to influence directly through the two development finance institutions listed above.

Table 3: Sectoral Analysis of Angolan DFIs

Sector	Institution
Agriculture	BDA, BPC
Industry	BDA, BPC
Trade and Services	BDA, BPC
SMEs	BPC
Micro- financing	BPC
Capacity building	BPC

Source: BDA 2011 and BPC 2012 Annual Reports

Table 3 shows the government's long-term priority sectors identified as engines of economic growth and the DFIs responsible for these sectors. These priority long-term projects take into account the need for food security and infrastructure development. The sector strategies also take into account the need to create balanced approaches that seek to integrate Angola into both the regional and the world economy, while encouraging the recovery of domestic sectors.

As illustrated in Table 3, each sector has an overarching development policy objective out of which the mandates of the two DFIs have been drawn. In some instances there are mandate overlaps between the two National DFIs.

3.1 Development Bank of Angola (BDA)

Banco de Desenvolvimento de Angola (hereinafter referred to as 'Bank' or 'BDA') was established by Decree Law No. 37/06, published in the Diário da República of 7 June 2006, following approval by the Council of Ministers on 15 March 2006. BDA is fully owned by the Angolan state and was seen as a key instrument to leverage the non-mineral sector of the Angolan economy, by reducing dependence on revenues from non-renewable resources such as oil and diamonds. The Development Bank is licensed under the Financial Institutions Act of 2005, and regulated by the Bank of Angola (BNA).

In accordance with Article 4 of Chapter 2 of BDA's Articles of Association, enacted by Decree Law No. 37/06, the Bank's statutory capital is equivalent to US$ 50,000,000, set at 4,018,682 Kz. As at 31 December 2012, the share capital of BDA was fully paid.

3.1.1 BDA's Mandate

The principal mandate of the BDA is to facilitate the economic and social development of Angola, in a diverse and sustainable manner, by stimulating increased investment and productivity through the provision of long-term funding. The Bank is also charged with the responsibility of managing a Development Fund that receives 5% of the government's fiscal revenue from the oil industry and 2% of revenue from the diamond industry. This pool of financial resources is held in a special government account at BNA, but BDA is responsible for its management and allocation.

BDA is expected to achieve its mandate by directly financing projects of not less than US$5 million. Projects which require funding in excess of BDA's prudential limits are funded with loans from other financial institutions.

Projects requiring funds less than US$5 million are funded by partner commercial banks through credit extensions they receive from BDA, under terms and rules specified in an agreement with each partner bank. This model of lending shows that the Bank lends both directly and through wholesale lending to commercial banks.

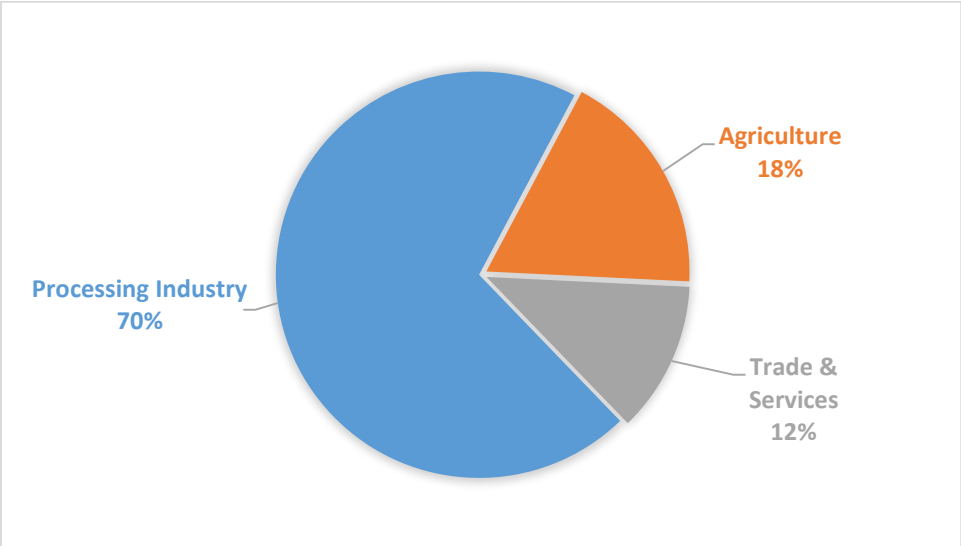
The following are some of the objectives of BDA.

- Finance programmes, projects, works and services that are included in the programme of economic and social development of the country;
- Mobilize financial and other resources, public and private, domestic and international, to finance projects for economic and social development;
- Assess, plan and monitor the implementation of projects of integrated investment in development programmes;
- Facilitate the participation of the private sector and community organizations in development projects and programmes;
- Provide technical assistance, especially in the training and development of human resources with a view to the identification, preparation, appraisal, financing, implementation and management of development projects and programmes;
- Provide or mobilize funds to finance initiatives to minimize the environmental impact on development projects and programmes;
- Provide consulting services, including training and capacity building for Angolan business people; and
- Assist in conducting technical audits.

3.1.2 Portfolio Analysis of BDA

BDA's portfolio covers a wide spectrum of economic sectors such as agriculture, livestock, agro-industry, manufacturing, trade and distribution, services, environmental, and micro, small and medium enterprises.

Figure 1: BDA Credit Distribution by Economic Sector 2011



Source: BDA Annual Report 2011

Figure 1 shows that, at the end of 2011, the bulk of funding from BDA was disbursed to the processing industry which accounted for 70% of BDA's approvals (2011), which in absolute terms corresponds to US$ 139,737,426.00. Agriculture with a credit volume of US$ 37,324,846.00, and Trade and Services, with US$ 23,337,377.00 accounted for the remaining 30%.

It is worth noting that Livestock Business made up 31% of the activities funded in the agricultural sector. Also noteworthy is the fact that 81% of funds spent on the trade and services sector was actually used to finance the Agricultural Mechanisation Brigades.

Some of the economic sectors covered by the BDA are also covered by Banco De Poupança E Crédito (BPC), showing that there are mandate overlaps between the two DFIs currently operating in Angola. Unless the mandates for the two DFIs are clearly defined and streamlined, this may contribute to inefficient use of public resources.

3.1.3. Corporate Governance and Risk Management for BDA

3.1.3.1 The Governing Legal Environment

Article 4 of Chapter 2 of BDA's Articles of Association, enacted by Decree Law No. 37/06, empowers the Government to formulate the Bank's operational processes including the appointment of the Board of Directors. For this reason, the BDA operational mandate is subject to the Decree as well as the oversight of the head of government and the supervision of the Ministry of Finance. The same controls obtains with respect to Banco Nacional de Angola (BNA).

3.1.3.2 The Board

Currently the Board of Directors, which is the governing body of the Bank, is made up of three members, the chairperson who is also the managing director of the Bank and two other directors. The board is appointed by the President through the powers conferred upon him by Decree.

3.1.3.3 Risk Management

The risk management policy of the Bank is guided by the Bank's strategic objectives and the expectations of the Board of Directors. The Board of Directors is responsible for:

- Defining the quantitative and/or qualitative analysis assumptions and processes for identification, follow-up, monitoring and control of exposure to the risks deemed relevant to the Bank;
- Implementing processes for monitoring risks, with appropriate quantitative support, with the aim of linking exposure to risks with the corresponding impacts on capital;
- Creating a sustainable basis for the execution of the various activities, for evaluation of strategic alternatives and for establishing objectives consistent with the strategy selected; and
- Quantifying the risks associated with trading activities, by ensuring monitoring of the risks assumed.

As at 31 December 2011 and 2010, the Bank had established provisions for loans and advances to clients amounting to AKz 4,233,124 and AKz 4,297,461 respectively, to hedge for the risk of failure to recover the loan portfolio. These provisions are relatively high for such young institutions and there is an urgent need to bring this under control as soon as possible.

3.1.4 BDA's Business Model

The Bank's activities are mainly funded through a development fund created from revenue from oil and diamonds which are ring-fenced through a development fund. BDA projects amounting to US$5 million or more are funded directly by the Bank. In other instances, the Bank extends credit lines to partner commercial banks for smaller projects. Additionally, BDA has been undertaking capital investments, offering long-term finance to commercial banks, providing grants for business development services, and offering risk guarantees of up to 90% to commercial banks. BDA also focuses on financing value chains in four priority sectors: maize, beans, cotton, and construction materials. Based on this, it is safe to state that BDA uses both retail and wholesale lending to its clients, who also include BPC.

Table 4: Funding and Lending for BDA

	2011 AKz Million	Breakdown (%)	2010 AKz Million	Breakdown (%)
Long-term	135.2	97.1	70.5	98.7
Short-term	3.8	2.9	0.9	1.3
Sub-total	139.2	100.0	71.4	100.0
Equity	12.3		11.9	
Total Funding	148.5		83.3	

Source: Annual Report BDA 2011

As noted in section 3.1.1, BDA's activities are funded through shareholders' equity and 5% and 3% revenue from oil and diamonds respectively. The breakdown in financing shows on one hand that the Bank, at 97.1% long-term external funding (2011), has predominantly long-term sources of external funding. This business model is currently sustainable, since the Bank's lending is predominately long-term due to the nature of the sectors and investment the banks supports. On the other hand, while the funding model appears sustainable in the short term, the low level of liabilities and the failure of the Bank use its balance sheet as leverage to mobilize resources from the market raises questions about its viability in the medium to long term. If the government chose to stop using oil and diamond revenue to fund the Bank, or if there were significant fluctuations in that revenue, this could place serious constraints on projects already approved by the Bank.

3.1.5 Financial Performance of BDA

Since the beginning of the financial crisis, which also affected the performance of the Angolan economy and led to a drop in the mobilization of resources from the Government of Angola, BDA showed a growth in its activities. In 2011, credit activities registered a relative growth of about 232.5% or an increase of AKz 142.7 million over 2010.

Table 5 below shows the financial performance of the Bank based on key selected financial indicators.

Table 5: Statement of Financial Position of BDA

	2011 (AKz Million)	% change	2010 (AKz Million)
Assets			
Total Assets	151,490.0	82.0	83,314.0
Liabilities and Equity			
Equity	12,314.0	3.0	11,900.0
Liabilities			
Total liabilities	139,176.0	95.0	71,414.0
Total Equity and Liabilities	51,490.0		83,314.0
Statement of Comprehensive Income			
Net Interest Income	4,983.0	725.0	604.0
Net income for the year	387.0	(72.0)	1,406.0
Operating expenses	2,944.0	48.0	1,991.0
Impairments	4,719.0	1375.0	320.0
Key ratios	(%)		(%)
Return on Assets	0.3		1.7
Return on Equity	3.1		11.8
Net Profit margin	8.0		233.0
Operating cost as % of NII	59.0		330.0
Impairment as % of NII	95.0		53.0
Impairment and operating exp. As % of NII	154.0		383.0

Source: BDA 2011 Annual Report

A summary of the financial position of BDA is presented below:

a) Between 2010 and 2011 total assets and liabilities both grew by 82% and 95% respectively and this contributed to the net worth value of the Bank increasing by 3%. This positive variation was in large part the result of increased allocations from Fundo Nacional de Desenvolvimento (FND) and the creation of standardised projects;
b) The improved performance of the Bank alluded to in (a) also led to the substantial net interest growth of 725%. This did not, however, translate into a corresponding increase in net profit but rather a decrease of 72%. This was caused mainly by the increase in impairments, which grew by 1375%, as well as the increase in operating costs, which grew by 48%. As a result, return on assets and return on equity decreased over the period;
c) Operating costs as a percentage of NII were 59%, demonstrating that the Bank is able to cover its operating costs from net interest income; and
d) Impairments as a percentage of NII were 95%, which also shows that impairments can be covered by net interest income.

However, impairments and operating costs account for 154% of net interest income, demonstrating that the bank is not sustainable without government funding.

3.2 Banco De Poupança E Crédito (BPC)

The origin of the Banco de Poupança e Crédito (BPC) dates back to 1956 when the Bank was incorporated as Banco Comercial de Angola (BCA). Twenty years later, in 1976, Banco Popular de Angola (BPA), the predecessor of the BPC, was established through Decree No. 70/76 (10 November 1976) as a deposit bank, fully owned by the government. In 1991 the Council of Ministers, through Decree No. 47/91, renamed it Banco de Poupança e Crédito (BPC), SARL and the mandate of the Bank was expanded to include all the functions of a commercial bank.

The shareholders of the Bank are the Government of Angola (75%) and two local social security institutions, the National Social Security Institute (15%) and the Social Security Agency of Angolan Armed Forces (10%).

3.2.1 BPC's Mandate

The mandate of BPC since its inception in 1956 was to mobilize savings for economic development. Following the changes in the economic and financial structures of Angola in 1966 and 1991 respectively, the mandate of BPC was expanded to include trade and services as well as commercial banking activities. From the policy point of view, BPC is a social partner of the state in programmes that aim to enhance national productive capacities and improve the quality of life.

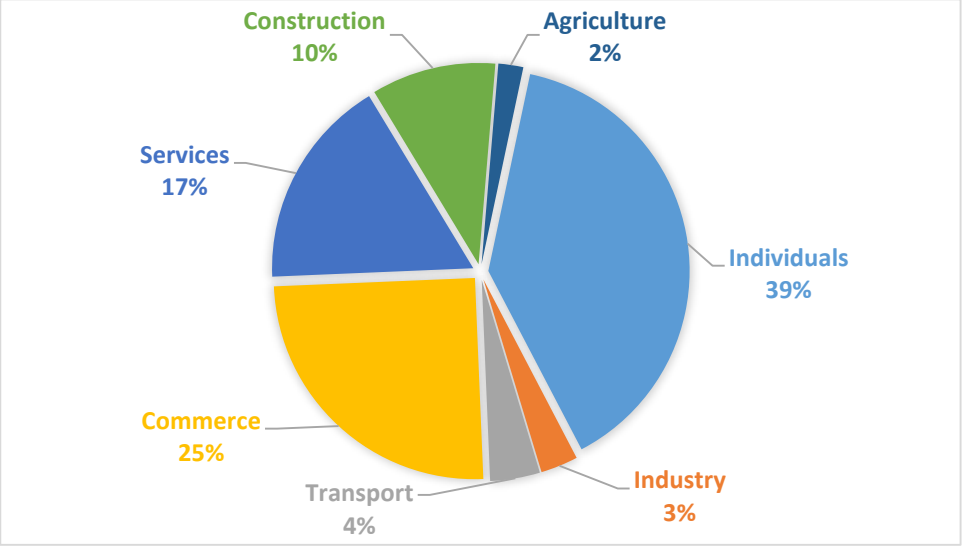
The Bank is thus expected to achieve its mandate and objectives by providing financial services to various sectors of the economy through the mobilization of private sector savings and the provision of commercial bank services.

3.2.2 Portfolio Analysis of BPC

In 2012, Banco de Poupança e Crédito continued supporting the initiatives of the government of Angola, businesses and individuals, extending close to AKz 486.1 billion in credit, equivalent to US$ 5.1 billion. As a result, at the end 2012, loans to customers recorded a gross balance of 609.1 billion, equivalent to US$ 6.4 billion. Figure 2 below shows the distribution of these resources with individuals accounting for 39% of loans followed by

commerce with 25% and services with 17%. The other 19% was distributed among the remaining sectors.

Figure 2: Breakdown of Loans by Economic Sector for BPC



Source: BPC 2012 Annual Report

This also shows that BPC has a broad mandate as the Bank supports a number of economic sectors, including industry, construction, agriculture, services, transport and SMEs. It appears that, in the current economic situation in Angola, the Bank has the capacity to support more projects than it currently does. More effort is needed to clarify the Bank's mandate with respect to development finance.

3.2.3 Corporate Governance and Risk Management for BPC

3.2.3.1 The Governing Legal Environment

BPC is governed by a Board whose establishment was embedded in two decrees: Law 70/76 (10 November 1976), which established the predecessor of the BPC, the Banco Popular de Angola (BPA), and Decree 47/91 (16 August 1991), issued by the Council of Ministers of the Republic of Angola, which changed the name of BPA to Banco de Poupança e Crédito.

3.2.3.2 The Board

According to the BPC corporate governance and internal control systems, the Board of Directors oversees and represents the Bank. The Board is made up of no more than five members, elected by the General Meeting. The Board is led by a chairperson, who is elected by and from amongst the members of the Board.

The Board meets at least twice a month or whenever the need arises. Under the bylaws of the Bank, the Board may delegate some of their powers to the management or various board committees which may be created whenever necessary.

Without prejudice to the powers assigned to it by the bylaws, the Board of Directors has power to:

- Define the general and specific policies of the Bank and approve the annual and multi-year plans and budgets;
- Establish the internal organisational structures of the Bank and delegate its powers to management;
- Propose and justify any capital increase, as well as the criteria for allocation of stock options to managers of the Bank;
- Acquire, encumber and dispose of any goods or rights whether movable or immovable; and
- Mobilize resources for the Bank;

It must be noted that although the Board has not formally constituted board committees in accordance with the bylaws, each Board member has been given a number of key areas of the Bank to monitor and supervise. For instance, the chairperson is in charge of HR, Audit and Inspection, International Unit, Marketing and Image, Treasury and Marketing, Regional Management, Commercial Coordination, and BPC investments

3.2.3.3 Risk Management

Prior to the publication of BNA Notices 1/13 and 2/13, BPC's focus on risk was mainly skewed towards credit risk management, particularly on (a) quality of customer, registration and risk data; (b) credit control; and (c) non-performing loans.

Following the BNA notice on risk management, BPC conducted an in-depth assessment of its risk management function and developed a plan that would meet the BNA requirement. The plan developed by BPC included five core areas: Governance, Credit Risk, Operational and Compliance Risk, Financial Risks, and Training and Support Information. It is expected that implementation of this plan will take at least three years to complete. It is thus clear that BPC does not have a comprehensive governance and risk framework and that the board and management are currently working on this issue.

3.2.4 BPC's Business Model

The Bank's activities are mainly funded through the deposits obtained from government, non-residents, public business sector, companies and individuals. In addition the Bank also mobilizes resources from other institutions including BDA. Table 6 shows the composition of the total funding over the two years under review.

Table 6: Funding and Lending for BPC

	2012 AKz Million	Breakdown (%)	2011 AKz Million	Breakdown (%)
Long-term	28.4	3.8	13.6	2.2
Short-term	81.8	11.1	20.0	3.3
Deposits	629.5	85.1	577.6	94.5
Sub-total	739.7	100.0	611.2	100.0
Equity	85.9		80.5	
Total Funding	825.6		691.7	
Lending	609.1		453.2	

Source: Annual Report BDA 2012

Table 6 shows that the Bank, at 85.1% and 94.5% of short-term funding in 2012 and 2011 respectively, has predominately short-term sources of external funding. This business model is not sustainable when one considers the developmental mandate of the Bank as well as the fact that over 60% of lending during both the 2012 and 2011 financial years ended up being long-term due to the nature of the agricultural, industry, housing and SME sectors. Given the fact that the Bank needs to roll over its short-term financing periodically and the fact that 85.1% of external resources (2012) are on call 24 hours introduces a funding risk, and may lead to the Bank failing to recall its term loans totalling 62% (2012). In addition, there is a serious issue of mismatch of assets and liabilities, as 62% of term loans with a maturity of over 1 year are only partially funded by the 3.8% long-term external funding, with the balance of 58.2% being financed by short-term resources.

3.2.5 Financial Performance of BPC

BPC's financial performance was marked by a 22.7% increase in total assets which saw assets rising to AKz 919.4 billion. This increase was mainly due to a 34% increase in customer loans. Similarly, bank liabilities, also increased by 24%, partly due to the aggressiveness of the bank in mobilizing savings.

Table 7: Statement of Financial position for BPC

	2012 (AKz Million)	% change	2011 (AKz Million)
Assets			
Total Assets	919,368.0	23.0	749,266.0
Liabilities And Equity			
Equity	85,924.0	7.0	80,522.0
Total liabilities	833,444.0	24.0	670,744.0
Total Equity And Liabilities	919,368		751,266.0
Statement of Comprehensive Income			
Net Interest Income	54,598.0	(6.0)	58,247.0
Net profit for the year	7,815.0	(41.0)	13,296.0
Operating expenses	38,995.0	(28.0)	30,364.0
Impairments	28,432.0	(7.0)	30,523.0
Key ratios	(%)		(%)
Return on Assets	0.9		1.8
Return on Equity	9.1		16.5
Net Profit margin	14.0		23.0
Operating cost as % of NII	71.0		52.0
Impairment as % of NII	52.0		52.0
Impairment and operating exp. As % of NII	123.0		105.0

Source: BPC 2012 Annual Report

Table 7 gives the following summary of the financial performance of the Bank during the two years under review:

- Total assets grew by 23% from 2011. This was due to a strong expansion in lending to customers and short-term investments. This also resulted in an increase in equity of 7%;
- Liabilities grew by 24% as a result of an increase in short-term borrowings in the interbank money market and foreign exchange transactions;
- Net interest income decreased slightly by 6%. However, net profit after tax dropped by a substantial rate of 41%. This was due to increase in operating costs by 28%. This also led to the drop in return on assets and return on equity;
- Operating costs were 71% of NII, demonstrating that the bank is able to cover its operating costs from net interest income. This is a position which remained consistent with the previous year when the rate was 52%; and
- Impairments were 52% of NII, the same as in 2011, showing that impairments can be covered by net interest income.

Collectively, however, impairments and operating costs account for 123% of net interest income, which demonstrates that the bank is not sustainable without government funding.

4 Co-ordination, Regulation and Supervision of DFIs in Angola

4.1 Co-ordination

Table 8 shows that BPC and BDA, being wholly-owned government institutions, fall under the Ministry of Finance and Planning. The Ministry of Finance and Planning, through the Fiscal Council, is charged with the responsibility of coordinating SOEs, which include the public banks. Nevertheless, Angola does not seem to have an overarching policy coordinating framework for DFIs.

There is a good case for having a unit within the Ministry of Finance which would be responsible for policy in relation to DFIs on issues to do with capital injections, subsidies and dividends. It could also cover policy on guarantees and other contingent liabilities. Coordination of the DFIs in Angola could also help the government to define the mandates of the two DFIs clearly as well as improve the capitalisation of the institution.

Table 8: Co-ordination, legal and Regulation of DFIs- Angola

Institutions	Legal and ownership	Co-ordinator	Regulator
49. Banco de Poupança e Crédito (BPC)	• Decree-Law No. 70/76 10.11.76 and Decree 47/91 of 16 August 1991 renaming BPA to BPC • Government 75% shareholding	• Ministry of Finance	Central Bank (BNA)
50. Development Bank of Angola	• Decree-Law No. 37/06 • Wholly owned Government	• Ministry of Finance	Central Bank (BNA)

Sources: BPC and BDA website

4.2 Regulation and Supervision of DFIs in Angola

The financial regulatory environment at present is governed by two principal laws: the Financial Institutions Act (Act No 13/05 of September 30, 2006) and the Stock Exchange Act (Act No 12/05 of September 23, 2006) to allow for the emergence of non-bank financial institutions (NBFIs) and the establishment of the stock market.

Under the Financial Institutions Act, BNA is responsible for the supervision and regulation of the banking sector and NBFIs.[30] BNA is therefore responsible for supervising not only commercial banks but also lending institutions such as DFIs, investment houses, fund management institutions, real estate agencies, credit card companies, risk capital managers, and so forth.[31]

Under the laws governing credit institutions and financial companies, such institutions are obliged to provide information to the BNA to enable it to verify the growth of liquidity and the solvency of the institutions, the risks to which they are exposed, their adherence to legal norms, their organization, and the efficacy of their internal controls.

While it is clear that both DFIs in Angola are regulated by the Central Bank the laws on credit institutions and financial companies, however, do not take into account the AADFI PSGRS. As a result, the DFIs' policy objectives could be negatively affected by the stringent regulatory policy rules in the same way as counter-cyclical effects on the DFIs when the economy of the country is not doing well.

5 Conclusion

The overall impression is that Angola is proceeding well with the implementation of economic developments through the development finance institutions. It does appear also that DFIs play a complementary role to the commercial banks. Most stakeholders interviewed referred to the Development Finance Institutions as important financial institutions for bridging the term financing gap which currently affects entrepreneur development in the country. It was gratifying to note that the Government of Angola has been using the newly established Development Bank and indeed BPC to diversify the economy using the oil and diamond revenue. The Development Bank of Angola has been receiving 5% and 3% of oil and diamond revenue respectively for onward lending to various sectors of the economy.

A brief overview of key findings is presented below:

- Economic performance has improved and this has been coupled with macroeconomic stability, with single-digit inflation during the period under review;

[30] Development Bank of Angola and BPC are included.
[31] BNA online information. Available at: http://www.bna.ao/ptg/supervisao_enq_legal.asp.

- Government has diversified the economy using the resources channelled through development finance institutions;
- Access to finance is low by international standards;
- There is a low level of capitalisation of DFIs, especially with regard to the newly-established Development Bank;
- There is no uniform statutory approach to establishing DFIs in Angola; although BDA is established under a specific decree, it is not clear under which decree the BPC was established;
- Although there is a uniform approach to regulating the DFIs, the decrees establishing the two DFIs may be in conflict with the Central Bank of Angola Act, thus leading to inappropriate regulations for DFIs;
- There is no standard practice with regard to shareholding representation on the boards of DFIs. Board members are appointed by the President, leading to weak corporate governance structures;
- There is no overarching policy framework for coordinating activities of the DFIs;
- Business models are not well aligned with the development finance model framework;
- None of DFIs currently operating in Angola are financially sustainable;
- There are no strong strategic plans that are in line with national development plans; and
- There is a lack of uniform risk management frameworks in place for DFIs.

COUNTRY STUDY 2: BOTSWANA

Dr. Lufeyo Banda of the SADC DFRC Project Team held discussions in Botswana on 20 October 2014 for the SADC DFI Scan study. The following review is based on the information collected as well as discussions with representatives from CEDA.

1 Background to Botswana

Botswana is a land-locked country in the SADC region, with just over two million people, and is known for its mining and natural resource base. Its economic performance improved in 2013, continuing the recovery that set in after the 2008/09 global economic crisis. Real GDP growth is estimated to have increased to 5.19 in 2012, mainly driven by service-oriented sectors, notably trade, transport and communication, and public and financial services. In addition, the country's predominant mining sector has rebounded in spite of the impact of the sluggish global prospects. These positive developments were, however, somehow counteracted by water shortages and electricity outages. The sound performance of the non-mining sectors is commendable as it suggests prudent steps have been taken by the government towards economic diversification. Short-term prospects are robust with economic growth expected to remain at around 5% per annum through to 2015, mainly premised on downstream manufacturing due to the recent relocation of De Beers' diamond-sorting and sales activity from London to Gaborone, as well as the attraction of a range of complementary activities.

Table 9: Key Figures for Botswana

Capital	Gaborone
Exchange Rate: 1 US$ =	8.67 Botswana Pula (P)
Population ^	2, 003, 910
Population growth rate (%) ^	0.86
Urban population (% of total) ^	62.25
Urbanisation rate (%) ^	1.89
GDP per capita (US$) ^	7,191.44
GDP growth rate (%, real) ^	5.19
GNI per capita, Atlas method (current US$) ^	7,720
Population less than US$2 per day~	49.4
Population below national poverty line *	30.3
Gini co-efficient ~	60.96
HDI (Global Ranking)"	119
HDI (Country Index Score) "	0.634
Unemployment rate (%) *	17.60
Bank branches per 100 000 ^	8.57
Lending Interest Rate ^	11.00
Deposit Interest Rate ^	3.61
Credit % of GDP ^	14.95
Inflation	7.54
Ease of Doing Business Ranking (out of 185 countries)	59

Sources: ^ World Bank's World Development Indicators (2012), ~ World Bank PovcalNet: an online poverty analysis tool, various years; = www.coinmill.com on 26 August 2013; " UNDP's International Human Development Indicators (2012); * African Economic Outlook, various years;! World Bank's Doing Business Survey Data (2013)

In the 2013 World Bank Ease of Doing Business report, Botswana was ranked 59th out of 185 countries, the third highest in SADC after Mauritius at 19 and South Africa at 39, and the fourth highest in sub-Saharan Africa after Rwanda (52). According to the report, processes involved in starting a business, protection of the investor and enforcement of contracts were the weak elements in the country's business environment. The Ibrahim Index of African Governance ranked Botswana third (with a score of 77.2%) in terms of overall sustainable economic opportunity, which is an improvement on its fourth place finish in 2011.

Despite its middle-income status, Botswana has to contend with challenges emanating from its narrow economic structure and the attendant over-dependence on the mining sector, in particular diamonds. While the government has a reputation for the prudent management of mining revenues and also boasts a good governance record and stable democracy, the need for diversification remains critical. On the social development front, the distribution of resources and level of development remain major concerns. With a Gini coefficient of 0.61, Botswana has a relatively unequal distribution of wealth. The incidence of poverty is also high, with 30.3% of the population living below the poverty line. Other challenges include a high unemployment rate of 17.6%, and a medium Human Development Index (HDI) ranking. A very high HIV/AIDS prevalence of 23.4% is seen as one factor working against an increase in the HDI.

2 Access to Finance in Botswana

The structure of Botswana's financial sector reveals a small but thriving system, with commercial banks and pension funds being the most dominant institutions by asset size. The sector's robustness is demonstrated by a number of prudential indicators pertaining to asset composition and portfolio quality. In addition, the country's stock market performs quite favourably and development finance institutions are sound enough to support the development of small-and medium-sized enterprises. However, recently there has been a public outcry about the behaviour of banks relating to the overall cost of borrowing, including high interest rates and other types of charges. In addition, the level of financial intermediation remains lower than those countries in the upper middle income category, with private sector credit at about 30% of GDP.

Access to finance in Botswana is relatively high by African standards, but quite low globally, especially considering the country's relatively high levels of GDP per capita (based on a purchasing price parity of US$16 800 in 2012). According to the 2010 World Bank Enterprise Survey data, roughly one-third of entrepreneurs have access to a formal financial institution. The surveys also indicate that of the total finance required for investment by the entrepreneurs, 24.7% is provided by the banks, 2.8% by suppliers of credit, 3.5% by capital markets, and the bulk (66.7%) finance is from internal sources. The statistics are presented in Table 10 below.

Table 10: Access to Finance - Botswana

#	Indicator	%	SSA Region
1	% of firms using banks to finance investment	32.8	18.0
2	Proportion of investment financed internally (%)	66.7	78.4
3	Proportion of investment financed by banks (%)	24.7	9.9
4	Proportion of investment financed by suppliers of credit (%)	2.8	3.8
5	Proportion of investment finance by equity or stock sale (%)	3.5	3.7
6	% of firms identifying access to finance as a major constraint	25.5	41.9

Source: Enterprise Surveys (http://www.enterprisesurveys.org), The World Bank 2010

While the number of banks has increased from two in the 1950s to seven in 2012, there has not been the same increase in entrepreneurs accessing finance. Table 10 shows that there is still a financing gap of roughly 66.7%, showing that the impact of DFIs is minimal compared to that of the commercial banks.

3 Analysis of Development Finance Institutions of Botswana

Botswana has seven development finance institutions (DFIs): the Botswana Development Corporation (BDC), Botswana Savings Bank, the Citizen Entrepreneurial Development Agency (CEDA), the Botswana Housing Corporation, the Local Enterprise Authority, the National Development Bank of Botswana (NDB), and Botswana Investment and Trade Centre (BITC). The project teams received completed questionnaire responses from all of them although meetings were only held with CEDA.

Table 11: Sectoral Analysis of DFIs in Botswana

Sector	Institution
Agriculture	NDB, BDC, CEDA
Industry	NDB, BDC, CEDA
Infrastructure	NDB, BDC, CEDA
Housing	NDB, BHC, BBS
Microfinancing and SMEs & others	NDB, CEDA, LEA, BITC

Source: Annual Reports

Each of the sectors outlined above has an overarching development policy objective from which the mandate of the DFIs currently operating in Botswana has been drawn. This structure, as can be seen in Table 11, has resulted in mandate overlaps. The analysis that follows focuses on mandate, corporate governance, business models of the DFIs, and their financial performance, coordination and regulatory and supervisory policy issues.

3.1 National Development Bank of Botswana (NDB)

The National Development Bank of Botswana is wholly owned by the government of Botswana and came into existence on May 1, 1964 by act of parliament (National Development Bank Act, 1963). The creation of the bank was perceived as a necessary adjunct to the commercial banking system in order to make available the types of finance that these institutions were less likely to provide. The most important of these were agricultural finance, long-term finance, and finance for small-scale enterprises. Over a period of time, and as agriculture turned out to be non-profitable, the NDB gradually expanded its portfolio to include the commercial and industrial sectors. In this sense, its business has increasingly overlapped with other DFIs such as the BDC. Unlike the BDC, however, the NDB focuses on small and medium enterprises and manages various projects for government on an agency basis (NDB, 2012).

It is also important to note that after five decades and with the change in the economic environment, the government of Botswana is in the process of privatising the NDB with the (Transitional) Bill having been passed by Parliament in December 2013 and published in February 2014. Based on this, NDB is likely to have a shareholding structure with government holding 51% and citizens and non-citizens holding the remaining 49% (out of which at least 30% is reserved for citizens) and 5% for Employee Shares Ownership Plan (ESOP).

3.1.1 NDB's Mandate

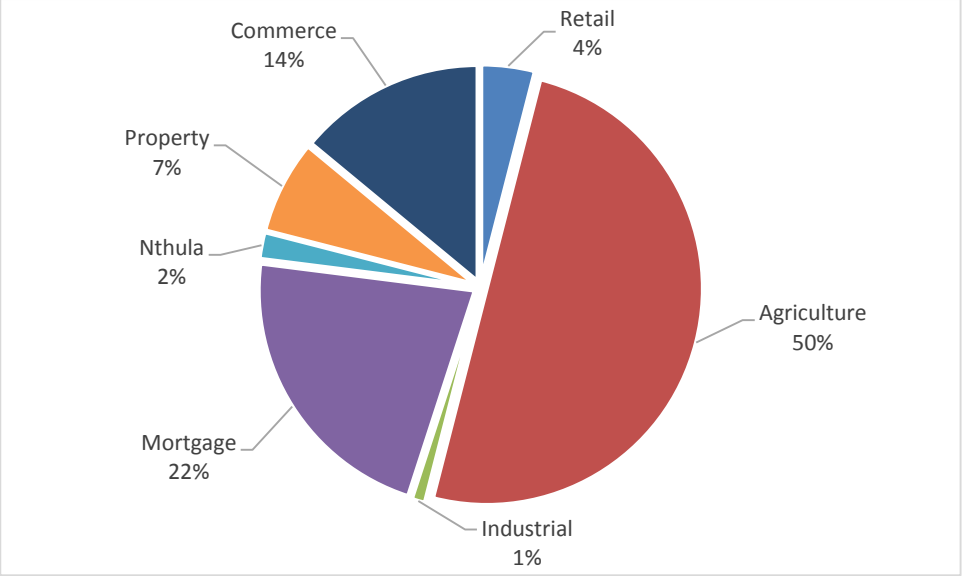
The NDB Act empowers the Bank to operate in a wide range of economic sectors, including agriculture, industry, housing, tourism, industrial services and capacity building. In addition to providing financial assistance, NDB is empowered to act as an agent for the administration of government funds on behalf of other organisations as approved by the Minister of Finance.

The Bank is expected to achieve its mandate and objectives through the mobilization of private sector financing and the provision of financial service assistance.

3.1.2 Portfolio Analysis for NDB

In keeping with their mandate, the bulk of the NDB's lending in 2012 was allocated to the agriculture sector. Figure 3 below illustrates the percentage distribution of credit at the end of 2012, with 50.5% loans allocated to agriculture. The next largest categories were mortgage and property, which attracted 22% and 14% respectively.

Figure 3: NDB Resources Distribution by Sector



Source: NDB 2012 Annual Report

Figure 3 shows that despite the Bank portfolio being spread over a number of economic sectors, the agricultural sector's continuous dominance in value and percentage terms reflected the mandate of the Bank. The Bank is therefore likely to contribute positively to job creation and the economic development of the nation through the activities financed by it.

3.1.3 Corporate Governance and Risk Management for NDB

3.1.3.1 The Governing Legal Environment

Establishment of a board of directors and the appointment of the general manager or chief executive officer of the bank is guided by the provisions of the NDB Act. Also guiding such appointments are the Memorandum and Articles of Association, the shareholders' expectations, corporate governance principles and the requirements of ISO9001:2000.

3.1.3.2 The Board

According to the NDB Act, Section 3, the board of NDB is supposed to consist of not less than four members appointed by the Minister of Finance and Development Planning. The corporation's board of directors consists of nine non-executive directors. The Minister also appoints from among the members of the board a chairperson and a deputy chairperson.

The board is responsible for the bank's ability to meet the expectations of its shareholders and stakeholders. The board also regularly reviews the corporation's processes and procedures to ensure the effectiveness of internal control systems and the accuracy of its financial reporting, both at holding company level and at group level.

The board uses a corporate governance structure consisting of the board, and its subcommittees and management committees. By 2012, the board of NDB had established nine subcommittees: Audit, Human Resources, Transformation, Credit, Tender, Management Executive, Management Credit, Assets and Liability, and Management Review.

3.1.3.3 Risk Management

The NDB has various risk exposures which emanate from the day-to-day conduct of its business. These risks include credit risk, liquidity risk, interest rate risk, foreign exchange risk and operational risk. It is the board's responsibility to ensure that there is an effective risk management framework in place and sufficient controls to guard against unwarranted exposure. It is to this end that the board of directors has established the Audit Committee and the Asset and Liability Committee (ALCO) to ensure that there is sufficient financial risk identification, measurement, monitoring and mitigation, and reporting to shareholders. The board, through the audit committee has also approved policies, and set limits and controls for the various facets of risk management. In line with good governance, the board

has also established an Asset and Liability Management (ALM) framework for monitoring the bank's assets and liabilities.

The board reviews risk management policies on an ongoing basis through the audit committee to ensure that they are relevant to the current market situation and consistent with the bank's strategic objectives.

3.1.4 Business Model of NDB

The NDB is a DFI which mainly supports various economic activities through equity and long-term financing from both commercial banks and regional DFIs. Long-term resources for the Bank are also made available through the issuance of National Development Bank bonds and government loans. The composition of NDB funding over the two years under review is presented in Table 12 below.

Table 12: Funding and Lending for NDB

	2012 **P' Million**	Breakdown (%)	2011 **P' Million**	Breakdown (%)
Long-term	337.9	76.5	272.3	69.7
Short-term	51.9	11.8	63.7	16.3
Overdraft	51.8	11.7	54.9	14.0
Sub-total	441.7	100.0	390.9	100.0
Equity/Capital	696.6		668.4	
Total Funding	1,138.3		1,059.3	
Lending	1,052.8		935.4	

Source: Annual Report NDB (2012)

Table 12 shows that long-term lending, at 76.5%, is the main source of external lending for the bank. This business model is sustainable since the bank's lending is likely to be long-term because of the nature of the economic sectors supported by the bank. Furthermore, the fact that the bank has more long-term resources than short-terms ones helps to mitigate the liquidity risk, thereby making the model sustainable in the long term.

In addition, as is common with development banks, NDB also relies on government-guaranteed loans from external sources and direct borrowings from the market. Although such funding has provided, in aggregate, an element of subsidy in the lending activities of NDB, some of the sources of funding may also create problems for the bank's operations. The elements of subsidy include: (a) PDSF borrowing, which has been below the prime rate; and (b) exchange rate risk sharing with government for funds borrowed offshore. There may be costs associated with such funding. For example, the fixed-rate term loans from the

Standard Chartered and National Development Bank bonds might lock the NDB into sources of funds that might become expensive over the years. This, coupled with lack of a price model for the DFI, could aggravate the Bank's high lending rates. This could result in a situation which in the medium to long term might lead to low profits and also a high impairment loss on financial assets.

3.1.5 Financial Performance of NDB

During the period under review, the Bank recorded a growth of 8% in total assets, from P1.1 billion in 2011 to P1.2 billion in 2012. The main contributing factors to this were loans and advances, which increased during 2012 by 12.7% compared to 4.04% in the previous year.

Table 13: Statement of Financial position of NDB

	2012 (P' Million)	% change	2011 (P'Million)
Assets			
Total Assets	1,163.0	8.0	1,077.0
Liabilities and Equity			
Equity	696.0		668.0
Total liabilities	466.0	14.0	409.0
Total Equity and Liabilities	1,162.0		1,077.0
Statement of Comprehensive Income			
Net Interest Income (NII)	138.0	5.0	131.0
Profit for period	40.0	18.0	49.0
Impairment losses	48.0		35.0
Operating costs	68.0		63.0
Key ratios	(%)		(%)
Return on Assets	3.0		5.0
Return on Equity	6.0		7.0
Net Profit margin	29.0		37.0
Impairment losses as % of NII	35.0		27.0
Operating profit as % of NII	49.0		48.0
Impairment losses& operating costs as% of NII	84.0		75.0
Debt/ Equity ratio	0.3		0.3

Source: NDB 2012 Annual Accounts

Table 13 shows that NDB is a profitable institution and has been reporting profits in recent years. A summary of the financial position of the bank is given below:

- Profit for the period decreased by 23% on account of an increase in non-specific loan loss impairments. Notwithstanding that, impairment losses and operating costs as a percentage of net interest income were 84% in 2012. This demonstrates that these

two cost components can be covered by net interest income, an indication of the sustainability of the bank even in the absence of government grants;

- Although equity capital accounts for only 7% of the total capital, retained earnings account for about 49% of the total capital. As mentioned earlier, the institution does not receive any government grants. The main source of income is interest income, which accounts for about 90% of the total income, followed by fees and commissions, which account on average for about 7% of the total income. The institution also enjoys on average a return on investment of about 6%;
- The return on assets of 3% is consistent with the fact that 50% of the loan book relates to the agricultural sector which is capital-intensive and highly risky. This is therefore an acceptable return given the industry focus; and
- The net profit margin is also high, at 29%, which gives the NDB the ability to fund projects using mostly retained earnings.

The above analysis shows that the Bank has consistently made good profit margins and has also retained good earnings all of which shows that the Bank is sustainable in the medium to long term.

3.2 Botswana Development Corporation

Botswana Development Corporation Limited was established in 1970 (Companies Act of Botswana 1959) to be Botswana's main agency for commercial and industrial development. All its ordinary shares are owned by the Government of Botswana. Initially, the Government of Botswana contributed P4 million and gradually increased its contribution to P864.2 million by 2012.

3.2.1 BDC's Mandate

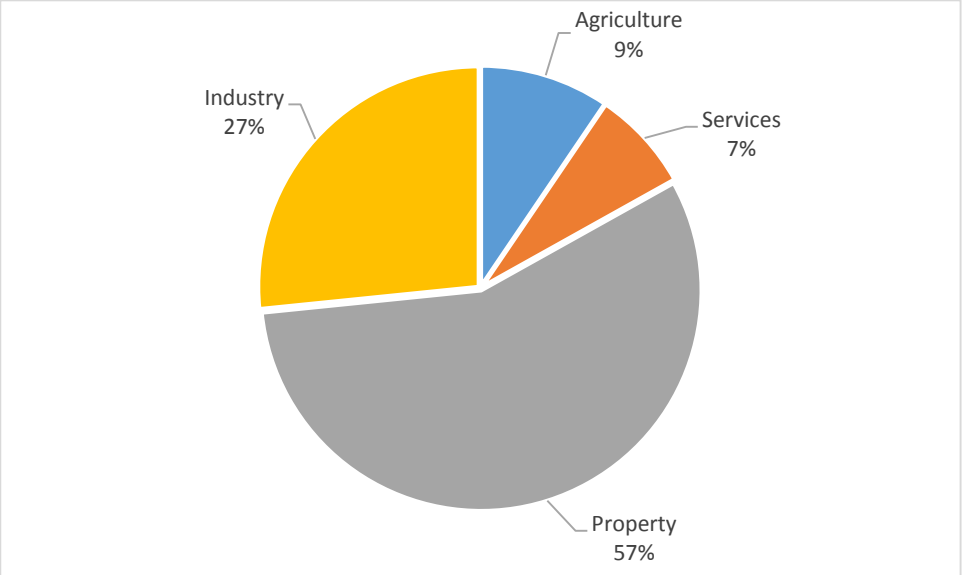
As indicated in the preceding section, BDC is wholly owned by the Government of Botswana and its mandate is to assist in developing and establishing viable businesses in Botswana and in the region. It is required to be profitable and to earn an acceptable return on investments. It is the largest provider 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, and providing management and consulting services, investment advice, and finished factory premises. Its main objective is to identify business opportunities in industry, commerce and agriculture and to assist financially and technically with their development. The subsidiary objectives are to conduct feasibility studies of specific projects

of interest and to participate in venture capital with private concerns either as a partner or by providing required loans. This clearly shows that the corporation has the widest investment and borrowing mandate of all DFIs currently operating in Botswana.

3.2.2 Portfolio Analysis for BDC

According to BDC's 2013 Annual Report, the industrial sector historically accounted for a greater part of the corporation's portfolio. However, since 2009, this sector has experienced a decline owing to the failure of a number of projects. Against this backdrop, BDC has seen a decline in the industrial portfolio share. As a result, 57% of the investment now comes from the property portfolio, 27% from the industrial sector and the remaining balance is split between agriculture and service industries.

Figure 4: BDC – Portfolio Review



Source: BDC Annual Report (2012)

The current portfolio indicates that the corporation's funding of activities is indeed still in line with the mandate for which the institution was created. However, there are mandate overlaps with other DFIs such as NDB, CEDA, and NHC.

After almost 57 years of existence and the recent poor performance of the corporation, the board of directors has decided to review the corporation's mandate, with a view to producing a relevant, sustainable, efficient and value-adding business model in line with the best practice. Through this exercise, the corporation is seeking to review its processes, structures, capabilities, governance and risk management systems. They are also looking to review their

portfolio and introduce more generally accepted standards for credit and risk assessment. It is envisaged that the outcome and recommendations of this exercise will yield positive results for the corporation and bring forward new prospects.

3.2.3 Corporate Governance and Risk Management for BDC

3.2.3.1 The Governing Legal Environment

BDC operates as a company and is therefore subject to the provisions of the Companies Act. As such, its objectives and structures are set out in the Memorandum and Articles of Association. The Corporation is also governed by an independent Board of Directors.

3.2.3.2 The Board

The board has a membership of nine directors who are appointed by the government through the Ministry of Trade and Industry. The chairperson of the board is also the Ministry Permanent Secretary, while one of the directors is selected by the board to become managing director of the corporation. There are five other members who represent various governmental agencies and five others who are professionals engaged in agriculture, banking and commerce. The board meets at the end of each calendar quarter and at such other times as the exigencies of the corporation may dictate.

The board delegates all the corporation's operational responsibilities to an Executive Committee of directors, which meets every two months. The corporation's activities are primarily carried out by its investments department. The corporation is in the process of re-organising its structures to cater for new responsibilities.

The change in the reporting lines from Ministry of Finance and Development Planning to the Ministry of Trade and Industry raises a number of issues such as the lack of a framework for coordinating Development Finance Institutions and political interference in the way these institutions are managed by the main shareholder.

3.2.3.3 Risk Management

The board and its committees oversee risk management. To this end, the board approves risk policies, appetite and strategies. The board also ensures that BDC's risk management is effective by (a) reviewing portfolio and treasury risks, (b) reviewing capital adequacy, and (c) setting clear levels of delegation of authority for various transactions.

Although all committees consider risk in their day-to-day running of the business, three committees, namely the Credit committee, audit and Risk committees, are charged with the responsibility for managing risk.

In carrying out its risk management mandate BDC has also put in place enterprise risk management policies that codify the integrated enterprise-wide processes for identifying, analysing, mitigating, monitoring and reporting risk. Despite these efforts, the corporation's financial performance over the past few years has been poor, with all key financial ratios showing negative performance.

3.2.4 Business Model of BDC

The Corporation's activities are funded mainly through shareholders' equity, government grants and borrowing from local commercial banks as well as from international Development Banks. The composition of the funding over the two years under review is shown in Table 14 below.

Table 14: Funding and Lending for BDC

	2012 P' Million	Breakdown (%)	2011 P' Million	Breakdown (%)
Long-term	63.9	18.7	121.9	73.1
Short-term	277.8	81.3	44.7	26.9
Sub-total	341.7	100.0	166.6	100.0
Equity	1,750.4		1,693.9	
Total Funding	2,092.1		1951.5	

Source: Annual Report BDC 2012

The table shows that the Corporation, at 81.3% short-term funding (2012), has predominantly short-term sources of external funding. This business model is not sustainable since the Corporation's investment is likely to be long-term because of the nature of the economic sectors the institution supports. The fact that the bulk of external funding is short-term while the Corporation's assets are mostly long-term introduces a liquidity risk which arises from the likelihood of a mismatch of the maturity of investment and liabilities.

Furthermore, Table 14 also shows that the Corporation has very low debt compared to equity. This means that the Corporation can expand on its lending activities by taking up more debt. This position is not good or desirable as the Corporation is currently not leveraging adequately on its balance sheet to mobilise external resources.

3.2.5 Financial Performance of BDC

The BDC is the largest development finance institution in Botswana, and was considered one of the most successful until fairly recently when it experienced problems with some of its investments.

Table 15 shows that the Corporation's assets grew by 5% from P2.3 billion in 2011 to P2.4 billion in 2012. The 5% growth was mainly attributed to an increase in investments and in liabilities.

The Corporation has also seen an increase in its investments in subsidiaries. This is mostly a result of investment holding in La Rona Ltd, amounting to P334.1 million at year end. Investment in associate companies also grew by 33% to P485.5 million, mainly on account of investment in Fengyue Glass Manufacturing Company. On the other hand, quoted investment during the period under review declined on account of the fall in the share price of Sechaba on the Botswana Stock Exchange.

Table 15: Statement of Financial position of BDC

	2012 (P Million)	% change	2011 (P Million)
ASSETS			
Non-current assets	2153	14	1882
Current assets	281	-37	443
Total Assets	2434	5	2325
Liabilities And Equity			
Equity	1750	3	1694
Liabilities			
Short term liability	620	22	509
Long term liability	64	-48	122
Total Liabilities	684	8	631
Total Equity and Liabilities	2434	5	2325
Statement of Comprehensive Income			
Revenue	104	-74	400
Profit before tax	3.00	-99	230.00
Expenditure	168	-16	201
Key ratios	%		%
Return on Assets	0.12		9.89
Return on Equity	0.17		13.58
Net Profit margin	2.88		57.50
Expenditure as a % of Revenue	161.54		50.25
Net working capital	-339		-66.0

Source: BDC 2012 Annual Report

A summary of the financial performance of the Corporation is presented below:

- Total assets increased by 5% from 2011. This was caused by an increase in investments in subsidiaries and an increase in associated companies and partnerships;
- Revenue decreased by 74% from 2011 to 2012. This led to a decrease in profit before tax of 99%. This profitability position occurred in spite of the reduction in corporation expenditure;
- Expenditure as a percentage of revenue is sitting at 161.54%. This shows that expenditure cannot be covered by revenue, indicating an unsustainable position; and
- Net working capital is negative at P339 million, indicating that, in the event that short-term liabilities are called in, the corporation would not be able to meet its obligations, which would result in a liquidity risk.

3.3 Citizen Entrepreneurial Development Agency (CEDA)

CEDA, which is a wholly-owned Government of Botswana Agency, was established in 2001 to provide financial and technical support for citizen-owned business enterprises. The Agency was incorporated as a company limited by guarantee on April 12th, 2001 and commenced operations in June 2001. The Agency was established in response to a recommendation made by the National Conference on Citizen Economic Empowerment (NCCEE) held in July 1999, in order to introduce the professional management of the government financial assistance initiatives and to streamline the numerous projects providing similar schemes.

3.3.1 CEDA's Mandate

The agency was established to provide financial and technical support for for business development of small-, medium- and large-scale enterprises. CEDA's mandate is mainly to offer concessional funding for capital expenditure, stock, or working capital for new and existing citizen-owned business ventures. It also offers training and mentoring for both new and seasoned entrepreneurs and business advisory services to entrepreneurs in various skills as identified through the needs assessment that is conducted during project monitoring. During the past thirteen years of operation, CEDA has mainly focused on supporting SMEs at the three levels indicated in the following section. In addition, the Agency also participates

in equity financing. This move was expected to result in an improvement of performance of CEDA's loan portfolio as the institution is now able to diversify risk.

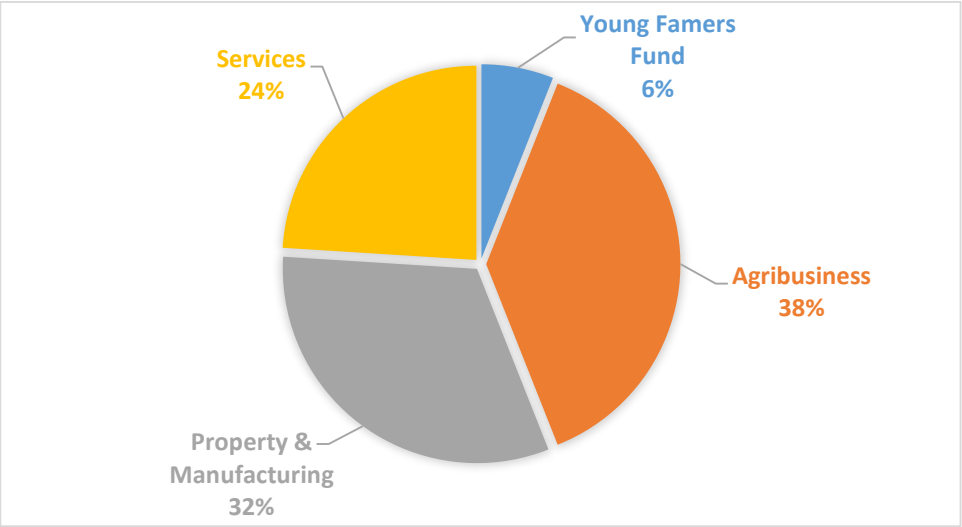
Currently there are three categories of lending:

- Micro/Small enterprises: loans from P500 to P500,000 at 5% interest per annum with repayment periods of up to 5 years;
- Medium enterprises: loans from P500,001 to P4 million at 7.5% interest per annum with repayment periods of up to 180 months:
  - loans of P500 001 to P2 000 000 with repayment periods of up to 120 months; and
  - loans of P2 000 001 to P4 million with repayment periods of up to 180 months.
- Large enterprises: loans from P4 000 001 to P30 million at prime-linked interest per annum with repayment periods of up to 15 years.

3.3.2 Portfolio Analysis for CEDA

During the period under review, the Agency approved a total of 372 projects, valued at 344 million Pula. The pie chart below shows the distribution of the portfolio between the sectors based on the total number of loans approved. Agribusiness represents the largest proportion of the distributed funding (38%), followed by the Property and Manufacturing Sectors (32%), Services (24%), and finally the Young Farmers Fund (11%).

Figure 5: CEDA – Portfolio Review



Source: CEDA Annual Report 2012

As indicated in Figure 5, broadening CEDA's mandate from simply financing start-ups has not only led to an increase in the range of economic sectors supported by the Agency but has also contributed to the mandate overlaps with other DFIs currently operating in Botswana, such as BDC and NDB. (See also Table 12 on page 36).

3.3.3 Corporate Governance and Risk Management for CEDA

3.3.3.1 The Governing Legal Environment

The affairs of CEDA are controlled by a board of directors which is appointed by the government of Botswana. The board itself is guided by various terms of references such as the board charter, sub-committee terms of reference, the CEDA constitution, the Companies Act of Botswana, King Report on Corporate Governance for South Africa 2009 (King III) and other applicable legislation.

The board also ensures that the management team and staff subscribe to and implement principles of good corporate governance. To achieve this, CEDA has adopted codes of corporate governance which encourage a culture of fairness and transparency. The board keeps abreast of trends in corporate governance through periodical capacity-building initiatives provided through the SADC DFRC.

3.3.3.2 The Board

Currently the board for CEDA is made up of ten non-executive members, eight of whom are independent. All board members are appointed by the Minister of Trade and Industry for a renewable term of four years. The Chief Executive Officer is appointed by the Minister of Trade and Industry on the recommendation of the board of directors.

The board is assisted by three board committees: the Finance and Audit Committee, the Human Resources Committee and the Board Tender Committee. Furthermore, the CEDA board oversees the activities of the CEDA Venture Capital Fund (CVCF) Board, as a subsidiary company within the CEDA Group.

3.3.3.3 Risk Management

The board provides written principles for overall risk management, as well as written policies covering specific areas such as interest rate risk, credit risk and the investment of excess liquidity. The actual implementation of the management of risk is carried out by an audit committee.

The Agency's risk management system is subject to regular review to ensure compliance with the King III principles of corporate governance and the COSO II framework on internal control and enterprise risk management.

Despite the adoption of a risk management framework, CEDA's financial position is weak, partly because of the high risk of credit. This position is compounded by a high level of non-performing loans and interest risk owing to interest subsidies offered by the Agency.

3.3.4 Business Model for CEDA

The major source of funding for CEDA is equity. As the government of Botswana is the Agency's only shareholder, 95% of capital resources come from the government.

Table 16: Funding and Lending for CEDA

	2012 **P' Million**	Breakdown (%)	2011 **P' Million**	Breakdown (%)
Long-term	---		---	
Short-term	---		---	
Sub-total	---		---	
Equity	993.1		981.2	
Total Funding	993.1		981.2	
Lending	1, 268.0	18↑	1,072.0	

Source: Annual Report CEDA 2012

Table 16 shows that CEDA does not have external resources on its books and that its main source of funding is equity. CEDA's dependence on government funding creates two fundamental problems. In the first place, government may not always be able to supply the resources required by the Agency, which would lead to liquidity constraints.

The second problem introduced by this kind of funding model relates to the investment rate. The fact that CEDA mobilises its resources from the government not only impedes the development of capital markets, but also inhibits the investment rate owing to the failure of the institution to mobilise private or external resources from the market. Thus, unless the Agency manages to mobilise external resources using its own balance sheet, the Agency will always be viewed as an extension or department of the government and not a fully-fledged DFI.

3.3.5 Financial Performance of CEDA

The annual report for the 2011/2012 period indicates that CEDA experienced a 2% rise in total assets. The Agency's assets held for distribution amounted to P52 million, consisting

of investments in AON Botswana, MRI, Hyperbola, Tannery Industries and Easy Concrete. CEDA's investments in the CEDA Venture Capital Fund (CVCF) declined to P116 million during the year, reflecting difficult trading conditions for the underlying investments. The total liabilities amount to P53 million, which is an increase of 13% from the previous year.

Table 17: Statement of Financial position for CEDA

	2012 (P'Million)	**% change**	**2011 (P'Million)**
Assets			
Total Assets	**1046**	2.0	**1028**
Liabilities and Equity			
Equity	993	1.0	981
Liabilities			
Short term liability	53	13.0	47
Long term liability	0		0
Total liabilities	53	13.0	47
Total Equity And Liabilities	**1046**	2.0	**1028**
Statement of Comprehensive Income			
Revenue	57	6.0	54
Operating costs	347	9.0	318
Operating profit	-290		-264
finance costs-net	0.00		0.00
Net loss	(290.00)	10.0	(264.00)
Impairments	205		191
Key ratios	(%)		(%)
Return on Assets	(28.0)		(25.0)
Return on Equity	(29.0)		(27.0)
Net Profit margin	(509.0)		(489.0)
Operating costs as a % of Revenue	(609.0)		589.0
Loan impairment as % of Revenue	(360.0)		354.0

Source: CEDA 2011/2012 Annual Report

Table 17 also shows that the operating loss of the Agency increased by 10% from 2011 to 2012 on account of an increase in provision for bad and doubtful debts. Furthermore, interest earned on loans and advances decreased because of loans being rescheduled, resulting in a moratorium period during which no interest was charged.

With losses increasing over the period, it is clear that loan impairments and operating costs could not be met from revenue and this poses a serious risk to the medium- to long-term sustainability of the Agency.

The capital resources in CEDA are almost entirely made up of government equity, which accounts for the 95% of the capital. The institution has been reporting a small surplus from operations. Although the institution offers loans to private citizen companies and individual citizens, government grants account for about 48% of total revenue.

The evidence clearly shows that using its current business model, the financial position of CEDA is not sustainable. The Agency needs urgently to review its business model in order to become sustainable.

3.4 Botswana Housing Corporation (BHC)

Botswana Housing Corporation (BHC) is a parastatal corporation solely owned by the Botswana government. It was established by an Act of Parliament (Act No: 75 of 1970) and started its operation on February 1971. The Corporation was established mainly to provide housing for rent or sale to government, local authorities and individuals.

To date, the BHC has built over 17,000 houses in urban areas, comprising high-, medium- and low-rent houses. The low-income housing makes up the majority of housing units in every major urban area in Botswana. However, this is changing, driven by new market forces.

3.4.1 BHC's Mandate

The mandate of the BHC, as stipulated by the Act and its subsequent amendments, is to provide housing, office and other building needs for government and local authorities, and to assist and make arrangements for other persons to meet the requirements of building schemes in Botswana.

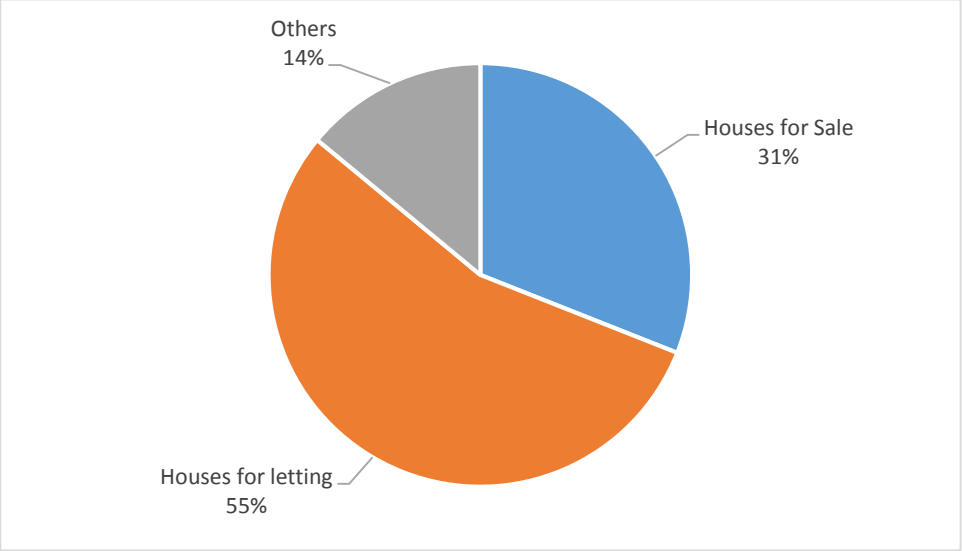
The BHC's initial mandate to provide affordable housing to Citizen of Botswana, initially at subsidised rents, and later through tenant purchase schemes, has long given way to mainstream commercial development. The Corporation is very active in the middle-income housing market, although 'low-cost' units dating from the 1960s and 1970s still exist and accommodate a limited number of low-income households. Developments in the last decade have all been beyond the affordability of the lower income groups, suggesting that the Corporation has moved away from its mandate to provide low-income housing. This is illustrated by some of the projects such as the "Turnkey Housing Scheme". This scheme was

originally part of the SHHA programme and intended for the low-income group, but it has now been transferred to benefit the middle- and high-income groups.

3.4.2 Portfolio Analysis for BHC

The BHC portfolio covers segments such as the sale and rental of properties. The segment 'Others' includes consultancy provision and other activities not covered by the other segments.

Figure 6: NDB Resources Distribution by Sector



Source: BHC Annual Report (2012)

Figure 6 shows the portfolio distribution of total assets with a value of P2, 615.3 million (2012) among the three segments, with 55% of the assets being allocated to the letting of properties, 31% to the sale of houses, and 14% to other uses. The portfolio distribution highlights the narrow focus of the corporation's mandate.

3.4.3 Corporate Governance and Risk Management for BHC

3.4.3.1 The Governing Legal Environment

The board of directors has the ultimate responsibility for the affairs of the Corporation and the carrying out of its mandate. It is guided by the BHC Act, the King III code on Corporate Governance and other applicable legislation. The board gives strategic direction, and monitors and measures the Corporation's performance against key performance indicators. In terms of Section 4(1) of the BHC Act, membership of the board consists of not less than seven or more than ten members at any given time.

3.4.3.2 The Board

In line with the Act establishing the BHC, members of the board are appointed by the Minister of Lands and Housing. During the period under review, the BHC Board consisted of ten members appointed by the minister for a renewable period not exceeding four years. All board members are non-executive and drawn from diverse backgrounds. Their varied experiences enable them to make sound, independent and objective decisions.

The Board meets every quarter, but further meetings can be scheduled should the need arise. The Board meets to review performance, give direction and ensure that management pursues the best interests of all stakeholders.

In terms of Section 12 of the BHC Act, "the Board may, from time to time, establish committees of the Board, and may delegate to such committees such of its powers or functions as it may specify in each case". During the period under review, there were three committees of the board: the Finance and Audit Committee, the Human Resource Committee and the Tender Committee.

3.4.3.3 Risk Management

The Board pays a great deal of attention to the management of the risks faced by the Corporation, and approves policies to govern risk management. These cover specific areas, such as foreign exchange risk, interest rate risk, credit risk, use of non-derivative financial instruments, and investment of excess liquidity.

The low level of loan impairment as a percentage of revenue (3%) in 2012 is evidence that BHC's risk management at is effective.

3.4.4 Business Model for BHC

The major sources for funding BHC's activities are equity, government loans, commercial banks and other institutions providing agency funds. This clearly shows that the Corporation does not depend on the government subvention in order to sustain its operation.

Table 18: Funding and Lending for BHC

	2012 **P' Million**	Breakdown (%)	2011 **P' Million**	Breakdown (%)
Long-term	579.6	69.4	648.5	82.7
Agency Funds	55.9	6.7	66.2	8.4
Short-term	200.1	23.9	69.8	8.9
Sub-total	835.6	100.0	784.5	100.0
Equity	1,341.6		1,310.9	
Total Funding	2,177.2		2,095.4	
Lending	1,261.9		1,010.3	

Source: Annual Report BHC 2012

Table 18 shows that the Corporation, at 69.4% long-term funding in 2012, has predominately long-term sources of external funding. This position is further buttressed by 6.7% agency funding which is ring-fenced and on which the Corporation collects fees. This model is sustainable in the medium to long term, since it matches its long-term funding with long-term investments. Their borrowing is also conservative, as the debt to equity ratio was roughly 60% in 2012.

3.4.5 Financial Performance of BHC

The Corporation's total assets grew by a small margin of 3%, from P2.5 billion (2011) to P2.6 billion (2012). This, according to BHC's 2012 annual report, was due to scaling down the construction of new projects because of a slow moving inventory. Liabilities also increased by almost the same margin. According to BHC's 2012 annual report, this position is likely to improve as the economy of Botswana gains momentum.

Furthermore, despite the slow uptake of some of BHC's properties in areas like Francistown and Selebi Phikwe, sales revenue grew by 34% on the back of marketing targeted at sitting tenants. Professional fees earned by the Corporation for management of third-party projects, especially for government and government-related entities, declined by 56%, negating the growth in other revenue lines. This decline was mainly due to government budget cuts which led to fewer projects being undertaken in 2011 and 2012.

Table 19: Statement of Financial position BHC

	2012 (P' Million)	% change	2011 (P' Million)
Assets			
Non-current assets	1409	23.0	1142
Current assets	1207	-13.0	1394
Total Assets	**2616**	3.0	**2536**
Liabilities And Equity			
Equity	1342	2.0	1311
Short term liability	638	25.0	510
Long term liability	636	-11.0	715
Total liabilities	1274	4.0	1225
Total Equity And Liabilities	**2616**	3.0	**2536**
Statement of Comprehensive Income			
Revenue	342	10.0	312
Operating costs	271	20.0	226
Operating profit	71	-17.0	86
finance costs-net	(28.00)	100.0	(14.00)
Net profit	43.00	-40.0	72.00
Key ratios	**(%)**		**(%)**
Return on Assets	2		3
Return on Equity	3		5
Net Profit margin	13		23
Debt/ Equity ratio	49		48
Operating costs as a % of Revenue	79		72
Loan impairment as % of Revenue	3		6

Source: BHC 2012 Annual Report

The financial position of the BHC during the period under review, as indicated in Table 19, can be summarised as follows:

- The financial performance of the BHC is fairly stable;
- The Corporation's revenue grew by 10% from 2011 to 2012 on the back of an 8% growth in rental income. Further, sales revenue grew by 34%. However, these gains were affected by the decline of 56% in professional fees earned by the corporation for the management of third-party projects. This decline negates the growth in other revenue lines;
- Operating cost as a percentage of revenue is sitting at 79%, up from 72%. Operating profit declined by 18% mainly on the back of the increase in costs;
- Loan impairment as a percentage of revenue is 3%;

- Revenue is sufficient to cover both operating costs and impairment, indicating the sustainability of the corporation;
- The institution has also been producing a large reserve of retained earnings. The retained earnings account for about 53% of the total capital of the institution. No government grant is received to support the operations. The liquidity levels are over 150% and thus high enough to sustain the working capital;
- However, despite the good performance exhibited by the Corporation, its net profit margin at 13% is considered small, especially in view of the fact that 51% of the funding comes from retained earnings; and
- The fact that the projects supported by the Corporation are of a long-term nature and only 24% of the funding comes from long-term liabilities clearly creates a mismatch between assets and liabilities and ultimately leads to the risk of maturity transformation of assets. This view is supported by an acid test ratio of 0.5 which shows that in the event that short-term liabilities are called in, BHC would not be able to cover its liabilities in full. This, coupled with the thin net profit margins, would create funding challenges in the short-to medium term.

Despite the mixed picture, the Corporation's position is sustainable and the institution can survive from operating income.

3.5 Local Enterprise Authority (LEA)

The Local Enterprise Authority (LEA) is a statutory authority body established in 2003 through the Small Business Act of Botswana (Number 7 of 2004). The main objective of the LEA is to promote and facilitate entrepreneurship and SMME development through targeted interventions.

3.5.1 LEA's Mandate

The Local Enterprise Authority's mandate as articulated in Section 4 of the Act is to promote entrepreneurship and SMME development through:

- Providing business development services e.g. screening, business planning facilitation, training and mentoring;
- Identifying business opportunities for existing and future SMMEs;
- Promoting domestic and international linkages, especially between SMMEs and government, large business entities and other SMMEs;

- Encouraging exploitation of government and large firm procurement opportunities;
- Facilitating access to finance;
- Facilitating technology adoption and diffusion; and
- Promoting general entrepreneurship and SMME awareness;

The LEA does not have the mandate either to mobilise resources or lend to entrepreneurs. For this reason, LEA's core operates more as a facilitator and developer of SMMEs through mentorship.

In order to achieve its mandate, LEA has a SMME Training and Support Executive whose main role is to train, support and monitor SMME development. To this end, LEA has taken over the functions of the Integrated Field Services (IFS), which was under the Ministry of Trade and Industry.

The LEA has been set up to provide development and support services for the domestic SMME industry, with the ultimate goal of nurturing excellence and sustainability. It also coordinates all institutional activities relating to SMMEs in order to improve their impact and reduce wasteful duplication of efforts currently in place.

3.5.2 Portfolio Analysis for LEA

Despite the LEA being categorised as a development finance institution, it cannot mobilise resources or provide credit to SMMEs. Its role is mainly facilitating access to finance for SMEs. The main portfolio of LEA is SMMEs, to which support is rendered by the Agency.

3.5.3 Corporate Governance and Risk Management for LEA

3.5.3.1 The Governing Legal Environment

The Small Business Act of 2004 provides for the establishment of an operational office of a Chief Executive Officer and the establishment of a Board of Directors. In accordance with the Act, the Minister of Trade and Industrial Development appoints the board which is made up of not more than 15 members. The majority of the members are expected to be selected from the private sector and SMME community. The Minister also appoints the board cChair among the board members.

Furthermore, according to the Small Business Act, the Local Enterprise Authority board is responsible for strategic guidance of the organization, to ensure that the Authority carries

out its function of promoting and facilitating entrepreneurship and enterprise development in Botswana.

3.5.3.2 The Board

At the time of this review the LEA board was made up of 10 non-executive members, five of whom were independent. All board members were appointed for a renewable term of three years and they meet four times per year.

In order to carry out its mandate effectively, the Board has put in place four (4) subcommittees to assist the board. These include:

- a Technical Advisory Committee;
- a Human Resource Committee;
- a Tender Committee; and
- a Finance and Audit Committee; and

3.5.3.3 Risk Management

Notwithstanding the fact that the LEA does not provide credit, the Agency has implemented an enterprise-wide risk management from which a comprehensive risk register is generated. The risk register focuses on the organisation of effective risk management by identifying all risks which could impact on the achievement of the corporate and business objectives, as well as the control measures necessary for mitigating these risks.

In order to fulfil its mandate, the board uses the Internal Audit Division which provides independent, objective assurance and consultation. The scope of the Internal Audit Division is to determine whether the LEA's risk management, internal control, governance processes, and implementation of best practices is efficient, reliable, and compliant with policies, procedures, laws and regulations.

3.5.4 Business Model for LEA

The activities of the Agency are funded mainly through government subventions and accumulated surplus. The government resources come in two forms: (a) grants for acquiring property, plant and equipment, and (b) grants specifically for operating expenses. These grants are both recognised directly in the statement of comprehensive income. The total composition of the funding of the LEA over the two years under review is shown in Table 20 below.

Table 20: Funding and Lending for LEA

	2012 **P' Million**	Breakdown (%)	2011 **P' Million**	Breakdown (%)
Long-term	---		---	---
Short-term	3.2	100.0	1.6	100.0
Sub-total	3.2	100.0	1.6	100.0
Equity	153.1		171.1	
Total Funding	156.3		172.7	
Lending	---		----	

Source: Annual Report LEA 2012

Table 20 shows that the Authority has only short-term sources of external funding.[32] Even though the authority is not mandated to lend to SMMEs, the current business model is not sustainable since the activities supported by the LEA are not likely to yield enough to cover the costs of running the Agency. This position is reflected in the growing trend of deficits incurred by the Authority during the two years under review. This trend is expected to grow further if the model is not changed.

Even though the LEA is categorised as a Development Finance Institution, its business model shows that it is not. It is clear that the LEA does not play the developmental role of a typical DFI. A typical DFI's mandate would include resource mobilisation and the provision of credit, which are not part of the LEA mandate.

3.5.5 Financial Performance of LEA

The sustainability of the LEA is totally dependent on the government's continued financial support of both operational and capital expenditure. One of the largest operation expenditures is staff welfare and salaries. Table 21 shows that the Agency had a 16% fall in liabilities over the period reviewed. This was partly due to a reduced bank overdraft.

[32] The Authority does not have a bank overdraft facility. Instead the amount reflected in Table 20 as short-term funding is mainly due to an overdrawn position.

Table 21: Statement of Financial position LEA

	2012 (P' Million)	% change	2011 (P' Million
Assets			
Non-current assets	99.0	3.0	96.0
Current Assets	81.0	-24.0	107.0
Total Assets	180.0	-11.0	203.0
Liabilities and Equity			
Equity	153.0	-11.0	171.0
Liabilities			
Short term liability	24.0	-20.0	30.0
Long term liability	3.0	50.0	2.0
Total liabilities	27.0	-16.0	32.0
Total Equity and Liabilities	180.0	-11.0	203.0
Statement of Comprehensive Income			
Net Interest Income	122.0	-3.0	126
Other Operating income	128.0		132.0
Operating expenditure	(146.0)		(142.0)
Operating deficit	(21.0)		(13.0)
Finance income	3.0		4.0
Finance expense			(0.60)
Net deficit before tax	(18.00)		(9.60)
Key ratios	%		%
Return on Assets	(10.0)		(4.7)
Return on Equity	(11.8)		(5.6)
Net Profit margin	(14.8)		(7.6)
Debt/ Equity ratio	15.0		15.8
Loan impairments as % of Net Income	0.6		0.0
Operating expenditure as % of Net Income	120.0		113.0

Source: LEA 2012 Annual Report

The LEA's financial performance over the two years under review (shown in Table 21) can be summarised as follows:

- Interest income from commercial banks accounts for about 3% of the total income;
- The entire capital of the LEA is made up of the capital grant from the government. In addition, the debt/equity ratio of 15% indicates that most of the funding comes from equity and a smaller portion from short-term liabilities.
- There was a decline in the net deficit before tax of about 87% from 2011 to 2012, an indication of cost control challenges;

- Profitability also shows a declining trend, as indicated by the net profit margin, return on assets and return on equity, which have all declined by about 50% from 2011 to 2012;
- Loan impairments as a percentage of revenue is sitting at 0.6%, which is marginal. However, operating expenditure as a percentage of revenue is sitting at 120%, which shows that revenue cannot cover operating expenses and loan impairments. Therefore, the LEA cannot survive without government subventions.

In summary, the Authority's financial liability is mainly made up of accounts payable and short-term borrowings with maturities of less than 12 months. Since the LEA offers grants, there is little chance that the operations of this institution can be sustainable in the event that the government of Botswana ceased to support the institution financially.

3.6 Botswana Investment and Trade Centre (BITC)

The Botswana Investment and Trade Centre (BITC) is a wholly government-owned institution established in 2012 after a merger between the Botswana Export Development and Investment Authority (BEDIA) and Botswana International Financial Services (IFSC). The Centre was established under the Botswana Investment and Trade Centre Act, 2011 (No.12 of 2011), with the aim of creating an integrated Investment and Trade Promotion Authority (ITPA).

3.6.1 BITC's Mandate

As with the LEA, the BITC's mandate is to provide all investment assistance required by prospecting investors. The Centre provides assistance to local and foreign investors. It is also responsible for investor aftercare, promoting foreign direct investment, and promoting locally-manufactured goods in export markets. It also assists investors with company registration, land acquisition, factory shells, utility connections, and work and residence permits for essential staff.

The BITC promotes the International Financial Services Centre (IFSC) which provides a transparent business environment to support the delivery of financial and business services, including international business companies, international investment funds, International Banking and Insurance, Business Process Outsourcing and Contact Centres.

Thus, companies that are accredited to the IFSC in Botswana enjoy readily accessible incentives that include a competitive corporate tax incentive framework, exemption from

Capital Gains TAX (CGT) and Withholding Tax (WHT), access to a growing network of Double Taxation Avoidance (DTA) Treaties, no foreign exchange controls, and denomination of share capital in any major convertible currency.

3.6.2 Portfolio Analysis of BITC

The economic sectors within which the BITC promotes, encourages and facilitates export development for local and foreign investment in Botswana include Mining and Diamond Manufacturing, Agriculture, Tourism, Energy and Renewable Energy, Transport/Logistics, Education, Health, and Technological Research and Product Development.

Like the LEA, the BITC's sector focus does not include a credit portfolio as the institution is not mandated to provide credit or mobilise resources. Its role is mainly to facilitate foreign direct investment by promoting Botswana and making it easy for foreign investors to invest in Botswana. Thus, the BITC is more an investment promotion agency than a development finance institution.

3.6.3 Corporate Governance and Risk Management for BITC

3.6.3.1 The Governing Legal Environment

The Botswana Investment and Trade Centre Act (No. 12 of 2011), Section 4 provides for the establishment of a board of directors. According to this Act, the board is to consist of nine members appointed by the Minister. These include the Permanent Secretaries from the Ministry of Investment and Trade and the Ministry of Finance and Economic Development. Of the remaining seven board members, one is to be a legal advisor and another the Chief Executive Officer.

3.6.3.2 The Board

Currently, the BITC has a board made up of eight non-executive members, of whom six are independent. The board members are appointed for a renewable term of five years. The mandate of the board includes policy formulation, monitoring the performance of the Centre, reviewing where necessary the objectives and purpose of the Centre, and recommending to the Minister such changes as are necessary.

Section 5 (d) of the Act also mandates the board to establish such board committees as it deems necessary to assist it in fulfilling its mandate. The following committees have been

constituted and specific functions delegated to them: the Audit Committee, the Remuneration Committee, the Board Tender Committee, and the Internal Audit Committee.

3.6.3.3 Risk Management

The Centre's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potentially adverse effects on the Centre's financial performance. Risk management is therefore carried out under policies approved by the board of directors and the Audit Committee plays an integral role in this regard.

The purpose of the Audit Committee is to ensure that financial reporting processes are followed, that the internal control systems and the audit processes comply with laws, regulations and codes of ethics.

3.6.4 Business Model for BITC

The BITC's activities are funded mainly through Government subventions, and these subventions are divided into two parts: (a) capital grants for the acquiring of property, plant and equipment, and (b) grants specifically for operating expenses. This is reflected in the statement of comprehensive income. The composition of the total funding over the two years of the review is shown in Table 22 below and this reflects that, like the LEA, BITC (BEDIA) does not provide loans.

Table 22: Funding and Lending for BITC

	2012 P' Million	Breakdown (%)	2011 P' Million	Breakdown (%)
Long-term	135.4	100.0	134.8	100.0
Short-term	---		---	
Sub-total	135.4		134.8	
Equity	174.6		161.6	
Total Funding	310.0		296.4	
Lending & Inv	187.7	5.4↑	178.0	

Source: Annual Report BEDIA 2012

Table 22 shows that the BITC has only long-term sources of external funding, 100% of which was received in 2012 in the form of government grants. This model, though appealing, is not viable in the medium to long term because of the fact that government funding is not always guaranteed. Furthermore, even if the funding were to be guaranteed, the Centre does not use its balance sheet to leverage on external resources, making it appear more like an IPA than a DFI.

This funding scenario therefore presents two problems: first, the Centre depends only on one source of funding, which introduces liquidity problems in the medium to long term, and second, lack of diversified source of income may also lead not only to a scaling down of the operations but also to closure of the Centre in the event that the government is not able to provide funding.

The Centre therefore needs to not only strengthen its balance sheet or capital from shareholders, but also to review its business model so that it can fulfil its mandate without necessarily depending on the government subventions.

3.6.5 Financial Performance of BITC

During the period under review the BITC's main focus was on its merger and consequent office relocation. Notwithstanding this, a total combined investment capital of P1.06 billion is said to have been realised, of which P698.7million was in the form of foreign direct investment and P362.5 million from new domestic investment and expansions by existing local companies.

The BITC experienced an increase of 5.5% in total assets from 2011. The percentage increase in assets is based on the restated figures for both 2011 and 2012.

Table 23: Statement of Financial position of BITC

	2013 (P'Million)	% change	2012 (P' Million
ASSETS			
Non-current assets	250	13	222
Current Assets	36	-65	107
Total Assets	286	6	329
Liabilities and Equity			
Equity	141	-19	175
Liabilities			
Short term liability	8	-58	19
Long term liability	137	1	135
Total liabilities	145	-6	154
Total Equity and Liabilities	286	-13	329
Statement of Comprehensive Income			
Interest Income	3	-25	4
Government grants	10	-84	62
Other Income	37	131	16
Total Revenue	50	-39	82
Expenditure	83	14	73
Excess of income over expenditure	-33	-467	9
Key ratios	%		%
Return on Assets	-12		3
Return on Equity	-23		5
Net Profit margin	-66		11
Expenditure as % of Interest Income	2767		1825

Source: BITC 2013 Annual Report

Total assets went down by 65%. This was mainly because significant reduction (68%) in cash and cash equivalents. Liabilities went down by 6% on the back of a reduction in staff accruals and other payables.

Total revenue went down by 39%. This was on account of a drop of 84% in government grants and a drop of 25% in interest income. Because of this reduction in revenue, coupled with a 14% increase in expenditure, BITC posted a loss of P33 million. The increase in expenditure can be attributed to the merger activities which took place during the period under review and which required a significant commitment of administrative expenses to be successful.

Expenditure as a percentage of interest income is sitting at 2767%. This demonstrates that operating expenditure cannot be covered by interest income alone, making the BITC unsustainable in the absence of government subventions.

3.7 Botswana Savings Bank (BSB)

The Botswana Savings Bank (BSB) was established in 1963. It was originally called the Post Office Savings Bank and was administered within the Department of Posts and Telecommunications Services of South Africa and Bechuanaland. Later in the same year, South Africa handed the Post Office Savings Bank to the Bechuanaland Postal Services Department under the Ministry of Works and Communications. In 1982, the Post Office Savings Bank was transferred to the Ministry of Finance and Development Planning and was upgraded to a full specialised government department –named the Botswana Savings Bank.

In 1992, Parliament passed the Botswana Savings Bank Act, which established the BSB as an independent, national financial institution, wholly owned by the Government of Botswana under the Ministry of Transport and Communication.[33]

The BSB is one of the government institutions that have been mentioned as possible candidates for privatisation.[34] In addition, BSB is in the process of merger with the Botswana Post Bank. This could potentially have a dramatic effect on access to financial services as private management is likely to take a much more conservative and profit-driven view of the provision of financial services. The proposed merger will, however, expand the footprint of the bank in Botswana.

3.7.1 BSB's Mandate

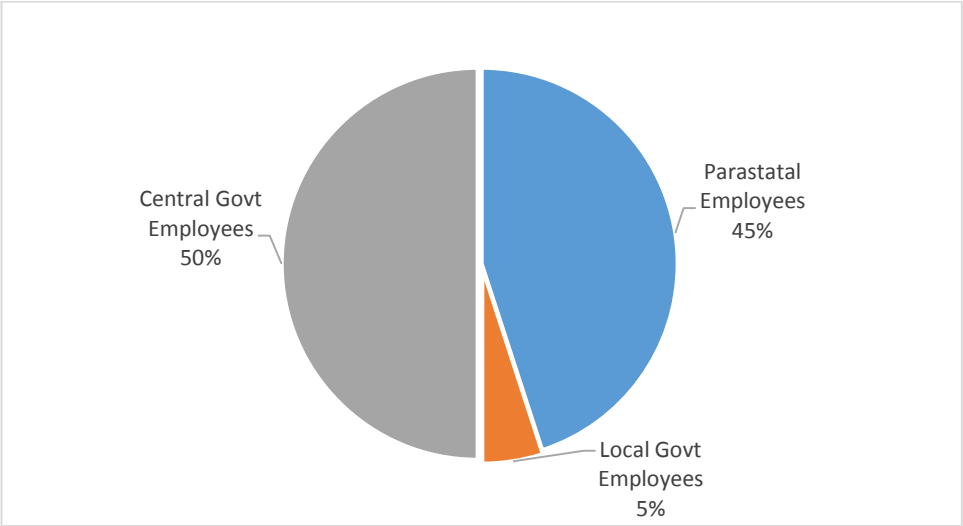
The Botswana Savings Bank's (BSB) mandate is savings mobilisation and the provision of savings facilities to small savers, particularly in remote areas not covered by other financial institutions. The Bank operates through a network of post offices and one banking hall. The average size of its demand, notice and fixed deposits is relatively small, compared to average savings deposit in the commercial banks. In terms of customer service ratio for the country, BSB serves almost one out of every six Botswana citizens.

[33] The assignment of overall control to the Ministry of Transport and Communications follows the decision to merge BSB with the Post Bank.
[34] The other one is the National Development Bank.

3.7.2 Portfolio Analysis of BSB

Of the total loan and advance portfolio of the Bank, roughly 95% are in the medium- to long-term category. The distribution according to type of client is shown in Figure 7 below.

Figure 7: Distribution of Credit by Portfolio for BSB



Source: BSB 2012 Annual Report

Figure 7 shows that 50% of the loans and advances are distributed to employees of central government, 45% to parastatal employees, and 5% to employees of local government and to other customers. Most of these loans are either 80% guaranteed by the employers or, in cases where no security is required for the loan, deductions are made at source by the employer. This minimises the risk of default by the clients.

3.7.3 Corporate Governance and Risk Management for BSB

3.7.3.1 The Governing Legal Environment

The Botswana Savings Bank is an autonomous Development Finance Institution which is a member of both the DFRC and the World Savings Bank Institute. The latter is an association of savings banks in over 90 countries worldwide. The bank is required to carry out its business according to sound commercial principles and in accordance with the Banking Act of 1995 and the Botswana Savings Bank Act of 1992. The Acts provide the basis for the establishment of a board of governors and a Chief Executive Officer and spell out their respective powers and mandates.

3.7.3.2 The Board

The Board of Directors of the BSB assumes the overall responsibility of running the bank. Since the merger of the two institutions that make up the BSB, the members of the board have been appointed by the Minister of Transport and Communication. In a bid to promote independence, the government, although it is the only shareholder of the bank, has appointed four non-executive board members from the private sector, in addition to the four board members appointed from the public service.

The board as required by the Act has put in place subcommittees that are responsible for formulating and running specific initiatives to facilitate efficiency. These committees include Finance and Audit, Staff and Remuneration, and Tender.

3.7.3.3 Risk Management

Although risk is not a key concern for the board, the board has nevertheless put in place mechanisms aimed at striking a balance between risk return and minimising potential adverse effects on the bank's financial performance. The risk management policies and principles have been designed to identify and analyse the operational and financial risks which affect the Bank, covering specific areas such as interest rate risk, credit risk, and non-derivative financial instruments. In addition, an internal audit gives an independent review of the risk management and control environment. This allows the Board to set limits and controls, and to monitor the risks and adherence to limits using reliable and up-to-date information systems.

3.7.4 Business Model for BSB

The Bank's activities, which include loans and advances, are funded mainly through shareholders' equity and resources from numerous small depositors from all corners of the country. The composition of the funding over the two years under review is shown in Table 24 below.

Table 24: Funding and Lending for BSB

	2012 P' Million	Breakdown (%)	2011 P' Million	Breakdown (%)
Short-term	555.8	100.0	474.8	100.0
Sub-total	555.8	100.0	474.8	100.0
Equity	125.9		112.1	
Total Funding	681.7		586.9	
Lending	528.1	30.2↑	405.6	

Source: Annual Report BSB 2012

Table 24 above shows that the BSB has been fulfilling its mandate of savings mobilisation. The breakdown of total funding indicates that the Bank has exclusively (100%) short-term sources of external funding. This business model is not sustainable because 95% of the loans and advances financed by the Bank fall within the medium- to long-term category. Since the Bank needs to roll over its short-term financing periodically, the situation introduces a funding risk as the bank may not be able to recall its loans should it fail to roll over or mobilise enough savings. This would lead to the risk of maturity transformation, where the bank borrows money on shorter timeframes than it lends money out.

3.7.5 Financial Performance of BSB

The BSB has performed satisfactorily during the period under review and it is one of the institutions that the Government wants to privatise. Table 25 below shows some of the institution's key indicators. The BSB's reserve fund (reflecting the full retention of annual surpluses) has grown from P112 million in March 2011 to P126 million in March 2012. The institution has been self-sustaining, partly due to a Ministry decision to maintain BSB's deposit rates at levels higher than those paid by other financial institutions. While higher rates could have the desirable effect of promoting the savings habit among smaller borrowers, it is important to ensure that this does not take place at the expense of BSB's financial viability. It would be worthwhile for government to assess the appropriate level of rates carefully, bearing in mind that ultimately everyone is better off if the BSB can operate on a commercial basis and remain financially sound. The BSB should be able to set its own rates, based on market rates. If necessary, the government could provide subsidies to cover the cost of providing a slightly higher rate; such subsidies should be explicitly recognized

Table 25: Statement of Financial position for BSB

	2012 P' Million)	% Change	2011 (P' Million)
Assets			
Total Assets	**711.0**		**606**
Liabilities and Equity			
Equity	126.0	13.0	112
Total liabilities	585.0		494
Total Equity and Liabilities	**711.0**		**606**
Statement of Comprehensive Income			
Net Interest Income (NII)	527.0	14.0	453
Profit for period	123.0	8.0	113
Impairment losses	72.0		66
Operating costs	413.0		366
Key ratios	%		%
Return on Assets	17.0		19.0
Return on Equity	98.0		101.0
Net Profit margin	23.0		25.0
Impairment losses as % of NII	14.0		15.0
Operating profit as % of NII	78.0		81.0
Impairment losses & operating costs as % of NII	92.0		95.0
Debt/ Equity ratio	0.3		0.3

Source: BSB 2012 Annual Accounts

Table 25 also shows that:

- The BSB is a profitable entity as demonstrated by the return on rssets, return on equity and net profit margin, which have been consistent over the two year period under review. This is attributed mainly to a 14% increase in Net Interest Income;
- Liquidity risk is minimal, with a net worth of P126 million (US$17.3 million), an increase of 13% from 2011. The entity is able to meet its debt obligations when called upon.
- Most of the loan portfolio is financed using debt (82%). With total assets in excess of liabilities, the funding model is successful. Efficiency is also demonstrated through the efficient cost control mechanism. Impairment losses as a percentage of net interest income are 14% while operating income as a percentage of net interest income is 78%. These two cost components together account for 92% of net interest income, making the bank sustainable as it can cover its costs from net interest income.

In summary, it is important to note that while the BSB is profitable and sustainable, the Bank is a Development Finance Institution and shareholders should keep this in mind when

contemplating any more significant transformation of its role in the future. Given that many people in Botswana lack access to finance, it might be best to retain the BSB's present status as a riskless, accessible government service to small savers throughout the country. This could evolve over time into a more autonomous institution.

4 Co-ordination, Regulation and Supervision of DFIs in Botswana

4.1 Co-ordination

DFIs in Botswana are coordinated by different ministries depending on the economic sectors the DFIs support. For instance, the NHC is under the Ministry of Lands & Housing, BDC,[35] CEDA, LEA, and BEDIA all fall under the Ministry of Trade and Industry, BSB under the Ministry of Transport and Communication, and the NDB is under the Ministry of Finance. This clearly shows a lack of an overarching policy coordinating DFIs in Botswana.

The supervision of non-banking financial institutions, such as building societies, savings banks and other financial parastatals is, primarily, the responsibility of the Ministry of Finance and Development Planning and, to a limited extent, the Central Bank. The authorisation of such institutions lies with the Ministry of Finance and Development Planning, and they are constituted under separate Acts of Parliament. However, the Bank of Botswana is empowered by the Banking Act to conduct examinations of the financial condition of institutions which they accept deposits from the public. The Bank of Botswana's supervision over these institutions is limited to examination only. From time to time the Bank of Botswana carries out on-site inspections of the institutions and advises the Ministry on the findings.

The current thinking is that the central bank should have full supervisory powers over all deposit-taking financial institutions while the Ministry of Finance and Development Planning focuses its attention on other institutions falling under different line ministries.

[35] The NDC until 2013 fell under the Ministry of Finance and Economic Development, but financial difficulties experienced by the Corporation in 2012 led the government to change the reporting line of the institution from the Ministry of Finance to the Ministry of Trade and Industry.

Table 26: Co-ordination, legal and Regulation of DFIs- Botswana

Institutions	Legal and ownership	Co-ordinator	Regulator
1. **Botswana Development Corporation (BDC)**	• Companies Act, 1970 • Wholly owned Government	• Ministry of Trade and Industry	• Own Act
2. **Botswana Savings Bank**	• Botswana Savings Bank Act (CAP. 56:03) 1992 • Wholly owned Government	• Ministry of Transport and Communication	• Central Bank (BoB)
3. **Citizen Entrepreneurial Development Agency (CEDA)**	• Companies Act • Wholly owned Government	• Ministry of Trade and Industry	• Own Act
4. **Botswana Housing Corporation (BHC)**	• BHC Act of Parliament (CAP 74:03) of 1970 • Wholly owned Government	• Ministry of Lands & Housing	• Own Act
5. **Local Enterprise Authority (LEA)**	• Small Business Act, Number 7 of 2004 • Wholly owned Government	• The Minister of Trade and Industry	• Own Act
6. **National Development Bank of Botswana (NDB)**	• National Development Bank Act of Parliament (CAP. 74:05), 1963 • Wholly owned Government	• Minister of Finance and Development Planning	• Central Bank (BoB)
7. **Business Model for BITC (BEDIA)**	• Botswana Investment and Trade Centre Act N0 11, 2011 • Wholly owned Government	• The Minister of Trade and Industry	• Own Act

Sources: Questionnaires, Botswana Savings Bank Act 1992, BHC Act 1970, Small Business Act, Number 7 of 2004, NDB Act 1963, BITC Act 2011

The current situation, in which DFIs currently operating in Botswana have different reporting lines, clearly shows a lack of an overarching DFI-coordinating framework in Botswana. This situation not only leads to inefficient use of public resources but also mandate overlaps among the DFIs.

4.2 Regulation and Supervision

Table 26 also shows that of the seven DFIs discussed in this study only two (BSB and NDB) are regulated by the by the Central Bank. The remaining five are regulated by their own Acts through their respective ministries.

With respect to the PSGRS, despite the fact that these guidelines are being used by the DFIs to gauge their corporate governance performance, the guidelines have neither been formally adopted by the Government of Botswana nor used by Bank of Botswana to regulate the DFIs.

The situation shows a lack of consistency in the regulation of DFIs and that not all DFIs are regulated. Furthermore, this lack of an overarching regulatory policy framework for the DFIs has the potential to cause financial instability. This is an issue which the Government of Botswana needs to consider. Both DFI performance and capitalisation issues will continue to impact negatively on DFIs as long as issues of regulation and coordination are not sorted out by the Government.

5 Conclusion

In the matter of term-financing and the provision of development finance support services, Botswana is in a better position than the other SADC countries as a relatively larger proportion of firms have access to credit and financial services. In addition, the economy is healthy despite slowing down significantly from the levels of the 1980s. However, the economy is heavily concentrated in a few sectors and at least one of these is a primary commodity with a limited supply. There is, therefore, a concern about the capacity of these sectors to fuel future growth. There is also concern that the commercial banking sector is not able or willing to fulfil its role as intermediary in the financial system and that this will impose barriers to further development.

Despite the strong growth, local industry is not developing and the economy remains concentrated in diamonds and beef. The government has launched several initiatives to promote the diversification of the economy and fill the gaps left by the commercial banks.

These mostly involve providing finance directly on a subsidised or grant basis and have been partially successful in achieving the desired outcomes.

A brief overview of key findings:

- Economic performance has improved to a certain degree and this has been coupled with macroeconomic stability, with inflation dipping to a single digit during the period under review;
- The government has worked hard to diversify the economy, using the resources channeled through development finance institutions;
- Access to finance, though relatively high, is low by international standards;
- There is a low level of capitalisation of DFIs, especially for those DFIs with no mandate to lend;
- There no uniform statutory approach to establishing DFIs in Botswana. While some DFIs were established by Act of Parliament, others were established under the Companies Act. The Acts also differ in terms of detail on operational issues and areas of emphasis;
- The mandates of most of the DFIs currently operating in Botswana are generally broad and they exhibit a high level of mandate creep;
- DFIs in Botswana generally do not have a regional mandate;
- Business models are not well aligned with the development finance model framework; as a result, there is a high level of liquidity risk among the DFIs;
- Most of the DFIs currently operating in Botswana are not financially sustainable, a situation which is partly attributable to the lack of a proper business model plan and weak corporate governance;
- Most DFIs in Botswana, with the exception of CEDA and BDC, need to improve their governance as the scores of these institutions fall below the AADFIs recommended threshold of 80%;
- There is a lack of uniform risk management framework in place for DFIs;
- There is no standard practice with regard to shareholding representation on the boards of DFIs. Most board members are appointed by government ministers;
- There is no overarching policy framework for coordinating the activities of the DFIs in Botswana;

- There is no uniform approach to regulating DFIs; for instance, while the BSB and the NDB are regulated by the Central Bank, the rest of the DFIs are not regulated at all; and
- Although two DFIs are regulated by the Central Bank, the Central Bank has limited supervisory powers over them, which could lead to weak regulation of the DFIs.

COUNTRY STUDY 3: LESOTHO

The SADC DFRC Project Team of Dr. Lufeyo Banda and Dr. Herrick Mpuku held discussions in Lesotho 12-16 May 2014 for the SADC DFI Scan study. The following review is based on the information collected and the discussions with representatives from the Ministry of Finance, the Central Bank of Lesotho, LNDC, BEDCO, the Lesotho Post Bank and the Lesotho Housing Corporation.

1 Background to Lesotho

Lesotho is a landlocked country which is completely surrounded by the Republic of South Africa. Also known as the Mountain Kingdom, Lesotho has a population of approximately 2 million people. In 2012, the country's GDP growth remained modest at 3.8%, as drought reduced agricultural production by 70%. Major contributors to the reported growth were the doubling of investments in the diamond-mining industry and increased activities in the construction sector. In 2012/13, through the medium term, Lesotho's macroeconomic prospects remain challenging, with growth expected at an average of 3.4%. However, construction activities related to the Metolong Dam, a project supported by the Millennium Challenge Compact, and Phase 11 of the Lesotho Highlands Water Project, coupled with other government investments in infrastructure development, are expected to contribute to growth in GDP through the medium term.

Table 27: Key Figures for Lesotho

Capital	Maseru
Exchange Rate: 1 US$ =	10.25 Lesotho Loti (M)
Population ^	2 051 545
Population growth rate (%) ^	1.08
Urban population (% of total) ^	28.30
Urbanisation rate (%) ^	3.68
GDP per capita (US$) ^	1 193.04
GDP growth rate (%, real) ^	2.85
GNI per capita, Atlas method (current US$) ^	1380
Population less than US$2 per day~	62.25
Population below national poverty line *	56.6
Gini co-efficient ~	52.5
HDI (Global Ranking)"	158
HDI (Country Index Score) "	0.461
Unemployment rate (%) *	27.26
Bank branches per 100 000 ^	3.24
Lending Interest Rate ^	10.12
Deposit Interest Rate ^	2.85
Credit % of GDP ^	3.13
Inflation	5
Ease of Doing Business Ranking (out of 185 countries)	136

Sources: ^ World Bank's World Development Indicators (2012), ~ World Bank PovcalNet: an online poverty analysis tool, various years; = www.coinmill.com on 26 August 2013; " UNDP's International Human Development Indicators (2012); * African Economic Outlook, various years; ! World Bank's Doing Business Survey Data (2013)

Table 27 reveals a number of challenges for the Mountain Kingdom. For instance, the Gini inequality coefficient is high at 52.5% in 2013. The unemployment rate is around 27.26%.

This is worse in the 20-29 age group and higher in rural areas than in urban areas. The retrenchment of migrant mine workers has further exacerbated the unemployment situation.

The National Strategic Development Plan has prioritised high, shared and employment creating economic growth in order to find a sustainable way to address the challenges of poverty, inequality and unemployment. The plan sets out strategies for resource allocations and budgeting decisions for integration in the annual medium term expenditure framework. The government needs strategic financial institutions such as DFIs to help implement the plan.

2 Access to Finance - Lesotho

The banking sector in Lesotho is very small. Table 28 shows that there are 3.24 banks per 100 000 people. The sector is also dominated by three commercial banks: Standard Lesotho Bank, First National Bank and Nedbank, and by the Lesotho Post Bank. The banks have a total of 40 branches, of which 28 are outside Maseru. Standard Lesotho Bank has the largest branch network with 16 branches (spread across all 10 districts), followed by Lesotho Post Bank with 13 branches. South African banks Nedbank and First National Bank (FNB) have seven and three branches respectively. The target clientele of Standard Lesotho Bank, Nedbank and FNB is the formal sector, mainly medium and large corporate enterprises and salaried employees in urban and peri-urban areas. Commercial banks have concentrated their operations in urban areas and have no immediate plans to extend their network to rural areas. Although credit in the past was mainly granted to clients with a high net worth, or to those with long business relationships with the banks, Nedbank and Standard Lesotho Bank have recently shown a keen interest in financing micro, small and medium enterprises by establishing SME units within their respective banks.

Table 28: Access to Finance - Lesotho

#	Indicator	%	SSA Region
1	% of firms using banks to finance investment	32.7	18.0
2	Proportion of investment financed internally (%)	50.9	78.4
3	Proportion of investment financed by banks (%)	23.3	9.9
4	Proportion of investment financed by suppliers of credit (%)	9.1	3.8
5	Proportion of investment finance by equity or stock sale (%)	6.6	3.7
6	% of firms identifying access to finance as a major constraint	28.6	41.9

Source: Enterprise Surveys (http://www.enterprisesurveys.org), The World Bank 2010

Despite the shift in the banks' attitude, there has not been any meaningful change in the financial situation for most people. The World Bank Business Indicators show that access to credit is still limited, as the country ranks 136th out of 185 countries. In 2010, the World Bank Enterprise Survey (see Table 29) shows that only a third of all entrepreneurs in Lesotho have access to finance for investment from Banks. The data also shows that of the total finance investment required, only 23.3% is supplied by banks, 9.1% by suppliers of credit, 6.6% through capital markets and the bulk of the required resources (50.9%) is mobilised internally. The government of Lesotho has tried to address the issue by creating Development Finance Institutions. Whether these have filled the gap is the subject of the report in the sections that follow.

3 Analysis of Development Finance Institutions of Lesotho

Lesotho has four development finance institutions (DFIs): the Lesotho Post Bank, the Lesotho Housing and Land and Development Corporation (LHLDC), the Lesotho National Development Corporation (LNDC) and the Basotho Enterprise Development Corporation (BEDCO). Table 29 below shows the market sectors which the DFIs serve.

Table 29: Sectoral Analysis of DFIs in Lesotho

Sector	Institution
Industry	LNDC
Housing	LHLDC
Micro financing and SMEs	BEDCO, Lesotho Post bank
Other	LNDC, BEDCO

***Source*:** Annual Reports

Each of the sectors outlined in Table 29 has a development policy objective out of which the mandate of each DFI has been drawn. As can be seen, there are mandate creeps, mandate overlaps and duplicated cost structures. The section below discusses in detail issues of mandate, governance, financial performance, coordination and regulation for the LNDC and BEDCO only. There was insufficient information on these issues for the other two DFIs.

3.1 Lesotho National Development Corporation (LNDC)

The Lesotho National Development Corporation (LNDC) is a wholly government-owned national development finance institution and 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. This was further amended by

the Lesotho National Development Corporation (Amendment) Act of 2000. It opened up 40% of the corporation's shareholding to private investors with the government retaining 60%. This position allowed a German investment company DEG to hold 10% shares in the LNDC. It later sold its shares back to the government, leaving the government of Lesotho as the only shareholder.

3.1.1 LNDC's Mandate

According to LNDC Act (No. 91 of 1990), the mandate of the Corporation is 'to initiate, promote and facilitate the development of manufacturing and processing industries, mining and commerce in a manner calculated to raise the level of income and employment in Lesotho'. In broad terms, the LNDC seeks to meet its development responsibilities by making equity and loan investments in enterprises falling into the medium to large category and by encouraging foreign investment through assistance with joint venture formation and the provision of industrial sites and premises.

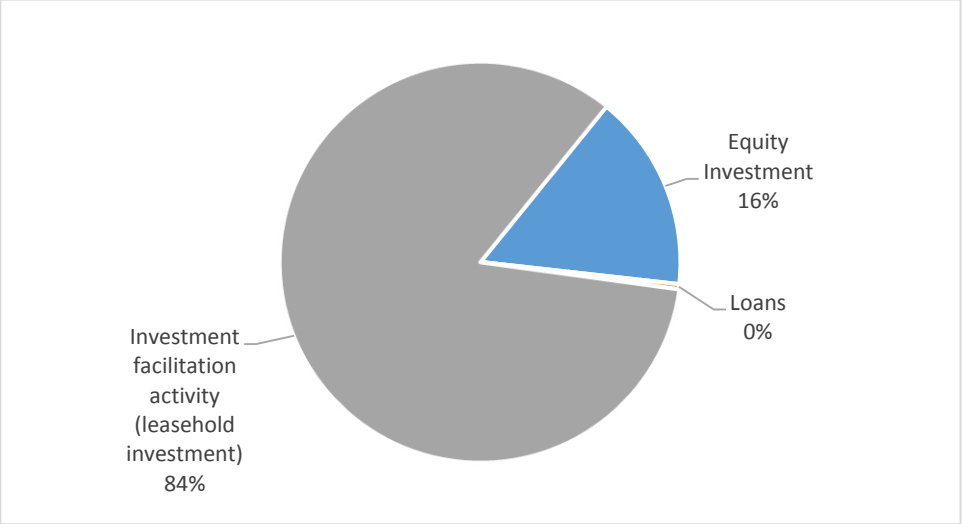
According to a World Bank (2004) report, the LNDC at one time did substantial lending, relying on government grants and lines of credit from institutions such as the European Investment Bank, the African Development Bank, the Commonwealth Development Corporation (CDC) and IDA, and was a substantial source of long term loans and equity for project finance. However, loan performance was so poor that eventually a decision was made to phase out term lending.

The LNDC is now primarily involved in promoting medium- and large-scale industrial investment, developing commercial real estate and industrial estates, and entrepreneur development. It still has a small equity portfolio valued at M 35 million consisting of 9 holdings, 7 of which are performing satisfactorily. The 51% holding in the Lesotho Brewing Company, its largest equity investment (net of provisions), is a major source of dividend income. While the LNDC is still collecting on a few past loans and has small unutilized amounts still available under an ADB line of credit, it has completely stopped any new lending or equity investment (with the exception of commercial real estate) because of large financial losses from these activities. LNDC's decision to get out of new lending and equity investments appears sound in light of the very poor performance of its past portfolio.

3.1.2 Portfolio Analysis of LNDC

The decision by LNDC to phase out term lending resulted in a reduced asset growth of 8.5% per annum over the 2010-2011 period.

Figure 8: LNDC Resources Distribution by Sector



Source: LNDC 2011 Annual Report

Figure 8 above shows that of the total investment facilitation activity (leasehold investment) in 2011, the leasehold portfolio accounted for 83.7%, followed by investment in subsidiaries which accounted for 16.2%, whereas only 0.1% was used for loans. The sectoral analysis of the LNDC leasehold portfolio shows LNDC's support of existing investors by providing factory space. Notwithstanding this initiative, the LNDC has experienced a mandate shrink, mainly attributable to the suspension of lending activities by the Corporation.

The situation outlined above compounds the problem of lack of term financing for entrepreneur support in Lesotho and this in the medium to long term has the potential to hinder the government development policy of accelerating economic growth, employment creation, and poverty reduction.

3.1.3 Corporate Governance and Risk Management for LNDC

3.1.3.1 The Governing Legal Environment

The Lesotho National Development Corporation (Amendment) Act 2000 requires the establishment of a Board of Directors and a Chief Executive Officer. The board has further established five committees to attend to some of its special assignments. These committees

are the Construction Committee, the Investment Committee, the Remuneration Committee, the Audit and Risk Management Committee and the Corporate Governance Committee.

3.1.3.2 The Board

The LNDC (Amendment) Act 2000 specifies that the board of directors is to consist of eleven directors, seven of whom constitute a quorum. The chairperson of the board is from the Ministry of Trade and Industry, and there are members are from the Ministry of Finance, the Ministry of Development Planning and the Ministry of Agriculture. Four more members represent respectively the Lesotho Chamber of Commerce, the Lesotho Tourist Board, the Lesotho Manufacturers Association and the Lesotho Consumer Association. The other three members are appointed by the Minister by virtue of (a) their holding at least a 10% share in the Corporation; or (b) their skills, knowledge and experience in matters relating to the functions of the Corporation. The tenure of office of the directors is three years from the date of appointment. The directors are eligible for reappointment at end of that term, although the Act does not specify how many times a director may be reappointed.

3.1.3.3 Risk Management

Risk management for the Corporation is managed by the board through the Internal Audit and Risk Assessment Division. The discontinuation of term lending was a positive outcome of the adoption of a revised Risk Management Framework.

3.1.4 Business Model for LNDC

The Corporation's activities, which include equity investment, the promotion of medium- and large-scale investment (investment promotion and facilitation), the development of commercial real estate (leasehold investments) and the development of entrepreneurs (local private sector development), are funded mainly through shareholders' equity, Government of Lesotho loans and grants, and loans from institutional partners who include the International Development Agency, KfW, AfDB, the European Investment Bank, local commercial banks, and the Public Investment Commission of Lesotho. The composition of the funding over the two years under review is shown in Table 30 below.

Table 30: Funding and Lending for LNDC

	2011 M' Million	Breakdown (%)	2010 M' Million	Breakdown (%)
Long-term	159.7	91.0	169.3	94.8
Short-term	15.7	9.0	9.2	5.2
Sub-total	175.4	100.0	178.5	100.0
Equity	695.7		609.0	
Total Funding	871.1		787.5	
Lending	568.4	8.5%	524.1	

Source: LNDC 2011 Annual Report

Table 30 indicates that the Corporation has mostly long-term sources of external funding, with a ratio 91% long-term funding to external funding in 2011. This model is sustainable since the Corporation's investment is mostly long-term. The model is further buttressed by the low gearing ratio of 25.2% for equity and total mobilized date in 2011.

3.1.5 Financial Performance of LNDC

The LNDC's financial performance over the two years under review has been satisfactory owing principally to prudent management of the Corporation. Its operating income was provided by interest paid on its loans, rental fees, and dividend payments from subsidiary and associate companies.

Total assets grew from M596 million in 2010 to M622 million in 2011 (the latest figures currently available). This reflects an increase of 5% in LNDC's operations over the two years under review.

As shown in Table 31, the Corporation's liquidity ratio during 2010 and 2011 was high, at a current ratio of 2.8%, while debt equity was under 1%. These ratios further indicate the LNDC's relatively favourable financial position and borrowing capacity during the period under review.

Table 31: Statement of Financial position of LNDC

	2011 (M' Million)	% Change	2010 (M' Million)
ASSETS			
Non-current assets	516		480
Current Assets	106		110
Total Assets	**622**	**5.0**	**590**
Liabilities and Equity			
Equity	421	11.0	378
Liabilities			
Short term liability	38		38
Long term liability	163	6.0	174
Total liabilities	201		212
Total Equity and Liabilities	**622**		**590**
Statement of Comprehensive Income			
Revenue	44	0.0	44
Profit for period	37	147.0	15
Operating expenses	51		57
Key ratios			
Return on Assets	6.0		3%
Return on Equity	9.0		4%
Net Profit margin	84.0		34%
Operating cost as % of revenue	116.0		130%
Current ratio	2.8		2.9
Working capital	68.0	(6.0)	72.0

Source: LNDC 2011 Annual Report

Table 31 shows the following about the financial performance of the Corporation:

- LNDC profit for the year increased by 147%. This increase led to an overall growth in total assets of 5% and an increase in shareholders' equity of 11%;
- The 6% decrease in long term liabilities was the result of repayments made during the year;
- The profitability ratios show that the LNDC has been profitable. Both Return on Assets and Return on Equity have doubled, with the net profit margin improving from 34% to 84%; and
- Liquidity has also been good, with a current ratio of 2.8 and a positive net working capital position.

When all this is summed up, however, the LNDC has operating expenses as percentage of revenue sitting at 116%. As operating expenses cannot be covered by revenue alone, the corporation is not sustainable and needs to continue to find other sources of income in order to become sustainable.

3.2 Basotho Enterprise Development Corporation (BEDCO)

The Basotho Enterprises Development Corporation (BEDCO) was established in 1975 as a limited liability company, under the Lesotho Companies Act, to promote the establishment and development of small-scale Basotho-owned enterprises, and in mid-1976, it became a wholly owned subsidiary of LNDC. Four years later Basotho Enterprise Development was established as an independent Corporation under the BEDCO Act No 9 of 1980 (revised in 2000).

3.2.1 BEDCO's Mandate

According to the Act of 1980 which establishes BEDCO, the mandate of the Corporation is enterprise development and promotion and business models have in the past included special financing/funding, which the government has since ceased to fund. Currently the Corporation is looking to restore this funding either directly or through a credit guarantee scheme or other models. While the mandate of BEDCO is not restricted to any economic sector of the Kingdom, traditionally the corporation has served micro, small and medium entities (MSMEs).

3.2.2 Portfolio Analysis of BEDCO

At one time BEDCO did substantial small-scale lending to SMEs but repayment performance was poor and led to a phasing out of this facility. As a result of this, BEDCO's current portfolio is made up of a small non-performing micro-finance loans which have been sitting on the books of the Corporation for over four years. This problem has been compounded by the fact that BEDCO has been unable to mobilize resources for some time, which has led the institution to be heavily dependent on government subventions for its operations.

BEDCO does not manage any active credit portfolio; instead the Corporation's most important activity has been the provision of premises to small-scale enterprises on industrial estates constructed with government assistance. Today, it engages primarily in entrepreneur training, technical support for small-scale businesses, and managing its industrial estates. This has led to mandate shrink and also mandate overlap with the LNDC.

3.2.3 Corporate Governance and Risk Management for BEDCO

3.2.3.1 The Governing Legal Environment

The Basotho Enterprises Development Corporation Act, No. 9 of 1980, provides the legal basis for the Board of Directors and the Chief Executive Officer. The duties and powers of the board are also stipulated in Section 5 of the Act.

3.2.3.2 The Board

The affairs of the Corporation are managed and governed by a board of directors through the Chief Executive Officer who is the head of the Corporation. Currently the board is made up of eight non-executive members of whom six are independent. The board is appointed by the Minister of Trade and Industry, Cooperatives and Marketing. The Board, which is chaired by a representative from the Ministry, is assisted by the executive management which is made up of the Chief Executive Officer and the executive heads of Finance & Administration, Infrastructure, and Consulting.

3.2.3.3 Risk Management

The risk management of the Corporation is managed by the board through the corporate secretary. The fact that the Corporation had not put a governance and risk management framework in place may have contributed to their decision to cease lending.[36] The poor repayment record which led to the discontinuation of the lending facility shows that the risk management was inefficient.

3.2.4 Business Model of BEDCO

As of March 2012, BEDCO's audited accounts show that the activities of the Corporation were mainly funded through shareholders' equity and government subventions. Table 32 below presents the composition of funding over the two years under review.

Table 32: Funding and Lending for BEDCO

	2012 M' Million	Breakdown (%)	2011 M' Million	Breakdown (%)
Long-term	1.9	100.0	1.9	100.0
Sub-total	1.9	100.0	1.9	100.0
Equity	24.0		25.1	
Total Funding	25.9		27.0	

Source: BEDCO 2012 Annual Report

[36] It is important to note that although BEDCO has risk management and governance frameworks in place, these have not yet been formally implemented by the institution.

Table 32 indicates that the Corporation had exclusively (100%) long-term sources of external funding in 2012. This model, though sustainable at face value, is not truly sustainable. This is mainly because the long-term funds are made up of government loans, some dating as far back as 1996, and therefore do not represent fresh sources of funds for BEDCO. With shareholders' equity amounting to only M24.0 million (2012), the balance sheet of the Corporation is weak, compounding the problem of resource mobilisation to provide lending to entrepreneurs.

In addition to the funding model mentioned above, the business model of BEDCO currently covers advisory services, training, coaching, mentoring, rural productivity promotion, incubation and acceleration programmes, assisting in development of value chain industries, linkages and clustering, providing business accommodation through its industrial estates, and project preparation for MSMEs.

From the above analysis, it is clear that currently BEDCO, like LNDC, does not operate as a development finance institution as it ceased term lending some time ago.

3.2.5 Financial Performance of BEDCO

The March 2012 report of BEDCO's audited accounts shows total assets of M 20 million, with some debt and a net worth of M 16 million. It had a 77% provision for bad debt on US$0.533 million in remaining loans (i.e., all loans relating to the microfinance fund) made in previous years.

The summary of accounts in Table 33 below shows that BEDCO's financial performance has not been impressive, as can be illustrated by reported losses in both 2011 and 2012. The largest portion of the total capital is the government capital grant that accounts for about 70%. For the operational revenue, the government subvention accounts for about 45%. The second highest source of income is rental, standing at about 40%. Furthermore, BEDCO's financial performance has steadily been deteriorating. Indeed, in the period between 2009 and 2012, BEDCO's provision for losses has increased almost seven times and stood at 77% at the end of 2012.

Key ratios regarding return on assets and equity all show a negative trend of performance for the institution and the operating costs as a percentage of revenue indicate that BEDCO is unable to meet operating costs from revenue, thereby bringing its sustainability into question.

Table 33: Statement of Financial position for BEDCO

	2011 (M' Million)	% Change	2010 (M' Million)
Assets			
Total Assets	**31.0**		**31**
Liabilities and Equity			
Equity	24.0		25
Liabilities			
Short term liability	7.0		6
Long term liability	0.0		0
Total liabilities	7.0		6
Total Equity and Liabilities	**31.0**		**31**
Statement of Comprehensive Income			
Net income	0.53	8.0	0.49
Other income	10.8		13
Total income	11.33		13.49
Operating costs	11.8	(15.0)	13.9
Operating loss	(0.47)		-0.41
finance costs-net	0.00		0.00
Net loss	(0.47)	15.0	(0.41)
Key ratios	% Change		% Change
Return on Assets	(2.0)		(1.0)
Return on Equity	(2.0)		(2.0)
Net Profit margin	(89.0)		(84.0)
Operating costs as a % of Revenue	(2,226.0)		(2,837.0)

Source: BEDCO 2012 Annual Report

The conclusion to be drawn is that BEDCO's performance should not be evaluated purely on the basis of financial results, since it requires annual government subsidies to offset its administrative overheads. It is BEDCO's objective, however, to eventually generate enough income from its equity and rental operations to cover its high overheads and eliminate its dependence on government.

4 Co-ordination, Regulation and Supervision of DFIs in Lesotho

4.1 Co-ordination

As indicated in Table 34 below, coordination of the DFIs in Lesotho is carried out by the Ministry of Trade and Industry, which is the parent ministry for both institutions and oversees the work of LNDC and BEDCO on behalf of the Government of Lesotho. Although

these two DFIs fall under MTICM, they also to some extent work with the Ministry of Finance.

Table 34: Co-ordination, legal and Regulation of DFIs- Lesotho

Institutions	Legal and ownership	Co-ordinator	Regulator
1. Basotho Enterprises Development Corporation (BEDCO)	• BEDCO Act No. 9 of 1980 • Wholly owned Government	• Ministry of Trade and Industry Cooperatives and Marketing	• Own Act
2. Lesotho National Development Corporation (LNDC)	• LNDC Act No.20 of 1967 • Wholly owned Government	• Ministry of Trade and Industry Cooperatives and Marketing	• Own Act

Sources: BEDCO 1980 Act and LNDC 1967 Act

4.2 Regulation and Supervision

Table 34 shows that the two DFIs, despite being categorised as the Development Finance Institutions, are not regulated. This situation clearly shows the deficiency in the enabling policies and legal regulatory framework for DFIs in Lesotho.

5 Conclusion

As indicated earlier, Lesotho's economic performance has remained modest at 3.8%, as drought reduced agricultural production by 70%. Major contributors to the reported growth were the doubling of investments in the diamond mining industry and increased activities in the construction industry. The macroeconomic prospects of Lesotho also remain challenging, with growth still expected to remain below 4% in the next few years.

The situation has been made worse by the gap created by lack of development finance support to the entrepreneurs in Lesotho and failure on the part of commercial banks to provide long-term funding. Today, the most important challenge for Lesotho is to diversify its economy by ensuring that that the Basotho are well catered for in terms of development finance support.

Key findings on the LNDC and BEDCO are briefly outlined below in view of their role as financial sector institutions:

- As a result of lack of development finance activities and the reluctance of commercial banks to provide development finance services, access to finance has been relatively low by international standards;
- DFIs have not been playing their role effectively due to inadequate capital;
- The two DFIs were initially established by Act of Parliament. BEDCO is negotiating with its board and its parent ministry to have the Corporation incorporated under the under Companies Act. There is clearly no uniform statutory approach to establishing DFIs in Lesotho;
- The mandates of the DFIs are all generally broad and they exhibit a high level of mandate creep;
- Business models are not well aligned with the development finance model framework. As a result, there is a high level of liquidity risk among the DFIs;
- Most of the DFIs currently operating in Lesotho are not financially sustainable. This situation is partly attributable to lack of a proper business model, and to lack of capital;
- DFIs lack strong strategic plans that are in line with the national development plans;
- DFIs have weak corporate governance;[37]
- DFIs lack uniform risk management frameworks;
- There is no standard practice with regard to shareholding representation on the boards of DFIs. Most board members are appointed by the Ministers;
- There is no overarching policy framework for coordinating the activities of the DFIs in Lesotho. This situation is reinforced by the DFIs reporting to different Ministries depending on the political situation;
- There is lack of regulatory framework for DFIs;

[37] For instance, at BEDCO, a government official chairs the board, the majority of board members have no executive responsibilities, and the institution does not have a written performance management agreement with government (accountability is reliant on professional ethics).

COUNTRY STUDY 4: MALAWI

The SADC DFRC Project Team, represented by Dr. Lufeyo Banda alone, held discussions in Malawi during 12-16 April 2014 for the SADC DFI Scan study. The following review is based on the information collected and the discussions with representatives from the Ministry of Finance, the Central Bank and the Export Development Fund.

1 Background on Malawi

Malawi is a relatively small country in the SADC region, with a population projected at 15.3 million in 2013, down from 15.9 million in 2012. The urban areas, including the cities of Blantyre and Lilongwe, account for 15% of the population. Agriculture is the dominant activity in the rural areas. Although household income is low – GDP per capita is estimated at US$268 in 2012— conditions have been improving, and between 1980 and 2012 Malawi's Human Development Index (HDI) value increased from 0.272 to 0.418, which was an increase of 54%, or an average annual increase of about 1.4%.

Table 35: Key Figures for Malawi

Capital	Lilongwe (capital), Blantyre
Exchange Rate: 1 US$ =	335.00 Malawian Kwacha (MK)
Population ^	15 906 483
Population growth rate (%) ^	2.86
Urban population (% of total) ^	15.85
Urbanisation rate (%) ^	3.83
GDP per capita (US$) ^	268.05
GDP growth rate (%, real) ^	-0.99
GNI per capita, Atlas method (current US$) ^	320
Population less than US$2 per day~	82.31
Population below national poverty line *	45.0
Gini co-efficient ~	43.91
HDI (Global Ranking)"	170
HDI (Country Index Score) "	0.418
Unemployment rate (%) *	7.80
Bank branches per 100 000 ^	1.09
Lending Interest Rate ^	32.33
Deposit Interest Rate ^	11.08
Credit % of GDP ^	35.58
Inflation	9
Ease of Doing Business Ranking (out of 185 countries)	157

Sources: ^ World Bank's World Development Indicators (2012), ~ World Bank PovcalNet: an online poverty analysis tool, various years; = www.coinmill.com on 26 August 2013; " UNDP's International Human Development Indicators (2012); * African Economic Outlook, various years; ! World Bank's Doing Business Survey Data (2013)

Malawi's economy has faced significant challenges in the past few years, and is just emerging from negative growth. In mid-2011, the International Monetary Fund's Enhanced Credit Facility (ECF) went off track owing to policy slippages, and this triggered a suspension in donor budget support. As a result, growth in 2012 slowed to -0.99% due to a decline in outputs for tobacco and maize, compounded by occasional shortages of foreign exchange and fuel. This led to growing arrears in international payments, which then led to

loss of external credit lines. However, bold reforms implemented after April 2012, including the devaluation and flotation of the Malawi currency and a tight fiscal stance, have put the economy on the track to recovery.

The economy is still highly dependent on donor support for development financing but in the medium term Malawi is poised to experience buoyant transformation owing to the mining and quarrying sectors. The mineral sector experienced a tremendous growth of 14.6% in 2012, and the discovery of oil may revolutionise the economy in the near future. Growth in 2013 and 2014 is projected to rebound to 5.5% and 6.1%, respectively.

2 Access to Finance - Malawi

Malawi's financial sector has limited outreach and is relatively small and concentrated. Banks are dominant in the financial system, accounting for about 80% of total financial sector assets. Two banks hold slightly more than half of the banking industry's total assets and deposits. The financial sector offers a limited range of financial services and products. While the financial sector has witnessed rapid growth in recent years, supported by innovation, access to financial services remains limited. Only 20.6% of firms have access to banking services. In the 2014 World Bank Ease of Doing Business survey, Malawi's ranking on the ability to get credit slipped from 126th to 130th.

Table 36: Access to Finance - Malawi

#	Indicator	%	SSA Region
1	% of firms using banks to finance investment	20.6	18.0
2	Proportion of investment financed internally (%)	75.5	78.4
3	Proportion of investment financed by banks (%)	13.4	9.9
4	Proportion of investment financed by suppliers of credit (%)	2.5	3.8
5	Proportion of investment finance by equity or stock sale %)	2.9	3.7
6	% of firms identifying access to finance as a major constraint	51.0	41.9

Source: Enterprise Surveys (http://www.enterprisesurveys.org), The World Bank.

Table 36 shows that access to finance for small and medium-sized enterprises (SMEs) is a major challenge, especially accessing long-term finance. Banks are unwilling to lend to SMEs, which make up the largest number of private sector actors. The reasons for this unwillingness are the perceived risk associated with this market segment, lack of conventional forms of collateral and lack of information on credit history to help monitor

borrowers. Medium-term and long-term project financing are also not readily available in Malawi.

Out of the total investment required by entrepreneurs, only 13.4% was provided by the banks, 2.5% by the suppliers of credit, 2.9% through equity or stock sale, and the remaining 75.5% was financed internally.

Notwithstanding the huge challenge faced by entrepreneurs, the need for DFIs in Malawi is growing. Their importance in the financial system is likely to be consolidated by a series of important steps being taken by the Government of Malawi. For instance, in 2012 the government created the Export Development Fund and plans are also under way to create a National Development Bank in the near future so that it can help to mobilize resources as well as granting credit to those entrepreneurs who cannot access credit from the commercial banks. A brief analysis of development finance institutions currently operating in Malawi is given in the next section.

3 Analysis of Development Finance Institutions of Malawi

Various attempts have been made by the Government of Malawi in the past to address market failures, with no success. For many, the governance and administrative structures do not provide an incentive-compatible framework to expand outreach in a cost-effective and sustainable manner. There are, therefore, significant risks of political interference, and most of the DFIs created have ultimately closed down. The DFIs which the Government of Malawi created and which eventually collapsed include:

- The Malawi Rural Finance Corporation whose main focus was to support agricultural production, SMEs, microcredits and to help individuals with disabilities;
- The Malawi Rural Development Fund (MARDEF), whose aim was to increase access to finance for low-income groups in rural communities;
- The Small Enterprise Development Organization of Malawi (SEDOM) whose focus was mainly on a crop-marketing loan scheme and a group lending facility; and
- The Development of Malawi Enterprises Trust (DEMAT) which focused on business advisory services and also provided limited loan services to small enterprises.

With the collapse of all the DFIs listed above, Malawi now has only one “DFI”, the Export Development Fund. Plans to create a development bank are at an advanced stage, with a

feasibility study on the Development Bank of Malawi having been commissioned by the Government. A brief analysis of the DFI in Malawi is given. It focuses on the mandate, business model, and governance and sustainability issues.

3.1 The Export Development Fund of Malawi

The Export Development Fund (EDF) is a recently formed DFI. The Fund was registered as a limited liability company on the 6th of February 2012. The company was registered with a share capital of K500 million (five hundred million kwacha) divided into 500 million shares of K1.00 each. Further to this, additional paid-in capital of K600 million was injected into the EDF by the Reserve Bank of Malawi bringing the total investment in the EDF to K1.1 billion. At the moment, the Reserve Bank of Malawi has 99% equity in EDF. However, it is expected that other stakeholders, commercial banks and other financial institutions, will buy shares so that the Bank would no longer have the controlling shares in the company. Currently the Reserve Bank has control over the EDF.

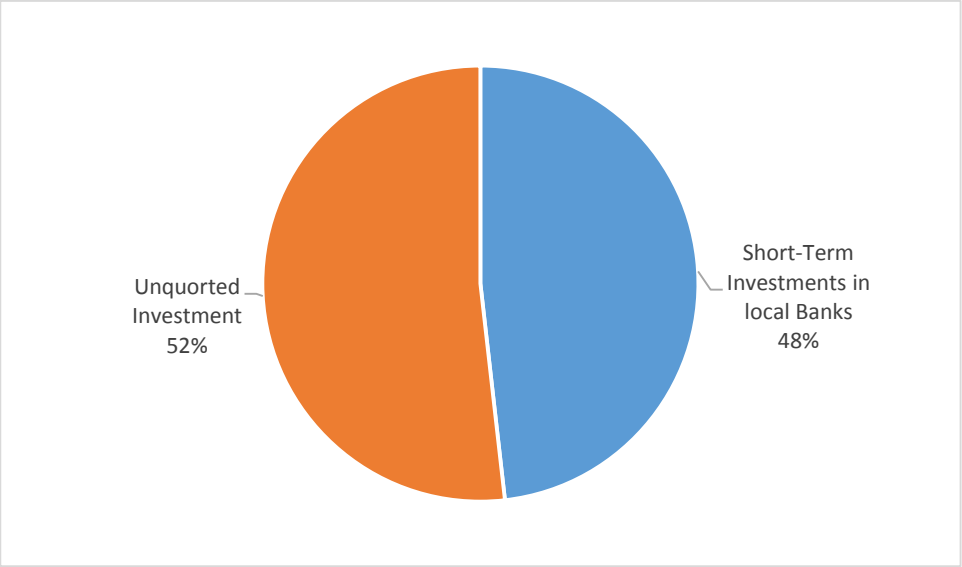
3.1.1 EDF's Mandate

The Export Development Fund Limited (EDF) was set up by the Malawi Government through the Reserve Bank of Malawi. Its main objective is to ensure that Malawi's vast export potential and business opportunities are exploited in order to generate much-needed foreign exchange for the country. In pursuance of this objective, EDF will (a) serve as a pool of financial resources for export diversification and growth, (b) offer insurance to exporters against payment risks, (c) refinance participating financial institutions, (d) provide guidance on export-related activities, (e) encourage production and value addition for exports, (f) generate foreign exchange and create employment and (g) provide guarantees, financial services and products to persons involved in the export trade.

3.1.2 Portfolio Analysis of EDF

During 2012, the Export Development Fund had a portfolio investment made up of equity investment and short-term investment in local commercial banks. Figure 9 below shows that the distribution of the total investment of the fund was split almost evenly between equity and short-term investment. The splitting of the investment into only two portfolios can mainly be attributed to the fact that the institution is relatively new and has yet to develop its credit portfolio.

Figure 9: Portfolio Distribution by Sector for EDF



Source: EDF 2013 Financial Statements

Figure 9 shows that 52% of the Fund's investment was allotted to equity investment in the form of unquoted shares held in Norsad Finance Limited, a company incorporated in Botswana. The company holds 400 shares, representing a shareholding of 3.68%. Furthermore, the company had 48% of its remaining resources invested in short-term financial instruments placed on fixed terms with local banks, namely the CHD Investment Bank, the Malawi Savings Bank, and FDH Bank. This situation, where large amounts of money have been placed with banks to earn interest, shows that the company is still in its infancy and is trying to set up its business model framework. The Fund has not yet started advancing credit to its customers.

3.1.3 Corporate Governance and Risk Management for EDF

3.1.3.1 The Governing Legal Environment

The Export Development Fund is a company incorporated under the Companies Act, 1984 and registered in Malawi. Its board adheres to the standards of corporate governance as enshrined in the Code of Best Practice for Corporate Governance in Malawi, which is concerned with the establishment of an appropriate legal, economic and institutional environment.

3.1.3.2 The Board

The board of the Export Development Fund, which is headed by an independent non-executive Chair, is comprised of seven non-executive directors drawn from a wide spectrum of people with high degrees of expertise in finance, banking and auditing, economics,

financial marketing, agribusiness, trade and the law. All board members are appointed by the sole shareholder, in this case the government of Malawi.

3.1.3.3 Risk Management

The Board of Directors has overall responsibility for the establishment and supervision of the company's risk management framework. To this end, the Board has established the Loans and Investments Committee and the Finance and Audit Committee both which are responsible for developing and monitoring company risk management policies in their specified areas. Further, all board committees are chaired by non-executive members and report regularly to the main board of directors on their activities.

3.1.4 Business Model of EDF

Despite being a relatively new institution, the EDF's activities are expected to include financial products such as equity participation, performance bonds or guarantees, and an advisory service for the set-up, expansion and modernization of viable enterprises in the medium- and large-scale enterprises sector, which will be funded through shareholders' equity, fees on financial instruments, and credit lines. The Company will also mobilise resources from the market and from strategic partners.

Table 37: Funding and Lending for EDF

	2013 MK' Million	Breakdown (%)	2012 MK' Million	Breakdown (%)
Long-term	---		---	
Short-term	0.1	100.0	1.5	100.0
Sub-total	0.1	100.0	1.5	100.0
Equity	2,632.1		2,305.1	
Total Funding	2,632.2		2,306.6	
Lending	1,400.5		1,205.0	

Source: EDF 2012 Financial Statements

From Table 37, it is clear that the company has no external sources of funding and that all of its funding is in the short-term form. One needs to bear in mind that the company is relatively new and that more time is required to establish its business model for development finance.

3.1.5 Financial Performance of EDF

The Company's total assets showed an increase of 15% during the period under review. This positive variation was mainly due to an increase in the equity investment, in the form of unquoted shares, held in Norsad Finance Limited.

As a result of the increase in total assets, there was an increase in activities, with total income increasing by 210%. Income is made up of guarantee fees and investment income, which also led to a corresponding increase in profitability, with profit before tax showing an increase of 107%. This was achieved despite the increase in operating costs. The increase in operating costs was expected, given that the EDF is still in its infancy.

Table 38: Statement of Financial position for EDF

	2013 (MK Million)	% change	2012 (MK Million
ASSETS			
Non-current assets	1468	22	1205
Current Assets	1312	9	1204
Total Assets	2780	15	2409
Liabilities and Equity			
Equity	2632	14	2305
Liabilities			
Short term liability	146	46	100
Long term liability	2	-33	3
Total liabilities	148	42	104
Total Equity and Liabilities	2780	15	2409
Statement of Comprehensive Income			
Guarantee fees	8	100	4
Investment income	398	213	127
Total Income	406	210	131
Operating expenses	207	196	70
Impairments	71		0
Profit before tax	89	107	43
Key ratios	%		%
Return on Assets	3		2
Return on Equity	3		2
Net Profit margin	22		33
Impairments as % of Interest Income	17		0
Operating expenses as % of Income	51		53
Impairments & operating costs as % of Y	68		53

Source: EDF 2013 Annual Report

Further analysis of the key financial indicators in Table 38 shows that:

- The percentage ratio of operating costs to income was 51%. This shows that the operating costs can be covered by income.
- The percentage ratio of impairments to income was 17%, which also shows that income is sufficient to cover impairments.

Together, operating costs and impairments amounted to only 68% of income, which demonstrates sustainability of the company.

4 Co-ordination, Regulation and Supervision of DFIs in Malawi

4.1 Co-ordination

Currently the activities of the company are coordinated by the Ministry of Finance and the Reserve Bank of Malawi, which is the holding company of the Fund. This situation does not introduce any obstacles to the way the Fund is coordinated by the Ministry of Finance through the Central Bank, because of clear reporting lines.

Table 39: Co-ordination, legal and Regulation of DFIs- Malawi

Institutions	Legal and ownership	Co-ordinator	Regulator
1. Export Development Fund	• Companies Act • Wholly owned Government	• Central Bank/Ministry of Finance	• Not regulated

Sources: Reserve Bank of Malawi 2013 Annual Report

4.2 Regulation and Supervision

The Company is currently not regulated by any independent regulatory body. The Reserve Bank of Malawi is actively looking into this issue with a view to ensuring that proper regulatory policies for the new DFI are put in place.

5 Conclusion

Malawi is emerging from two consecutive years of slowdown in growth caused by exogenous shocks, aggravated by slippage in macroeconomic policies and the suspension of donor budget support because of governance concerns. Real GDP growth slowed down to -0.99%, mainly owing to a decline in primary commodities, coupled with shortages of foreign exchange and fuel. The EDF was created to bridge the financing gap and to in facilitating economic growth of the country.

The key findings on Malawi, in particular the EDF, are briefly outlined below:

- As a result of the lack of development finance activities and the reluctance of commercial banks to provide development finance services, access to finance has been relatively low by international standards;
- The mandate of the EDF is generally broad, as is to be expected given that it is the only DFI currently operating in Malawi;
- Although the Fund is relatively new, its business model is not in line with a development finance model. This could be partly because the institution is has not yet fully developed its business model;
- Although the institution is new, it nevertheless needs to strengthen its corporate governance structures;
- As the institution prepares to start providing credit, there is an urgent need for a risk management framework to be put in place for both the EDF and its credit policy, so as to avoid bad lending; and
- Authorities need to consider putting in place a proper regulatory policy framework for the DFI.

COUNTRY STUDY 5: MAURITIUS

Dr. Lufeyo Banda of the SADC DFRC Project Team held discussions in Mauritius over 1-4 April 2014 for the SADC DFI Scan study. The following review is based on the information collected and on discussions with representatives from the Ministry of Finance, the Central Bank and the Development Bank of Mauritius, the National Pension Fund, the Mauritius State Investment Corporation, the Mauritius Housing Corporation, the Mauritius Post and Corporative Bank, and the Financial Services Commission Mauritius.

1 Background on Mauritius

Mauritius is a small island country in the Indian Ocean with an area of only 2000 km^2. It has a population of about 1.28 million people, or 341,000 households. The Mauritian economy is well run, with sound political and economic management practices. In 2013, for the fifth year in a row, Mauritius was ranked as the easiest place to do business in sub-Saharan Africa, and 19th overall out of 185 countries, according to the World Bank's Doing Business report. Despite the country's exposure to external shocks in the world economy, its GDP growth rate was only moderately down to 2.73% in 2012 from 3.8% in 2011. The economy was expected to grow at around 3.5% in 2013. The finance, real estate and business services sector delivered 11% of GDP in 2013, and construction delivered 6.2%. Inflation declined from 6.5% in 2011 to 4.1% in 2012, and the Central Bank set the key repo rate at 4.9% in March 2012, reflecting a rate cut of 50 basis points. A further cut was applied in July 2013, bringing the rate to 4.65%.

Table 40: Key Figures for Mauritius

Capital	Port Louis (capital)
Exchange Rate: 1 US$ =	30.70 Mauritian Rupee (Rs)
Population ^	1 291 456
Population growth rate (%) ^	0.42
Urban population (% of total) ^	41.82
Urbanisation rate (%) ^	0.46
GDP per capita (US$) ^	8 124.17
GDP growth rate (%, real) ^	2.73
GNI per capita, Atlas method (current US$) ^	8570
Population less than US$2 per day~	
Population below national poverty line *	
Gini co-efficient ~	
HDI (Global Ranking)"	80
HDI (Country Index Score) "	0.737
Unemployment rate (%) *	7.25
Bank branches per 100 000 ^	21.29
Lending Interest Rate ^	8.67
Deposit Interest Rate ^	6.23
Credit % of GDP ^	113.63
Inflation	4.1
Ease of Doing Business Ranking (out of 185 countries)	19

Sources: ^ World Bank's World Development Indicators (2012), ~ World Bank PovcalNet: an online poverty analysis tool, various years; = www.coinmill.com on 26 August 2013; " UNDP's International Human Development Indicators (2012); * African Economic Outlook, various years; ! World Bank's Doing Business Survey Data (2013)

The Mauritian government is currently working towards diversifying the economy beyond the five major sectors. To this end, sectors such as real estate and seafood have become

increasingly significant. This strategy is expected to help the country to increase its competitiveness and reduce the impact of exogenous shocks. A key challenge is development finance resources to support these initiatives.

2 Access to Finance - Mauritius

The Bank of Mauritius reports that there are 21 banks in Mauritius, six local, ten which are foreign owned, four which are branches of foreign-owned banks and one which is a joint venture. Deposits are the main source of funding for the banking sector, and 67.8% of banking sector liabilities came from deposits from customers who are both residents and non-residents. In 2012, loans and advances accounted for 65% of total bank assets, and credit to the private sector stood at 49.1%. This was a 10% increase from the 2011 figures.

The banking system in Mauritius is highly concentrated, with four of the major banks accounting for 85% of the whole banking system's assets and 70% of the country's financial sector. Despite the tough operating environment from 2009 to 2011, banks remained strong, liquid and profitable. In 2012, the financial sector represented about 10.2% of GDP and grew by 5.5%. Like the majority of banks on the continent, Mauritian banks had limited involvement in the long-term financing of entrepreneurs.

Table 41: Access to Finance - Mauritius

#	Indicator	%	SSA Region
1	% of firms using banks to finance investment	37.5	18.0
2	Proportion of investment financed internally (%)	51.9	78.4
3	Proportion of investment financed by banks (%)	30.8	9.9
4	Proportion of investment financed by suppliers of credit (%)	1.5	3.8
5	Proportion of investment finance by equity or stock sale (%)	0.0	3.7
6	% of firms identifying access to finance as a major constraint	46.3	41.9

Source: Enterprise Surveys (http://www.enterprisesurveys.org), The World Bank 2009

Access to financial services is generally good, with 37.5% of entrepreneurs using banks to finance their investments. The 2009 World Bank Enterprise Survey data shows that out of the total resources required to finance investment in Mauritius, only 30.8% was provided by the banks, 1.5% from trade credit financing, and the bulk of resources, amounting to 51.9%, was mobilised from internal sources. The fact that the bulk of the resources is being sourced internally by the entrepreneurs clearly shows a financing gap which requires government intervention. Ideally, the government should continue to support and strengthen further development finance institutions, in order to complement the roles played by existing ones.

3 Analysis of Development Finance Institutions of Mauritius

The major Development Finance Institutions in Mauritius are the Development Bank of Mauritius, the Mauritius Housing Corporation, the Mauritius Leasing Corporation, the National Mauritius Housing Corporation and the State Investment Corporation, all of which are sources of long-term financing or equity investment. In addition, the Mauritius Post Office Saving Bank collects savings deposits, all of which are invested in government securities. Table 42 below shows the key economic sectors the DFIs support.

Table 42: Sectoral Analysis of DFIs in Mauritius

Sector	Institution
Agricultural	DBM, SICM
Industry	DBM, SICM
Infrastructure	DBM, SICM
Housing	MHC
Micro financing and SMEs	DBM, MPCB

***Source*: Annual Reports**

3.1 Development Bank of Mauritius (DBM)

The Development Bank of Mauritius (DBM) is a publicly-owned, limited liability company majority owned by the government. The Bank was established in 1964 as a statutory body to finance the development of industry, tourism, and agricultural diversification. Upon its creation, the DBM took over the assets and liabilities of the Mauritius Agricultural Bank, which then ceased operations. The DBM is a major source of medium and long-term loans for investment in fixed assets, and it operates a number of programmes reflecting the government's priorities in economic development.

After 50 years in operation, the Government of Mauritius has decided to restructure the DBM. A new company known as New DBM Ltd has been registered to carry out banking business with a banking licence from the –central bank, the Bank of Mauritius. The selected strategic partners are two foreign shareholders, namely the Small Industries Development Bank of India (SIDBI) and the Bank of Maharashtra. The setting up of the new bank was formally approved by the government in June 2014.

3.1.1 DBM's Mandate

The Bank was created with the core mandate to finance projects involving the modernisation and diversification of agriculture, manufacturing, the promotion of SMEs, the dissemination of information technology and the promotion of a 'computer culture'. The Bank makes

equity investments in associated companies and provides various kinds of loan financing to clients. The 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 and household computer use.

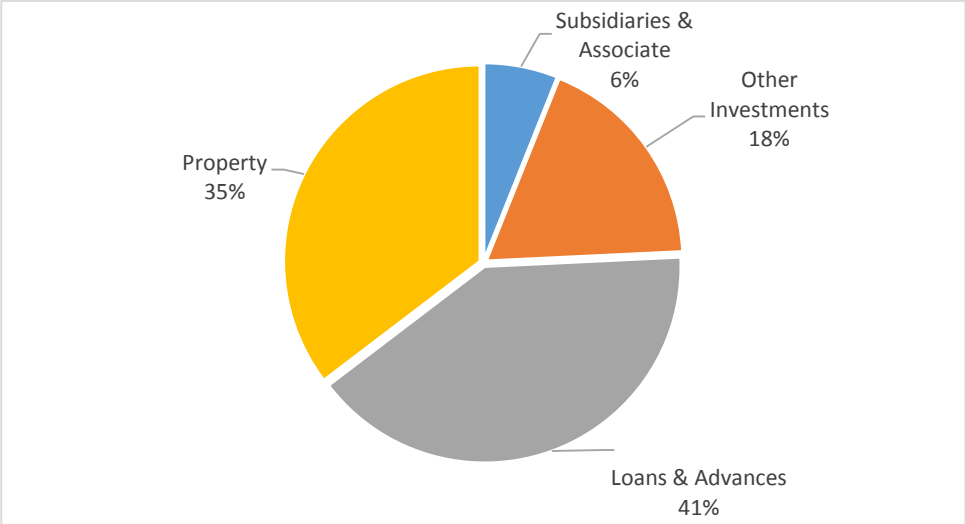
However, it is expected that the mandate of the DBM will be affected as New DBM Ltd is expected to offer 50% of its services to SMEs, and the rest to the public in general. The question is whether the mandate of the restructured entity should focus on development finance or commercial banking priorities. Furthermore, it is not clear whether the envisaged plan of restructuring will turn around the fortunes of the Bank. It is uncertain whether by catering mainly for SMEs the Bank will have the critical mass to be profitable in the world of stiff competition and a strong regulatory environment as well as of moderate economic growth. One wonders whether the gap which was previously filled by the DBM can be filled by the restructured Bank whose mandate will be more to maximise profit than to support social projects.

3.1.2 Portfolio Analysis of DBM

DBM had a gross loan portfolio of Rs3.7 billion. The net portfolio after provision and impairment is Rs2.8 billion. Total assets are Rs7.4 billion. During 2012, the Bank provided loans totalling Rs484.2 million to 4,346 cases: Rs160.9 million for 2,766 cases under the government window and Rs323.2 million for 1,580 cases under the commercial window. Total disbursements were Rs465.8 million for loans. In addition to loans the Bank had investment in subsidiary companies, associate companies, property and other investments.

Sector-wise distribution of the investments is illustrated in in Figure 10 below.

Figure 10: DBM Resources Distribution by Sector



Source: DBM 2012 Annual Report

As indicated in Figure 10 above, loans and advances accounted for 41% of the Bank's Rs 5,000.5 million in total investment by 2012, followed by investment in property at 35%. Total investment in subsidiary and associate companies amounted to 6%, and other investments 18%. It is also evident that the Bank has been playing a positive role in developing the Mauritius Stock Exchange through the active use of the institution for attracting investments through instruments such as debenture and debt.

3.1.3 Corporate Governance and Risk Management for DBM

3.1.3.1 The Governing Legal Environment

The DBM is a public company registered under the Companies Act. It complies with the provisions of corporate governance under the Financial Reporting Act. The Act also sets out the mandate and the governance framework, including the overall operations and the duties and responsibilities of the Board of Directors and the Bank's Management.

3.1.3.2 The Board

Currently the Board of Directors is composed of ten members all appointed by the shareholders at the annual meeting after clearance by Minister of Finance. The board is led by the Chairperson while the executive management of the Company has been entrusted to the Acting Managing Director who is assisted by senior and middle managers. In addition, the Bank also has five standing committees: the Risk Committee, the Human Resources & Remunerations Committee, the Credit Committee, the Audit Committee, and the Corporate Governance Committee.

3.1.3.3 Risk Management

The Risk Committee is responsible for the design and implementation of risk management processes as well as day-to-day management of risk.

The Bank's policy on risk management encompasses all significant business risks including physical, operational, human resources, technological, business continuity, financial, compliance, and reputational risks which could influence the achievement of the Bank's objectives.

However, it must be noted that despite the Bank's risk management being in place, the Bank has had a high level of non-performing loans (currently standing at 38%) and this has been attributed to partial laxity in the lending policy by the Bank and also to the promulgation of Borrowers Protection Act of 2007 which prohibits banks from taking defaulters to court. For these reasons, the DBM over the period under review had approximately Rs400 million of debt owing to it which is taking longer to recover than it should.

3.1.4 Business Model of DBM

As of March 2012, DBM's audited accounts show that the activities of the Bank are mainly funded through shareholders' equity, deposits and funding from both local and international institutional investors, such as the Mauritius National Pensions Fund, the government of Mauritius, Anglo Mauritius and the State Bank of Mauritius. Table 43 below presents the composition of funding over the two years under review.

Table 43: Funding and Lending for DBM

	2012 Rs Million	Breakdown (%)	2011 Rs Million	Breakdown (%)
Long-term	2,378.8	41.0	3,111.7	55.0
Short-term	3,492.5	59.0	2,565.0	45.0
Sub-total	5,871.3	100.0	5,676.7	100.0
Equity	1,318.8		1,304.0	
Total Funding	7,190.1		6,980.7	
Lending & Inv.	6,815.6	8.2↑	6,301.6	

Source: DBM 2012 Annual Report

The table shows that in 2012, the Bank, at 59% short-term funding, had a predominantly short-term sources of external funding. This business model is not sustainable, since most of the Bank's lending is likely to be long-term due to the nature of the economic sectors supported by the Bank. In In addition, a closer look at the equity and current debt of the

Bank shows that the institution is highly geared and introducing the risk of the Bank failing to mobilise sufficient resources from the market.

Table 43 also shows a marginal increase of 1% in investment of the Bank from the previous year (2011). The increase in the investment of the Bank is mainly attributable to a slump in loans and advances of both long-term and short-term nature. This also could have been due to the poor performance of the loan portfolio performance of the Bank which stood at roughly 38% of NPL at the end 2012.

3.1.5 Financial Performance of DBM

The Development Bank of Mauritius has continued to play a key role in providing assistance to enable the development of the local economy. This has been achieved through the mobilisation of low cost funds, lending and investments. However, despite the commendable effort by the Bank, its performance during the period under review was below the expectation of the shareholders and this is clearly illustrated by the sharp decline in profit after tax of 117%.

Table 44: Statement of Financial position for DBM

	2012 (Rs Million)	% change	2011 (Rs Million)
Assets			
Non-current assets	5,277.0	(5.0)	5,556.0
Current Assets	2,126.0	28.0	1,661.0
Total Assets	**7,403.0**	3.0	**7,217.0**
Liabilities and Equity			
Equity	1,319.0		1,304.0
Liabilities			
Short term liability	3,640.0		2,733.0
Long term liability	2,443.0		3,180.0
Total liabilities	6,083.0		5,913.0
Total Equity And Liabilities	**7,402.0**		**7,217.0**
Statement of Comprehensive Income			
Net Interest Income (NII)	12.0	(48.0)	23.0
Profit after tax	152.0	(117.0)	(913.00)
Operating expenses	249.0		322.0
Impairment of investments	112.0		857.0
Key ratios	**%**		**%**
Return on Assets	2.0		(13.0)
Return on Equity	12.0		(70.0)
Net Profit margin	1,267.0		(3,970.0)
Operating cost as % of revenue	2,075.0		1,400.0
Impairment as percentage of revenue	933.0		3,726.0
Current ratio	0.6		0.6
Working capital	(1,514.0)	(41.0)	(1,072.0)

Source: DBM 2012 Annual Report

Table 44 gives a summary of the financial performance of the Bank during the period under review:

- Net current assets decreased by 5% following a reduction in investment properties and loans and advances. On the other hand, current assets increased by 28% following an increase in short-term deposits; the overall effect was a 3% increase in total assets.
- In spite of a decrease in net interest income of 48%, there was an improvement in profit after tax, moving from a loss to a profit, leading to an improvement in return on assets and return on equity.
- The bank's liquidity position is tight, with a current ratio of 0.6 and a negative net working capital of R1, 514 million. This position is a worsening from 2011's R1, 072 million. The bank is therefore exposed to liquidity risk.

Operating expenses and impairments, as a percentage of NII, are 2075% and 933% respectively. These two cost components cannot be covered by net interest income alone, but rather by other income, gain on exchange of shares and increases in fair value of investments. This demonstrates that the DBM in its current state is not sustainable.

3.2 State Investment Corporation of Mauritius (SIC)

The State Investment Corporation (SIC) was established by the government in August 1984 as a limited liability company, after taking over the Mauritius Equity Financing Fund whose mandate was too limited for the rapidly expanding and diversifying industrial sector in Mauritius. The government is the sole owner of the Corporation, and all government investments in the SIC took the form of equity investments: Rs 60 million in 1984, Rs 20 million in 1986, and Rs 20 million in 1989. Based on this, SIC is regarded as the investment arm of the Government of Mauritius and is the major institutional investor in the local economy. The Corporation has diversified its investments in a large number of business activities and has invested in key strategic sectors of the economy and developed into a strong DFI with a well-diversified portfolio. The institution is profitable, liquid, and managed by a very small team of professionals.

3.2.1 SIC's Mandate

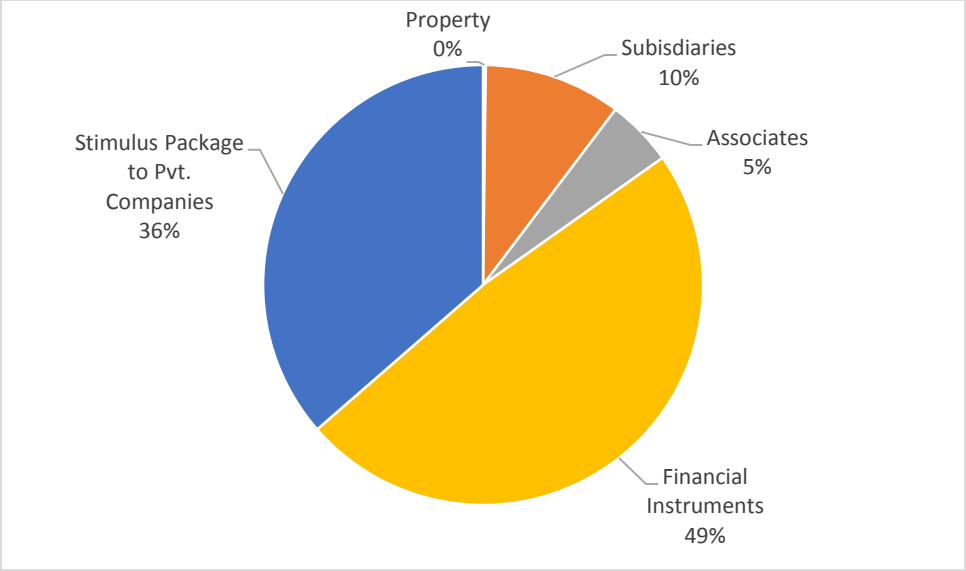
The mandate of the Corporation is to finance existing enterprises and to enter into joint ventures with local or foreign investors to accelerate and diversify the country's industrial, tourism and agricultural base. It also intervenes to cure sick enterprises in which public funds have been invested or whose debt obligations are guaranteed by government. 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 also empowered to manage the investment portfolio of government in the private sector. It takes up equity and provides loans 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 on the smaller end of the scale. The SIC is regarded as an important government venture used for investing in and controlling companies operating in essential industries and services.

3.2.2 Portfolio Analysis of SIC

Figure 11 below shows that out of the total investment of Rs 6,815.6 million made by the end of 2012, 49% was accounted for by equity shares, 5% and 10% were invested in associates and subsidiary companies respectively, including companies operating in gaming, fund management, property development, food and consumer goods, training, leisure and entertainment, and financial services. 36% of the portfolio was made up of funds which were specifically introduced by the government for transitional support for the private sector. The funds were meant to assist firms facing financial difficulties during the world economic crisis of 2008.

Figure 11: SIC Resources Distribution by Sector for SIC



Source: SIC 2012 Annual Report

SIC's investment in property is very small. This could be because there are already key players operating in this sector, such as the Mauritius Housing Company and the Development Bank of Mauritius.

3.2.3 Corporate Governance and Risk Management for SIC

3.2.3.1 The Governing Legal Environment

Similarly to the DBM, the State Investment Corporation is guided by the principles of best practices of the Mauritius Code on Corporate Governance (the "Code"). These principles are a fundamental part of its responsibility to protect and enhance shareholders' value.

3.2.3.2 The Board

At the time of the review, the board of SIC had eight board members. The board is composed of the chairperson, an Executive Director, and six non-executive Directors. Its composition represents a blend of knowledge, skills and expertise relevant to the corporation and its related business activities, from both the private sector and government.

The roles of the Chairman and Executive Director are distinct and separate. No one group of directors or individual member dominates the board's decisions. The non-executive directors are actively involved in the activities of the board through four subcommittees. These committees include the Corporate Governance committee, the Audit and Risk committee, the Nomination and Remuneration committee, and the Investment committee. Each committee established by the SIC has detailed specifications regarding its membership, purpose, terms of reference, function and authority. They provide independent assessments and views on proposals submitted by management and on the risk management and internal control systems. They also determine the corporation's strategy, approve audited accounts, declare final dividends, determine significant capital expenditure and approve investments.

3.2.3.3 Risk Management

The Board is responsible for risk management and procedures in the organisation. The Board is also in charge of determining the overall strategy for risk tolerance. The management and of risk is addressed by the Audit and Risk committee. The committee is thus responsible for the design and implementation of risk management processes and day-to- day management of risk performance.

The Company's policy on risk management covers all significant business risk including physical, operational, human resources, technological, business continuity, financial, compliance and reputational.

Despite the Company putting a risk management framework in place , it experienced a sharp increase in the impairment of investment from Rs4.9 million in 2011 to Rs169.5 million in 2012. The technical insolvency of the Mauritius Land-Based Oceanic Park Ltd. was the principal cause of the increase in impairment.

3.2.4 Business Model of SIC

In terms of funding, the SIC is currently comparable to a closed fund with an irregular inflow of funds. However, management has the flexibility to raise finance as and when new investment opportunities arise. The composition of the total funding and investment over the two years under review is shown in Table 45.

Table 45: Funding and Lending for SIC

	2012 Rs Million	Breakdown (%)	2011 Rs Million	Breakdown (%)
Long-term	2,631.4	97.8	2,363.5	98.1
Short-term	59.9	2.2	45.5	1.9
Sub-total	2,691.3	100.0	2,409.0	100.0
Equity	5,040.8		5,208.5	
Total Funding	7,732.1		7,617.3	
Lending	6,815.6	↑1.7	6,703.7	

Source: SIC 2012 Annual Report

Table 45 shows that the Corporation had mostly long-term sources of external funding (97.8%) in 2012. This business model is perfect for such an institution and it is sustainable in the medium- to long-term provided the Corporation is able to continue matching its long-term investments or lending to its long-term funding. If it can, the institution will be able to continue to maintain a low level of both the risk of maturity transformation and liquidity risk. The moderate gearing ratio of 0.53 which shows that the Corporation is prudent in its borrowing requirements and that it uses its balance sheet to mobilise external resources.

3.2.5 Financial Performance of SIC

In 2012, the Corporation's profit after tax stood at Rs174.6 million (Rs126.2 million in 2011). The difference in profit on the figures in the annual report for 2012 was mainly due to the implementation of the fair-value accounting standards adopted in 2013.

As at 31 December 2012, the net asset value of the SIC reached a record high of Rs6.9 billion, compared to Rs6.8 billion in 2011. This increase was mainly attributable to continuing investment in key sectors such as financial services, tourism, and gaming.

Table 46: Statement of Financial position for SIC

	2012 (Rs Million)	% change	2011 (Rs Million)
ASSETS			
Non-current assets	6,867		6,760
Current Assets	1,696		986
Total Assets	8,563	11	7,746
Liabilities and Equity			
Equity	5,041	-3	5,208
Liabilities			
Short term liability	891		174
Long term liability	2,631		2,364
Total liabilities	3,522	39	2,538
Total Equity and Liabilities	8,563		7,746
Statement of Comprehensive Income			
Revenue	171	-11	193
Profit for period	205	63	126
Operating expenses	78		123
Impairment of investments	169	3280	5
Key ratios	%		%
Return on Assets	2		2
Return on Equity	4		2
Net Profit margin	120		65
Operating cost as % of revenue	46		64
Impairment as percentage of revenue	99		3
Operating costs and impairments as % of Rev	144		66
Current ratio	1.9		5.7
Working capital	805.0	-1	812.0

Source: SIC 2012 Annual Report

Table 46 also shows that:

- The total assets increased by 11%. This was driven by an increase in long-term receivables, trade and other receivables coupled with an increase in cash and short-term deposits. This increase in assets did not, however, lead to an increase in net worth. Instead, net worth went down by 3% because of a 39% increase in liabilities. The increase in liabilities was the result of an increase in trade and other payables and an increase in interest-bearing loans and borrowings. These loans consist of overdrafts, a loan with the Development Bank of Mauritius, finance leases and a loan with the Government of Mauritius;
- Revenue decreased by 11%. This was attributed to the decrease in investments in associates which had diminished by 3% from 2011. Despite the decrease in revenue, profit for the year increased by 63%. This was caused by a gain on disposal of

investments which had risen by 549% from 2011. Nevertheless, impairments increased by 3280% from 2011 and this had an impact on the sustainability of the corporation; and

- Impairments as a percentage of revenue were 99%, a sharp increase from 3% in 2011. Operating costs as a percentage of revenue were 46%. This was a decrease from 64% in 2011. Revenue is, therefore, sufficient to cover either impairments or operating costs alone, but together they account for 144% of revenue, which shows that the corporation cannot sustain itself from its net operating income alone.

3.3 The Mauritius Housing Company Ltd (MHC)

The Mauritius Housing Corporation was established under MHC Ordinance No. 36 of 1962. Initially, its activities were limited to the housing finance business. With the widening of the Corporation's role and expectations, Ordinance No. 36 of 1962 was replaced by the Mauritius Housing Corporation Act 1974. Subsequently, in 1989, the Mauritius Housing Corporation changed its legal status from being a parastatal body to become a private company, the Mauritius Housing Company Ltd. Currently, the Corporation is owned by four institutions: the Government of Mauritius, 60.1%, the State Investment Corporation, 13.3%, the State Insurance Company, 13.3% and the National Pensions Fund, 13.3%. It must be pointed out that all the other three shareholders are state institutions, which means that the Corporation's shares are wholly government-owned.

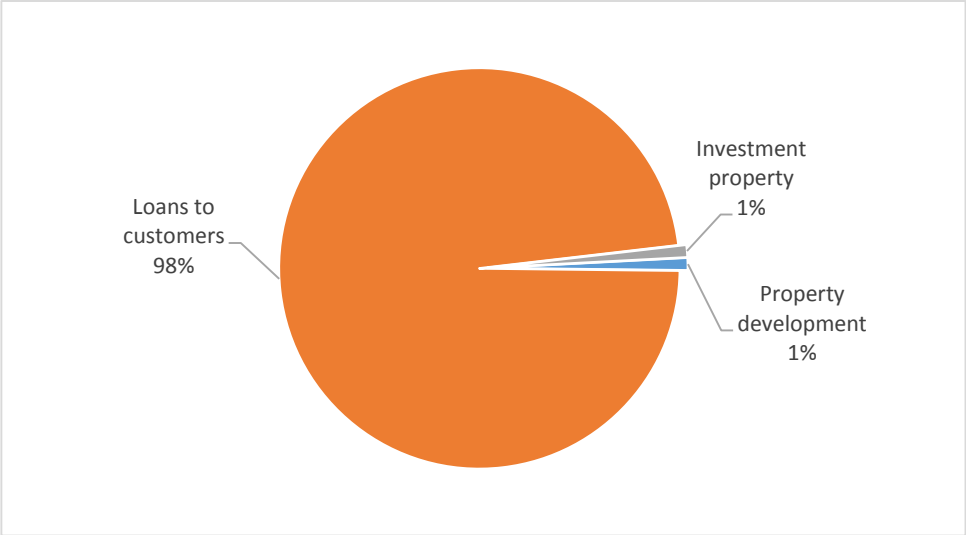
3.3.1 MHC's Mandate

The Mauritius Housing Company Ltd was set up to address the housing finance requirements of low-income households. The MHC is the main financial intermediary providing long-term housing loans (up to 25 years' maturity). It is also the only institution which provides subsidized mortgage loans to low-income households. In order to carry out its mandate, the MHC is empowered to establish a savings scheme known as Housing Savings Scheme. The company is also authorised by the Bank of Mauritius to transact deposit-taking business. The main business, however, of MHC Ltd remains the granting of mortgage loans to the public for the purchase, construction, reconstruction, repair or improvement of non-commercial buildings.

3.3.2 Portfolio Analysis of MHC

The MHC is the main Corporation in the financial sector providing long-term funding for housing development and, as a result, it has a narrow mandate. Figure 12 below shows the three areas of housing which the Corporation has been focusing its investment on.

Figure 12: SIC Resources Distribution by Sector for MHC



Source: MHC 2012 Annual Report

Figure 12 shows that out of the total investment of Rs5.1 billion in 2012, 98% was allotted to housing loans provided to customers (the majority of which were long-term), and the remaining 2% was split evenly between investment in property and property development.

The portfolio split also demonstrates that despite the Corporation's legal persona changing from SOE to Company, the Corporation still supports the policy mandate of the state on housing. In this regard, the MHC has a remarkable track record. It still caters for various social strata of the population in accordance with its original mandate. To date, the MHC has enabled more than 100,000 families to become house owners. The MHC has contributed to the current situation in Mauritius, where 90% of households have had access to long-term loans for housing development.

3.3.3 Corporate Governance and Risk Management for MHC

3.3.3.1 The Governing Legal Environment

It is necessary to underline that the MHC is a state-owned company, and it is governed by a series of legislation (Companies Act. Banking Act, Borrowers Protection Act, Public Procurement Act, to mention a few). The MHC is guided by the principles of best practice

of the Mauritius Code on Corporate Governance (the "Code"). These principles are observed and practiced by the board of MHC as a fundamental part of its responsibilities. The MHC has also put in place a corporate governance framework involving the board of directors, board committees, management, management forums, employees, internal and external auditors, and other stakeholders.

3.3.3.2 The Board

The MHC Board has 9 directors, all appointed by the 'shareholders'. To give more transparency to the Company's overall operations and especially to recognize the importance of employees stakeholders in the Company, the board include staff members as non-executive directors of the board. In addition, the requirements that 40% of the directors be independent (Banking Act 2004), that the Audit Committee be comprised of independent directors and that the Conduct Review and Risk Committee be split into two separate committees have also been implemented following the 2014 Board meeting.

The roles of the Chairman and of the Managing Director are separate and well defined. It is the responsibility of the Managing Director to oversee all the operations of the Company. The management team meets on a weekly basis for this purpose. They have full and timely access to all relevant information. The shareholders determine the remuneration of the Chairman, the Managing Director and the non-executive directors.

Directors meet regularly on a monthly basis. In addition to monthly board meetings, special sessions are held as and when urgent matters arise. All major policies and operational matters, as well as significant capital expenditure, the appointment of staff and special loans to companies with Housing Development Certificates, are submitted by management to the board.

3.3.3.3 Risk Management

According to the MHC annual report for 2012, an effective risk management strategy, which has an enterprise-wide approach to the identification, measurement, monitoring and mitigation of risk, is fundamental to the success of the company.

The board approves policies and limits and executes comprehensive risk management in order to keep the level of risk within a range appropriate to the MHC's operating capabilities. Management sets the risk policies and monitors the progress and implementation through the Conduct Review and Risk Committee (now two separate committees). Moreover, the

Conduct Review and Risk Committee and the Loans Approval Committee comprehensively gauge, evaluate and monitor the occurrence and management of each type of risk. As a result of this effort, the Corporation has experienced a decline in impairment and loss on foreclosed properties from Rs11 million in 2011 to Rs8 million in 2012 (see Table 49 below for more details).

3.3.4 Business Model for MHC

The Mauritius Housing Company has various avenues through which external resources are mobilised these include innovative long-term savings like Plan Epargne Logement (PEL), which was launched primarily to assist people to save for a house through the use of housing deposit certificates. In addition, the MHC finances its investment using resources generated from loans obtained from institutional partners, government, and shareholders' equity. Table 47 below shows the total funding which has been mobilised during the two years under review.

Table 47: Funding and Lending for MHC

	2012 Rs Million	Breakdown (%)	2011 Rs Million	Breakdown (%)
Long-term	3,328.8	88.2	3,357.4	99.1
Short-term	446.7	1.8	330.7	0.9
Sub-total	3,775.5	100.0	3,388.1	100.0
Equity	2,366.7		1,979.2	
Total Funding	6,142.2		5,667.3	
Lending	5,066.1		4,886.4	

Source: MHC 2012 Annual Report

Table 47 shows that the Company, at 88.2% long-term funding for 2012, has predominantly long-term sources of external funding. This business model is good as the Company is a DFI dealing with term-funding. The sector covered by the Corporation also means that its lending is likely to be long-term because of the nature of the housing sector. Furthermore, the debt to equity ratio is acceptable, at 159%.

3.3.5 Financial Performance of the Mauritius Housing Corporation

During the period under review, the MHC performed well, with the assets of the Company increasing from Rs 5,985 million to Rs 6,464 million on account of an increase in Housing Loan Assets (i.e., from Rs 5, 925.3 million in 2011 to Rs 6,014.4 million in 2012) and revaluation of property. However, despite the increase in assets, borrowings decreased from Rs 1,554.6 to Rs 1,375.4 million in 2012.

It must also be pointed out that during this period the Company's core asset quality remained very strong. The cost to income ratio has decreased materially and customers have continued to benefit from the wide range of products and services that the Company offers.

The Company has been able to provide dividends to its shareholders. In the 2012 calendar year, the Company's final dividend per share was Rs 3.04. Total dividends payable for 2012 thus amounted to Rs 55,318,000.

Table 48: Statement of Financial position for MHC

	2012 (Rs Million)	**% change**	**2011 (Rs Million)**
Assets			
Total Assets	**6,463**		**5,985**
Liabilities and Equity			
Equity	2,367		1,979
Total liabilities	4,096		4,006
Total Equity and Liabilities	**6,463**	**8**	**5,985**
Statement of Comprehensive Income			
Net Interest Income	326	5	311
other income	106		105
Operating income	432		416
Operating expenses	168		166
Operating profit	264		250
Provision for credit losses	30		(7.00)
impairment /loss on foreclosed properties	(8.00)		(11.00)
Increase in fair value of investment properties	18		28
Profit for the year	304	17	260
Key ratios	**%**		**%**
Return on Assets	5		4
Return on Equity	13		13
Operating expenses as % of |NII	52		53

Source: MHC 2012 Annual Report

Table 48 also shows that the net profit of the company increased by 17% from 2011, as a consequence of the reversal of interest suspended and the provision made for credit losses (R30M) following measures taken to accelerate the recovery of arrears and the revaluation of properties.

Operating expenses as a percentage of NII were 52.5%, which is an indication that the company can sustain its operations as it can meet its operating costs from net interest earned.

3.4 The Mauritius Post and Cooperative Bank Ltd (MPCB)

The Mauritius Post and Cooperative Bank Ltd, commonly known as MPCB, was the result of a merger of the New Co-operative Bank Limited with the Post Office Savings Bank in August 2003. Its main shareholders are The Mauritius Post Limited (44.3%), the Government of Mauritius (35.72%), the Sugar Investment Trust (10%), the Development Bank of Mauritius (8.93%) and eight cooperative societies each holding 1.04% shares.

3.4.1 MPCB's Mandate

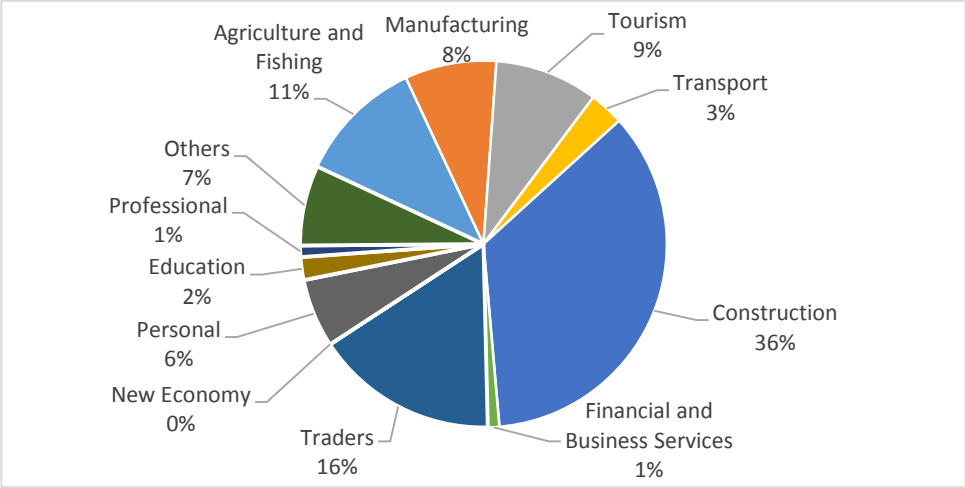
MPCB's mission is to deliver local banking services to its customers and to SMEs in Rodrigues and in Agalega. As part of the bank's agreement with The Mauritius Post Ltd, in areas where there is no MPCB branch, basic banking services are provided at post offices. Besides offering a range of products and services encompassing corporate banking, personal banking, treasury services and trade finance, the bank continues to introduce new financial products to meet market needs. MPCB's vision is to become a world-class international financial services provider with strategic and innovative offerings.

3.4.2 Portfolio Analysis of MPCB

MPCB provides commercial banking services, such as credit facilities, credit guarantees, acceptances and other similar commitments, which are extended by the bank to a single customer or a group of closely-related customers.

Total loans and advances to customers increased from Rs8.8 billion in 2011 to Rs11.4 billion in 2012, mainly owing to the increase in loans and advances. Figure 13 breaks down the bank's main portfolio distribution for loans and advances at their gross amounts, by industry sectors.

Figure 13: MPCB Resources Distribution by Economic Sector



Source: MPCB 2012 Annual Report

Figure 13 shows that of the total loans and advances of Rs 11,661.7 million invested so far, 36% were given for construction which included housing, 16% for trade, 11% went to the agriculture and finishing industry, 10.6% to consumers, 9% to tourism, 8% to manufacturing, and the balance to several smaller sectors. This portfolio distribution clearly shows that the Bank's mandate is broad.

3.4.3 Corporate Governance and Risk Management for MPCB

3.4.3.1 The Governing Legal Environment

MPCB is governed by a series of legislative acts (Companies Act. Banking Act, Borrowers Protection Act, and Public Procurement Act). Like other DFIs in Mauritius, MPCB is guided by the principles of best practice of the Mauritius Code on Corporate Governance (the "Code").

3.4.3.2 The Board

Currently the board of MPCB is made up of ten non-executive directors and two executive directors, all appointed by the shareholders. The board has also established board committees: the Audit Committee, the Remuneration and Nomination Committee, the Board Conduct Review, Risk Management and Corporate Governance Committee, the Credit Sanctioning Committee, the Disciplinary Committee and the Procurement Committee.

3.4.3.3 Risk Management

In order to protect the bank, the board has put in place risk management policies. These policies have been designed to identify and analyse risks, set appropriate risk limits and

controls, and monitor the risks and adherence to limits by means of reliable and up-to-date information systems. The board regularly reviews its risk management policies and systems to reflect changes in markets, products and emerging best practice.

Risk management is carried out by the Board Conduct Review, Risk Management and Corporate Governance Committee in accordance with policies approved by the Board of Directors. The Risk Management Committee identifies, evaluates and hedges financial risks in close co-operation with the Bank's operating units. The board provides written principles for overall risk management, as well as written policies covering specific areas such as foreign exchange risk, interest rate risk, credit risk, and the use of derivative and non-derivative financial instruments. In addition, an internal audit provides an independent review of risk management and the control environment. The most important types of risks are credit risk, liquidity risk, market risk and operational risk. Market risk includes currency risk, interest rate risk, and other price risk. Based on this risk management framework, the Bank has managed to maintain an NPLs ratio below 3%.

3.4.4 Business Model of MPCB

MPCB is a commercial bank. It funds most of its activities using resources mobilised from the following sources: deposits from its customers, borrowed funds from the Central Bank and from commercial banks in Mauritius, and subordinated debt. Its other sources of funding are through shareholders' equity and retained earnings. The composition of funding and lending during the two years under review is shown in Table 49 below.

Table 49: Funding and Lending for MPCB

	2012 Rs Million	Breakdown (%)	2011 Rs Million	Breakdown (%)
Long-term	4,695.1	34.1	3,925.9	35.1
Short-term	9,085.1	65.9	7,246.9	64.9
Sub-total	13,780.2	100.0	11,172.8	100.0
Equity	1,036.9		913.9	
Total Funding	14,817.1		12,086.7	
Lending	13,329.3		10,792.7	

Source: MPCB 2012 Annual Report

Table 49 shows that the Bank, at 65.9% of long-term funding to total external funding (2012), has a majority of long-term sources of external funding. This business model is sustainable since the bank's lending is likely to be long-term owing to the nature of the

sectors supported by the bank, which include agriculture, manufacturing, infrastructure, property, transport, and trade and services.

However, despite this good business model, the maturity structure must be balanced to avoid liquidity problems. As long as the bank avoids this scenario, the business model will be sustainable in medium to long-term.

3.4.5 Financial Performance of MPCB

During the period under review, the bank's total assets (excluding an allowance for credit impairment) grew by 23%, from Rs 12.195 billion in 2011 to Rs 14.964 billion in 2012. The increase in assets was mainly the result of an increase in loans and advances.

At 31 December 2012, loans and advances to customers reached Rs 11.4 billion, a 30% increase from Rs 8.8 billion at 31 December 2011. Deposits from customers also experienced a rise at this time, from Rs 10.6 billion to Rs 12.8 billion.

Table 50: Statement of Financial position for MPCB

	2012 (Rs Million)	% change	2011 (Rs Million)
Assets			
Total Assets	14,964	23.0	12,195
Liabilities and Equity			
Equity	1,037	13.0	914
Total liabilities	13,927	23.0	11,281
Total Equity and Liabilities	14,964	23.0	12,195
Statement of Comprehensive Income			
Net Interest Income (NII)	527	16.0	453
Profit for period	123	9.0	113
Impairment losses	72	9.0	66
Operating costs	413	13.0	366
Key ratios	%		%
Return on Assets	0.8		0.9
Return on Equity	11.9		12.4
Net Profit margin	23.3		24.9
Impairment losses as % of NII	13.7		14.6
Operating profit as % of NII	78.4		80.8
Non-Performing Loans %	2.2		2.8
Debt/ Equity ratio	0.3		0.3

Source: MPCB 2012 Annual Accounts

Table 50 shows that the bank registered a remarkable growth in its total interest income, from Rs 929.6 million for the year ending 31 December 2011 to Rs 1,083.6 million in 2012. Net interest income during 2012 amounted to Rs 526.8 million, compared to Rs 452.7

million in the previous year. However, the bank's interest expense rose from Rs 556.84 million in 2012 to Rs 642.97 million in 2013.

The continued growth in both the number of accounts and in total deposits shows that the functions of the MPCB are of value to the population. In addition, the bank has been performing exceptionally well, making profits in each of the past three years.

However, analysis of its resources shows that the Bank in its current state uses short-term funds to support its clients' investments. Therefore, although the Bank appears to be sound in the short to medium term, the Bank needs to consider the viability of its business model in the long term.

4 Co-ordination, Regulation and Supervision of DFIs in Mauritius

4.1 Co-ordination

Table 51 shows that the DFIs in Mauritius are coordinated by different Ministries. For instance, the Development Bank of Mauritius and the State Investment Corporation of Mauritius are under the Ministry of Finance and Economic Planning, while the Mauritius Housing Company Ltd (MHC) reports to the Ministry of Housing. While the Ministry of Finance and Economic Planning is the main ministry charged with the responsibility of coordinating the activities of these institutions, it is not clear whether the Government of Mauritius has developed or has in place an overarching policy framework for coordinating the DFIs. The mandate overlap among the Development Finance Institutions currently operating in Mauritius suggests that it does not.

Table 51: Co-ordination, legal and Regulation of DFIs- Mauritius

Institutions	Legal and ownership	Co-ordinator	Regulator
1. **Development Bank of Mauritius (DBM)**	• Mauritius Ordinance, 1963, replaced by Companies Act of 1988) • Majority owned by the State (91.67 %)	• Ministry of Finance and Economic Development	• MOFED
2. **State Investment Corporation of Mauritius (SIC)**	• Companies Act • Wholly owned Government	• Ministry of Finance and Economic Development	• MOFED
3. **The Mauritius Housing Company Ltd (MHC)**	• Ordinance No. 36 of 1962, replaced by the MHC Act 1974 • Majority owned by the State (60.1%)	• Ministry of Housing & Lands	• Bank of Mauritius
4. **The Mauritius Post and Cooperative Bank Ltd**	• Companies Act • Wholly owned Government	• Ministry of Finance and Economic Development	• Bank of Mauritius

Sources: MDB Ordinance, 1963 and 1988, MHC Ordinance No. 36 of 1962,

4.2 Regulation and Supervision

Mauritius has two main regulatory bodies: the Financial Services Commission (FSC) which was established in December, 2001 as the unified regulator for the non-bank financial sector, and the Bank of Mauritius (BOM) which is mainly responsible for banking regulation and supervision. It was decided at the time of the creation of the FSC that a review would be conducted in three years to determine whether, in light of national and international developments, the BOM and FSC should be merged into a single unified regulatory authority for the financial services sector. Unfortunately, to date this merger has not taken effect.

Two of the DFIs, the Development Bank of Mauritius and State Investment Corporation of Mauritius, are not regulated by either of the two regulatory institutions. The remaining DFIs, namely the Mauritius Housing Company Ltd and the Mauritius Post and Cooperative Bank, are regulated by Bank of Mauritius. This situation shows that, despite Mauritius making significant progress in the development of legal and regulatory policy frameworks for both commercial banks and non-banks, there is still no overarching regulatory framework for DFIs.

5 Conclusion

Although Mauritius has a relatively well-developed financial sector, ranking second that of to South Africa, the development of DFIs could increase competition and lead to greater access to financing at lower rates. Even though both small and large firms seem able to access financing, rates remain relatively high and firms may have difficulties financing growth owing to the widespread bank practice of not providing term financing. While the development finance system is already well-established in Mauritius, most companies still rely on self-financing, and this exposes them to liquidity risks. For this reason, there is need for government to support the development of the DFIs currently operating in Mauritius through the enactment of proper reforms, including putting in place proper laws.

The key findings on the development finance system of Mauritius are outlined below:

- Mauritius has a relatively well developed financial sector. Despite this, Mauritius still faces a significant development finance gap which DFIs can help to fill;
- Poor performance can be partly attributed to poor laws made by the government, such as the law which protects the borrowers from being forced to repay loans;
- DFIs have not been playing their developmental role effectively due to inadequate capitalisation;
- There is no uniform statutory approach to establishing DFIs in Mauritius. Although all the DFIs were established under the Acts of Parliament, over time the Acts have been replaced by the Companies Act in order to pave the way for privatisation of the DFIs.
- With the exception of the Mauritius Housing Company Ltd, the mandates of the DFIs are all generally broad and they exhibit a high level of mandate creep;

- While business models for SIC and MHC seem to be in line with the development finance model framework, the models for the Mauritius Post and Cooperative Bank Ltd and Development Bank of Mauritius risk maturity transformation;
- Most of the DFIs, with the exception of the Mauritius Development Bank, are financially sustainable;
- There are weak strategic plans or ones that are poorly aligned with national development plans;
- In some cases there are weak corporate governance structures;
- There is a weak uniform risk management framework in place for DFIs, or in some cases none at all;
- There is no standard practice with regard to shareholding representation on the boards of DFIs. Mostly board members are appointed by the Ministers; and
- There is no overarching policy framework for coordinating activities of the DFIs in Mauritius and this situation is further compounded by the DFIs reporting to different line ministries.

COUNTRY STUDY 6: MOZAMBIQUE

The SADC DFRC Project Team of Dr. Lufeyo Banda and Dr. Herrick Mpuku held discussions in Mozambique from 1-4 April 2014 for the SADC DFI Scan study. The following review is based on the information collected and the discussions with representatives from the Ministry of Finance, the Central Bank and the Development Bank of Mozambique and Gapi-Sociedade de Investimentos (Gapi-SI).

1 Background on Mozambique

Mozambique has experienced rapid economic growth in the past few years. In 2011, the GDP growth rate was 7.2%, rising to 7.87% by 2012. A large part of this growth has to do with Mozambique's natural resource base and mining activity, which grew by 54% in 2012. The recent natural gas discovery off the Mozambican coast has prompted further exploration for oil, and there are also plans for the expansion of coal production. Analysts expect that the development of these mineral resources could bring Mozambique's GDP to the level of Angola.

Table 52: Key Figures for Mozambique

Capital	Maputo
Exchange Rate: 1 US$ =	30.03 New Mozambican Metical (MZN)
Population ^	25 203 395
Population growth rate (%) ^	2.50
Urban population (% of total) ^	31.47
Urbanisation rate (%) ^	3.32
GDP per capita (US$) ^	578.80
GDP growth rate (%, real) ^	7.87
GNI per capita, Atlas method (current US$) ^	510
Population less than US$2 per day~	81.77
Population below national poverty line *	54.1
Gini co-efficient ~	45.66
HDI (Global Ranking)"	185
HDI (Country Index Score) "	0.327
Unemployment rate (%) *	2.24
Bank branches per 100 000 ^	3.63
Lending Interest Rate ^	16.81
Deposit Interest Rate ^	11.43
Credit % of GDP ^	28.08
Inflation	2.9
Ease of Doing Business Ranking (out of 185 countries)	146

Sources: ^ World Bank's World Development Indicators (2012), ~ World Bank PovcalNet: an online poverty analysis tool, various years; = www.coinmill.com on 26 August 2013; "UNDP's International Human Development Indicators (2012); * African Economic Outlook, various years; ! World Bank's Doing Business Survey Data (2013)

Agriculture, which is the main economic activity after mining, grew by 7.6% in 2012. While the construction sector grew by 3.9% in the same year, real estate and rental activities did not experience any change. The financial services sector, transport and communications all performed well in 2012. The inflation rate has been volatile, declining from 12.7% in 2010 to less than 3% in 2012. For 2013, inflation is forecast at 6.5%, largely because of the impact of the global economy and uncertainty related to factors in Mozambique's natural resource

exploitation. The International Monetary Fund's structural reform programme will continue to focus on public financial management, tax policy and administration, debt management and the strengthening of the financial sector.

2 Access to Development Finance - Mozambique

The financial sector of Mozambique continues to be underdeveloped, although it has the potential to expand quickly in line with the country's decentralised growth. Currently, approximately 90% of Mozambicans do not have access to formal financial institutions, and credit is only available to an estimated 3% of the population. There are 18 registered banks, representing 95% of total financial sector assets. However, 76% of the financial sector's assets are concentrated in the three largest banks, all of which are foreign owned, namely BIM (Banco Internacional de Mozambique) (32.01%), Banco Comercial de Investimentos (27.25%), and Standard Bank Mozambique (16.51%).

In order to facilitate access to finance, the Central Bank has been working to bring interest rates down, reducing its treasury bill rates by 78% and its reference rates by over 40% in the past few years. The prime lending rate, at around 17%, remains high, in part owing to uncertainty regarding Mozambique's volatile inflation. Bank credit to the private sector at the end of 2012 remained low at 28.08% of GDP, with only 10.5% of entrepreneurs having access to bank finance.

Table 53: Access to Finance - Mozambique

#	Indicator	%	SSA Region
1	% of firms using banks to finance investment	10.5	18.0
2	Proportion of investment financed internally (%)	86.0	78.4
3	Proportion of investment financed by banks (%)	4.7	9.9
4	Proportion of investment financed by suppliers of credit (%)	7.0	3.8
5	Proportion of investment finance by equity or stock sale (%)	0.2	3.7
6	% of firms identifying access to finance as a major constraint	50.1	41.9

Source: Enterprise Surveys (http://www.enterprisesurveys.org), The World Bank.

As indicated above, entrepreneurs in Mozambique have limited access to financial assistance, compared to other SADC countries. For instance, according to World Bank Enterprise Survey data, only 4.7% of the total investment required by entrepreneurs was financed by banks, and only 0.2% through equity or stock sale. The entrepreneurs also identified access to financial assistance as a major constraint on their businesses. This leaves the economy with a huge financing gap of 86%, which commercial banks are unable to fill.

To address the problem of limited access to finance, two development finance institutions have been set up by the government of Mozambique and its international cooperating partners, which include the Development Bank of Mozambique (BNI) and Gapi-Sociedade de Investimentos (Gapi-SI). These two DFIs each have a specific areas of focus as indicated in Table 54 below.

3 Analysis of Development Finance Institutions of Mozambique

As indicated in Table 54, there are two DFIs in which the government of Mozambique plays a direct role: one focuses on infrastructure development and the other one on SMEs.

Table 54: Sectoral Analysis in Mozambique

Sector	Institution
Infrastructure, Energy, Industry, Commerce and Agriculture	DBM
Micro financing and SMEs, Agriculture	GAPI-SI

Source: BNI and GAPI-SI Annual Reports

3.1 Development Bank of Mozambique (BNI)

BNI was founded in 2010, initially as the country's first investment bank, through a joint venture between the governments of Portugal (through Caixa Geral de Depósitos) and Mozambique (through the National Directorate). With a proposed initial capital of US$500 million, the bank was created to facilitate a closer cooperation between Mozambique and Portugal, and to encourage various projects in areas such as infrastructure, natural resources (mining & hydrocarbons) and energy.

In December 2012, the government acquired sole shareholding of BNI after purchasing the shares of Caixa Geral de Depositos through the equity agency IGEPE. At this point, the BNI, as well as its role as investment bank, also became a development bank.

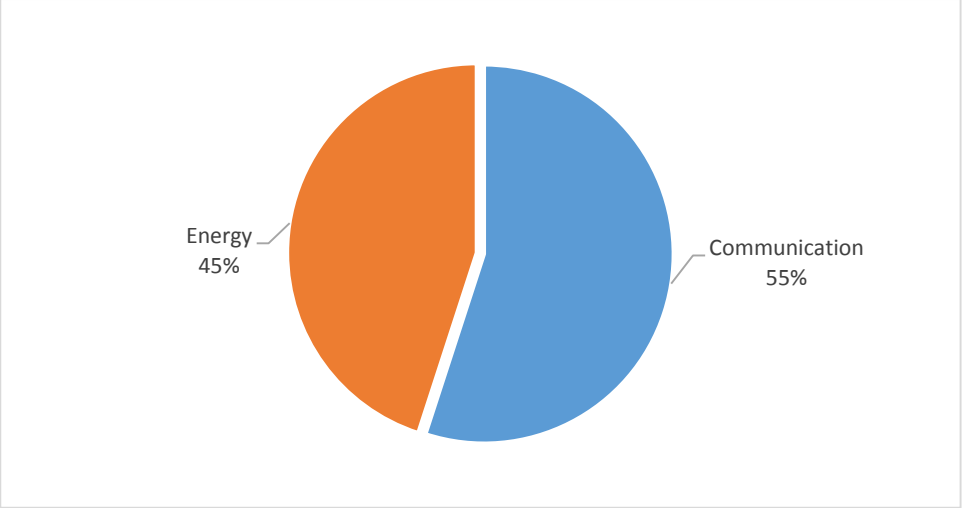
3.1.1 Mandate of BNI

BNI's mandate as a DFI is to provide long-term financing for sustainable activities that contribute to the country's social and economic development. The bank's main areas of activity are Infrastructure, Natural Resources, Energy, Agriculture, Industry & Commerce and Transportation. BNI also seeks to strengthen the capital structure of private companies and the development of capital markets.

3.1.2 Portfolio Analysis of BNI

BNI so far has managed to approve two credit facilities for its customers, amounting to 100.6 million meticais. Figure 14 below shows that out of the total loans portfolio, 55% was disbursed to the energy sector and the remaining 45% was disbursed to the communication sector.

Figure 14: Resources Distribution by Sector for BNI



Source: BNI Annual 2012 Annual Report

3.1.3 Corporate Governance and Risk Management for BNI

3.1.3.1 The Governing Legal Environment

The Bank's internal control system is based on a culture of compliance with the law and with all internal rules (policies, procedures, code of conduct of the Bank). The rules provide for the establishment of the board of directors. The board is also governed by the Bank of Mozambique Act which ensures that the Bank's activities and procedures mitigate BNI's exposure to the risk of incurring legal penalties or reputational harm due to contractual breaches or a negative public perception of the Bank.

3.1.3.2 The Board

The board of directors of the Development Bank of Mozambique has four board members, appointed by the Minister of Finance. The Board is responsible, amongst other duties, for setting the overall direction of the Bank's business. The Board is assisted by three sub-committees:

a) The Executive Committee is responsible for managing the company's business and carrying out all corporate activities;

b) The Risk Management Office (RMO) is the body responsible for protecting the Bank's capital in relation to credit, market and operational risk, and for monitoring and controlling lending activities; and
c) The Assets and Liabilities Committee (ALCO) is responsible for assessing and deciding on proposals related to the implementation of the business strategy and the risk management strategy.

3.1.3.3 Risk Management

The BNI risk control and management is carried out by the Risk Management Office within the scope of the policies approved by the Executive Committee. This Office is relatively new and its role is to identify, assess and monitor diverse financial risks in close cooperation with the Bank's other operating units.

3.1.4 Business Model of BNI

As a development bank, BNI's core functions are to finance infrastructure projects and industry. In the former area, the bank provides finance for cross-sector infrastructure projects, such as roadways, logistics platforms, communications, energy, mining and agriculture. It's lending to the production sectors of the economy focuses on projects which bring innovation and upgrades to transport, the distribution of electric power and gas and agriculture. BNI's activity as a development bank also involves managing assets and liabilities for public and private sector clients, managing development funds and working to strengthen the country's business.

The bank's core functions and activities are currently funded by resources mainly obtained from shareholders' equity. The composition of funding and investment over the two years under review is shown in Table 55 below.

Table 55: Funding and Lending for BNI (Million Meticais)

	2012 MZN Million	Breakdown (%)	2011 MZN Million	Breakdown (%)
Long-term	---	---	---	---
Short-term	---	---	---	---
Sub-total	---	---	---	---
Equity	2,605.8		2,130.7	
Total Funding	2,605.8		2,130.7	
Lending	100.6		---	

Source: BNI 2012 Annual Report

Table 55 also shows that the bank, during the past two years of its operations, did not contract any debt. This is understandable as it only started operation in 2010. Furthermore, several changes took place during the initial stages of operation, such as the buying back of shares equity from the two strategic partners of the Bank. The Bank is highly liquid and its loan portfolio has yet to be developed and mature. BNI is in its initial stages of development and the position presented in Table 56 is therefore acceptable. Over time, the bank should be able to increase its credit portfolio and mobilise resources from external sources.

3.1.5 Financial Performance of BNI

BNI's financial position, as indicated in Table 56, shows that its total assets and liabilities, amounting to Mt 2.8 billion and Mt 209.9 million, were 26% and 116% higher respectively than in 2011. There has been a resultant increase in equity by 22%. The return on assets and return on equity both showed positive change in 2012.

Table 56: Statement of Financial position BNI

	2012 (MZN Million)	% change	2011 (MZN Million)
Assets			
Total Assets	2,816	26	2,228
Liabilities and Equity			
Equity	2,606	22	2,131
Liabilities			
Total Liabilities	210	116	97
Total Equity and Liabilities	2,816		2,228
Statement of Comprehensive Income			
Net Interest Income	190	1167	15
Profit after tax	63	-158	(109)
Operating expenses	141	-12	160
Impairments	5,914	24	4,787
Key ratios	%		%
Return on Assets	2.2		-4.9
Return on Equity	2.4		-5.1
Net Profit margin	33		-727
Operating cost as % of revenue	74		1067

Source: BNI 2012 Annual Report

Table 56 also shows that, after a first-year loss in 2011 of nearly Mt 109.3 million as a result of the bank's incorporation, formation and start-up costs, BNI closed 2012 with a pre-tax profit of Mt 96.3 million, which, after deducting deferred tax, gives a net profit for the year of Mt 63.4 million. This performance was mainly attributable to the net interest income,

which increased by 1167% from 2011, and to the bank's investment in available-for-sale financial assets.

The improvement in the bank's profit was also a result of the 12% decrease in operating expenses following cost-control mechanisms put in place by the management.

Furthermore, operating expenses as a percentage of NII improved from 1067% in 2011 to 74% in 2012. This shows that NII can now cover its operating costs, demonstrating the viability of the Bank in the short to medium term.

3.2 Gapi-Sociedade de Investimentos (Gapi-SI)

GAPI-SI was created in 1990 by the Friedrich Ebert Foundation (30%) and BPD (70%), a parastatal development bank. It is a public-private partnership institution operating as a DFI in Mozambique. In 1999, GAPI was legally registered as a joint-stock company: GAPI SARL. In 2007, GAPI was licensed by the Central Bank as an investment company which could offer retail and wholesale credit to entrepreneurs. Its equity capital is held by three main shareholders: the Ministry of Finance (30%), the domestic private sector (40%), and civil society (30%).

3.2.1 GAPI'S Mandate

As indicated in the preceding section, Gapi-SI (Investment Society) is a financing institution, incorporated as a public-private partnership. Its mandate is to contribute to the creation of a more inclusive financial system, through the promotion of the creditworthiness of SMEs and community-based organizations (CBOs), as well as strengthening micro-finance institutions. It is legally registered in the banking sector as an investment company with a dual focus on increasing the bankability of small, micro and medium enterprises (SMME) and promoting the organisation of decentralised banking services. Each of its interventions can be considered as a PPP in its own right, including joint interventions, with private commercial banks, in the agricultural value chain, and the creation of micro-bank networks using mezzanine financing techniques with credit institutions.

GAPI's specific objectives include the following:

- Developing human capital and ensuring the improvement of conditions to access financial services, mainly in the rural areas.
- Carrying out training and advice activities directed to business development;

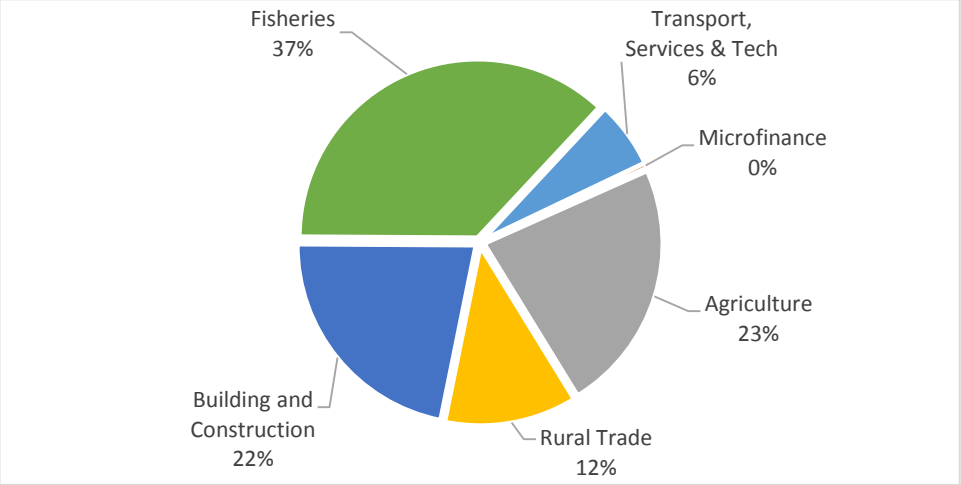
- Ensuring direct channelling of, or supplementary guarantees and risk mitigation instruments for, financial resources to integrated economic and infrastructure development programmes, operating at financial intermediation level; and
- Ensuring the availability of financial services to business initiatives of local entrepreneurs and communities, through the establishment of institutional partnerships with the banks and with municipal and local development entities.

GAPI aims to achieve its objectives through a combination of financial services, business development services (BDS), and technical assistance.

3.2.2 Portfolio Analysis of Gapi-SI

GAPI's lending focuses largely on rural areas, and some 82% of the loan book is in the agricultural, fisheries, and construction sectors, while the rest is channelled to the transport services, technology, microfinance, and rural trade. Figure 15 shows that Gapi-SI has a broad mandate as the institution supports a range of economic sectors.

Figure 15: Resources Distribution by Sector for Gapi-SI



Source: Gapi-SI 2012 Annual Report

In 2012, Gapi disbursed Mt 142.3 million to business development programmes, distributed in the order shown in Figure 15. The above Figure shows Fisheries, agriculture and rural trade received the largest share, a combined total of 71.85%. As some of these operations involve finance for groups and associations, there was also an indirect job creation benefit. Finance for construction and the acquisition of building materials also grew substantially, in response to growth in the country's construction sector Finance for value chains and skills development has continued to form the basis of Gapi's interventions. This means that their

financing structure covers both small and medium entrepreneurs, connecting the producer and the market.

3.2.3 Corporate Governance and Risk Management for Gapi-SI

3.2.3.1 The Governing Legal Environment

Gapi-SI is a public-private partnership DFI. It is also registered by the Central Bank as an investment company. The institution's governance structure is therefore governed by a series of legislations (Companies Act, Banking Act, Law 15/99, Decree 56/2004 and Commercial Code). Gapi-SI is also subject corporate governance guidelines for state-owned enterprises.

3.2.3.2 The Board

The Board of Directors, which is appointed by the shareholders or general assembly, is currently made up of five members, four of which are non-executive, i.e. not involved in the daily management of the institution. The board members are appointed for a term of two years and they meet every month.

3.2.4 Business Model of Gapi-SI

Although GAPI is registered as a financial institution by the Central Bank of Mozambique, it does not take deposits; instead, its activities are funded through shareholders' equity and resources mobilised from international cooperating partners. Table 57 below shows the composition of the funding based on the two years under review.

Table 57: Funding for Gapi-SI (Million Meticais)

	2012 MZN Million	Breakdown (%)	2011 MZN Million	Breakdown (%)
Long-term	374.4	100.0	328.0	97.9
Short-term	---	0.0	6.7	2.1
Sub-total	374.4	100.0	334.7	100.0
Equity	348.3		335.3	
Total Funding	722.7		670.0	

Source: Gapi-SI 2012 Annual Report

Table 57 shows that Gapi-SI has exclusively (100%) long-term sources of external funding. These resources have been mobilised from the Mozambique government in partnership with a wide range of donors: KfW, L'Agence Française de Développement, DANIDA, IPAD/IFADAP, IFAD, USAID, the EU, the African Development Bank, the World Bank, BADEA, the Nordic Development Fund, the Ford Foundation, and the Kellogg Foundation.

This business model appears sustainable since the DFI's lending is likely to be long-term owing to the nature of the SME and small-scale farming associations sectors. Moreover, as the Gapi-SI business model includes the provision of a combination of financial services (short- and medium-term loans), equity finance and business development services, it is able to cope with changes of priorities from the major sources of funding. Recently, as official development assistance from international cooperating agencies to the government is being reduced, the demand for Gapi services is growing. In addition, because of the development of megaprojects in Mozambique, Gapi is winning contracts with international companies to provide financial services in order to promote linkages, programmes and "local content" through projects aiming to support SMEs.

This business model explains why Gapi has consistently achieved positive financial results since its incorporation, with a growing impact and outreach.

3.2.5 Financial Performance of Gapi-SI

Gapi-SI had a total assets growth of 10% in 2012, mainly attributable to an increase in the loan book. This also increased net equity by 4% and net interest income by 29%.

Table 58: Statement of Financial position Gapi-SI

	2012 (MZN Million)	% change	2011 (MZN Million)
Assets			
Total Assets	956	10	872
Liabilities and Equity			
Equity	348	4	335
Liabilities			
Total liabilities	608	13	537
Total Equity and Liabilities	956		872
Statement of Comprehensive Income			
Net Interest Income	18	29	14
Profit after tax	13	117	6
Operating expenses	134	-9	148
Key ratios	%		%
Return on Assets	1.4		0.7
Return on Equity	3.7		1.8
Net Profit margin	72		43
Operating cost as % of revenue	744		1057

Source: Gapi-SI 2012 Annual Report

Table 58 also shows that, with operating costs being reduced by 9% in 2012, profit after tax improved by 117%, with improvements coming from returns on assets and return on equity.

However, despite the reduction in operating profit as a percentage of NII by 30%, which is 1057% and 744% in 2011 and 2012 respectively, NII is still insufficient to cover operating costs. The sustainability of GAPI-SI is being assured by a combination of different services and sources of income, namely BDS (consulting and business training) (51%), financing services (38%) and rentals (real estate) (11%). The success of the Gapi business model and financial results is attracting new private investors (capital increase), supporting a stronger role for Gapi and increased intervention in the equity finance for indigenous SMEs.

4 Co-ordination, Regulation and Supervision of DFIs in Mozambique

4.1 Co-ordination

In Mozambique, coordination of the activities of the two DFIs is governed by the Institute for Management of State Holdings (Instituto de Gestão das Participações do Estado (IGEPE)) which is wholly owned by the government of the Republic of Mozambique and manages all SOEs. Its mission is to strengthen public-private partnerships, creating benefits for the state in the development projects while facilitating new investment opportunities within viable sectors. IGEPE is tasked with the responsibility of holding and managing state investments/shares in various businesses, which include Gapi-SI and the Development Bank of Mozambique. However, Mozambique does not have a framework for coordinating the DFIs. This could be attributed to the fact that there are very few DFIs operating in Mozambique.[38]

Table 59: Co-ordination, legal and Regulation of DFIs- Mozambique

Institutions	Legal and ownership	Co-ordinator	Regulator
1. Development Bank of Mozambique (BNI)	• Limited shares corporation, • Wholly owned by Government	• IGEPE	• Central Bank of Mozambique
2. Gapi-Sociedade de Investimentos (Gapi-SI)	• Joint-stock company • Majority owned by the private sector	• IGEPE	• Central Bank of Mozambique

Source: BNI 2012 Annual Report

[38] Until 2010 when the Development Bank of Mozambique was created, there was only one DFI operating in Mozambique.

4.2 Regulation and Supervision

The Central Bank of Mozambique is responsible, in conjunction with the Ministry of Finance, for regulating the two development finance institutions currently operating in the country.

The two development finance institutions, Gapi-SI and Development Bank of Mozambique, have been licenced by the Central Bank of Mozambique and are regulated according to Law 15/99, amended by Law 9/04, and Decrees 56/2004 and 57/2004.

The DFIs are required to submit monthly balance sheets. The calculation of their annual balance, as well as regular on-site inspections, is done by the banking supervision department, with penalties for non-compliance.

The legal and regulatory framework used to regulate the DFIs in Mozambique does not take into account the AADFI PSGRS. This makes the regulation weak and inappropriate for the two DFIs.

5 Conclusion

Mozambique's economy remained one of the most dynamic on the continent in 2012, with a roughly 5% rate of real gross domestic product (GDP) growth, in spite of the major flooding which occurred during the first quarter and the politico-military low-intensity confrontations between government and the opposition movement. The main drivers of growth are foreign direct investment (FDI), focused mostly on the extractive sector, and increasing public expenditure. The fastest growing sectors in 2012 were the extractive sector, propelled by a boost in coal exports, and the financial sector, fuelled by credit expansion and increased income, mostly in urban areas. Other dynamic sectors are construction, services, and transport and communications, broadly correlated with infrastructure development and very large-scale projects, known in Mozambique as mega-projects.

The development finance sector continues to be underdeveloped, although it has the potential to expand quickly in line with the country's decentralised growth. Currently, approximately 90% of Mozambicans do not have access to formal financial institutions, and credit is only available to an estimated 3% of the population.

Key findings on the development finance system of Mozambique, outlining the gaps, are listed below:

- Mozambique has a relatively underdeveloped development finance institutions coupled with an underdeveloped financial system;
- Until 2010, Mozambique had no national development finance institution, except Gapi-SI which is a quasi-government-ICP-private DFI based on a PPP arrangement. For this reason, DFIs have not been playing an effective developmental role in Mozambique;
- There is no uniform statutory approach to establishing DFIs in Mozambique. Although both DFIs were established under Companies Act, originally they were both established through joint venture arrangements between the government and international stakeholders;
- The mandates of the two DFIs are generally broad and this might lead to mandate overlaps;
- While the business model for Gapi-SI is generally in line with that of a development finance institution, the same cannot be said of the Development Bank of Mozambique. This is mainly because the Development Bank is relatively new and it has yet to develop its line of credit and to establish itself in the market;
- Although the Development Bank of Mozambique is relatively new, it was found to be financially viable, while Gapi-SI was not;
- Strategic plans that are in line with the national development plans are lacking;
- In some cases there are weak corporate governance structures;
- There are no uniform risk management frameworks in place for DFIs;
- There is no standard practice with regard to shareholding representation on the boards of DFIs. Mostly board members are appointed by the Ministers;
- Both the Development Bank of Mozambique and Gapi-SI are not well capitalised;
- There is no overarching policy framework for coordinating the activities of DFIs in Mozambique; and
- There is a weak or inappropriate regulatory framework for DFIs.

COUNTRY STUDY 7: NAMIBIA

The SADC DFRC Project Team (Dr. Lufeyo Banda and Dr. Herrick Mpuku) held discussions in Namibia from 15-17 January 2014 for the SADC DFI Scan study. The summary review below is based on information collected and discussions with representatives from the Ministry of Finance, the Bank of Namibia (Central Bank), Development Bank of Namibia Ltd, SME Bank Ltd, the National Housing Enterprise, Agribank, the Industrial Development Corporation and the Environmental Investment Fund.

1 Background on Namibia

Namibia is a middle-income country in Southern Africa, with a GDP per capita in 2012 of US$5 668.39. GDP growth rates have hovered just below 6% since 2007, with a drop to--0.7% in 2009, but rose again to 3.04% in 2012. According to the Bank of Namibia, GDP grew at an estimated 4.8% in the first half of 2013. The main growth driver is the mining sector, especially diamond and uranium mining. The construction sector has grown significantly (estimated at 8%), in part due to Namibia's Targeted Intervention Programme for Employment and Economic Growth (TIPEEG). The programme was launched by the government in March 2011 in an effort to reduce Namibia's high unemployment rate (21.9%) by creating and retaining 104, 000 job opportunities.

Table 60: Key Figures for Namibia

Capital	Windhoek
Exchange Rate: 1 US$ =	10.19 Namibian Dollar (N$)
Population ^	2 259 393
Population growth rate (%) ^	1.87
Urban population (% of total) ^	38.96
Urbanisation rate (%) ^	3.35
GDP per capita (US$) ^	5 668.39
GDP growth rate (%, real) ^	3.04
GNI per capita, Atlas method (current US$) ^	5670
Population less than US$2 per day~	51.1
Population below national poverty line *	...
Gini co-efficient ~	63.9
HDI (Global Ranking)"	128
HDI (Country Index Score) "	0.608
Unemployment rate (%) *	27
Bank branches per 100 000 ^	7.10
Lending Interest Rate ^	8.65
Deposit Interest Rate ^	4.21
Credit % of GDP ^	50.56
Inflation	6.5
Ease of Doing Business Ranking (out of 185 countries)	87

Sources: ^ World Bank's World Development Indicators (2012), ~ World Bank PovcalNet: an online poverty analysis tool, various years; = www.coinmill.com on 26 August 2013; "UNDP's International Human Development Indicators (2012); * African Economic Outlook, various years; ! World Bank's Doing Business Survey Data (2013)

Table 61 shows that inflation has declined significantly, from 8.7% in 2009 to 4.5% in 2010. This was due to a drop in demand for agricultural outputs as well as a strong currency. The inflation rate averaged 6.5% during 2012, up from 5% in 2011. In August 2012, the Bank of Namibia brought the repo rate down to 5.5% after a slight increase earlier in the year.

Namibia is one of the least equal nations in the world; with a Gini coefficient of 63.9, there is a significant gap between the rich and the poor.

2 Access to Finance - Namibia

Namibia has one of the most developed financial systems in Africa, albeit with a number of significant limitations. Benefiting from close links with South Africa, Namibia's banking institutions are sophisticated, sound, profitable, and adequately capitalised. As a result of its strong financial foundation, the banking system has remained resilient to shocks emanating from the global and euro-area financial crises. The loans-to-assets ratio in the banking sector increased from 71.9% in December 2011 to 74.5% in December 2012, but remained below the international benchmark of 75.0%, while the loans-to-deposit ratio increased from 82.2% to 85.6% during the same period. Non-banking financial institutions are well capitalised, managing total assets amounting to almost N$ 100 billion (100% of GDP), 58% of which in December 2012 were managed by locally-based asset managers.

Table 61: Access to Finance - Namibia

#	Indicator	%	SSA Region
1	% of firms using banks to finance investment	8.1	18.0
2	Proportion of investment financed internally (%)	79.2	78.4
3	Proportion of investment financed by banks (%)	15.7	9.9
4	Proportion of investment financed by suppliers of credit (%)	1.6	3.8
5	Proportion of investment finance by equity or stock sale (%)	0.0	3.7
6	% of firms identifying access to finance as a major constraint	18.4	41.9

Source: Enterprise Surveys (http://www.enterprisesurveys.org), The World Bank 2006.

Despite the impressive performance by banks in Namibia, the level of credit extended to the productive sectors of the economy has not been encouraging. This is illustrated by the World Bank Enterprise Survey, which shows that only 8.1% of firms use banks to finance investment. Table 61 also illustrates this, showing that, of the total investment resources required, only 15.7% was financed by banks, 1.6% by trade finance credit, and the majority of the investment (roughly 79.2%) were financed using resources internally mobilised by entrepreneurs.

Namibia has a financing gap of 79.2% which needs to be filled by the financial system. For this reason, Namibia launched a Namibian Financial Sector Charter (NFSC) in May 2009, which will be in effect until 31 December 2019. The NFSC is a voluntary code of conduct for the transformation of the Namibian financial industry. Among its objectives are the

creating of greater access and affordability of financial products and services. There are specific targets regarding lending to previously disadvantaged members of the population. This should encourage greater lending by the financial sector. The NFSC was followed by a Namibia Financial Sector Strategy 2011-2021 (NFSS). In addition to putting these policies in place, the government has also created five development finance institutions to bridge the finance gap. These DFIs will form the basis of the discussion in the following sections.

3 Analysis of Development Finance Institutions of Namibia

The five development finance institutions set up by the Namibian government to increase access to financial services and to respond to the plight of the poor and small and medium enterprises (SMEs) consist of the Development Bank of Namibia (DBN), (which was formed from the Development Fund of Namibia), the Agricultural Bank of Namibia (Agribank), the National Housing Enterprise (NHE), SME Bank, and the Environmental Investment Fund of Namibia (EIF).

Table 62, below, shows the five development finance institutions, together with the economic sectors they cover, which include agriculture, industry, infrastructure, housing, microfinance and SMEs. Table 62 also shows that there is a duplication of mandates between DFIs, with some sectors covered by several DFIs.

Table 62: Sectoral Analysis in Namibia

Sector	Institution
Agricultural	Agribank, SME Bank
Industry	DBN
Infrastructure	DBN
Housing	NHE
Micro financing and SMEs	EIF, SME Bank

Source: 2012 Annual Reports

3.1 Agricultural Bank of Namibia (Agribank)

Agribank, although founded as the Agricultural Bank of Namibia, can trace its origins back to 1922, when it was first established as the Land and Agricultural Bank of South West Africa. In 1991, through the Agricultural Bank Amendment Act (No. 27 of 1991), the name Land and Agricultural Bank of South West Africa was amended to the Agricultural Bank of Namibia, commonly known as Agribank. The bank is wholly owned by the Government of Namibia.

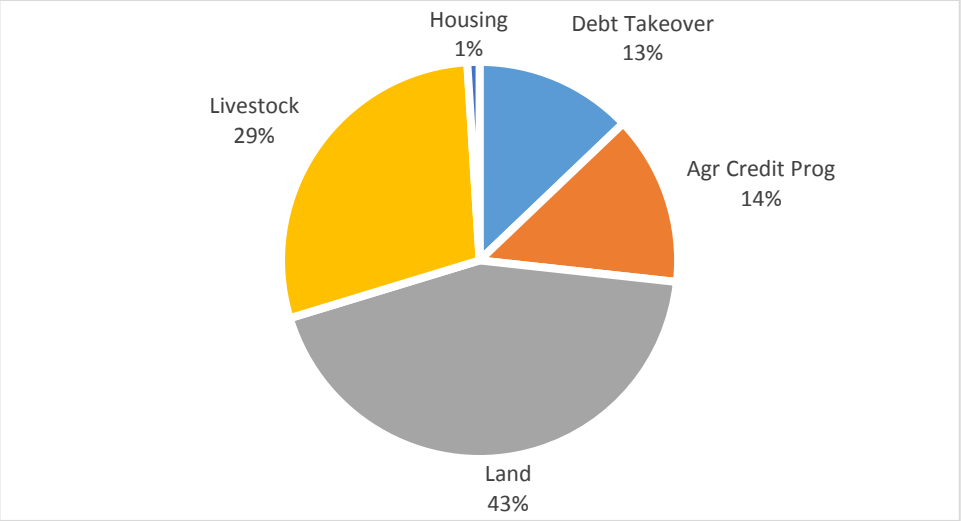
3.1.1 Agribank's Mandate

Agribank's mandate includes lending to farmers, cooperative companies and control boards in support of the agricultural sector. Agribank also manages agricultural schemes on behalf of government. Furthermore, Agribank provides housing loans for farm workers, as well as managing a number of special purpose funds on behalf of the Ministry of Lands and Resettlement, staff savings schemes, government ministries, and agricultural and farmers' unions.

3.1.2 Portfolio Analysis of Agribank

Figure 16 below shows that the bank approved a total of N$276.3 million worth of loans to the agricultural sector in 2012, of which livestock accounted for 29%, 43% went to commercial land purchases, 14% to the agriculture sector programme (which included the purchase of tractors, farm vehicles, drought relief, implements and clearing of the land), 13% to debt takeover, and roughly 1% was allocated to labourers housing scheme.

Chart 16: Resources Distribution by Sector for Agribank Namibia



Source: Agribank 2012 Annual Report

Chart 16 also shows that despite the Bank experiencing a mandate drift through funding of the housing sector, funding for this sector is relatively small and is focused on housing for farm workers. The bank's mandate can therefore be described as narrow and focused on agriculture and related activities.

3.1.3 Corporate Governance and Risk Management for Agribank

3.1.3.1 The Governing Legal Environment

Agribank is governed by two pieces of legislation: the Agricultural Bank of Namibia Act (Act No. 5 of 2003) and the State-Owned Enterprises Governance Act (Act No. 2 of 2006). The laws also call for the establishment of a Board of Directors, which is guided by the Board Charter, approved in 2010. The Charter sets out the board's role, responsibilities and the governance processes. The board meets monthly and is responsible for the policies, the management and control of the affairs of the Bank.

3.1.3.2 The Board

The board consists of five independent non-executive directors, including the chairman. The five non-executive directors are appointed by the Minister of Agriculture for a maximum of two three-year terms. The choice of directors is focused on retaining a balance of the skills, knowledge and experience necessary to achieve strategic objectives of the bank. The Chief Executive Officer attends board meetings as an ex-officio member.

The board of Agribank has delegated some of its responsibilities to five board subcommittees: the Human Resources, Audit, Risk, Credit and Executive Management committees. The Executive Management Committee consists representatives of all operational areas. This committee meets once a month and makes recommendations to the board on the policy and strategic direction of the bank.

3.1.3.3 Risk Management

The bank's activities expose it to a variety of financial risks, such as market risk, credit risk and liquidity risk. The bank's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimize their potential adverse effects for the bank. The board provides written principles for overall risk management, as well as written policies covering specific areas, such as credit risk and investment of excess liquidity. In addition, the board, through the Audit Committee, regularly monitors compliance to the regulating legislation.

Although the bank has a risk management framework, the quality of its loan book has deteriorated. Loans in arrears increased by N$ 17 million over the period under review, bringing arrears to N$ 254.1 million, or 15.4% of the gross loan book as at 31 March 2012.

Although the Bank has adequate security in place for most of its loans, the impact of poor debt collection on its liquidity remains a cause for concern.

3.1.4 Business Model of Agribank

Agribank's activities are mainly funded through shareholders' equity, resources from institutional investors such as the African Development Bank (AfDB), and various government schemes. The composition of the total funding during the period under review is shown in Table 63 below.

Table 63: Funding and Lending for Agribank (Million N$)

	2012 N$ Million	Breakdown (%)	2011 N$ Million	Breakdown (%)
Long-term	245.3	68.0	220.5	69.6
Short-term	115.3	32.0	96.3	30.4
Sub-total	360.6	100.0	316.8	100.0
Equity	1351.2		1,132.9	
Total Funding	1,711.8		1,449.7	
Lending	1,754.3	18.8↑	1,476.4	

Source: Agribank 2012 Annual Report

Table 63 shows that Agribank, at 68% long-term funding to total external funding in 2012, has predominantly long-term sources of external funding. This business model is sustainable since the bank's lending is likely to be long-term because of the nature of agricultural sector. The bank also has a low gearing ratio which gives it more room to increase its external borrowing.

The Government of Namibia has also played an important role in Agribank's operations. For instance, the government has in the past both repaid the bank's creditors and used the bank to support its social projects. This shows the importance that the Government of Namibia attaches to Agribank.

3.1.4 Financial Performance of Agribank

During the period under review, the Bank's total assets increased by 19%, from N$1,477 million in 2011 to N$1,754 million in 2012. The increase in total assets was mainly driven by an increase in current assets of 79% and an increase in non-current assets of 7%.

Table 64: Statement of Financial position Agribank Namibia

	2012 (N$ Million)	% change	2011 (N$ Million)
Assets			
Non-current assets	1,322.0	7.0	1,236.0
Current Assets	432.0	79.0	241.0
Total Assets	1,754.0	19.0	1,477.0
Liabilities and Equity			
Equity	1,351.0	19.0	1,133.0
Liabilities			
Short term liability	145.0		113.0
Long term liability	258.0		231.0
Total liabilities	403.0	17.0	344.0
Total Equity and Liabilities	1,754.0		1,477.0
Statement of Comprehensive Income			
Net Interest Income	124.0	12.0	111.0
Surplus (deficit) for the year	17.0	-19.0	21.0
Operating expenses	97.0	21.0	80.0
Impairment	24.0	-11.0	27.0
Key ratios	**%**		**%**
Return on Assets	1.0.0		1.4
Return on Equity	1.3.0		1.9
Net Profit margin	14.0		19.0
Operating cost as % of revenue	78.0		72.0
Impairment as % of NII	19.0		24.0
Operating & impairment as % of NII	98.0		96.0
Current ratio	3.0		2.1
Working capital	287.0	34.0	128.0

Source: Agribank 2012 Annual Report

Table 64 shows the following key facts about the financial performance of the Bank in 2011-2012:

- Net interest income grew by 12% while surplus for the year reduced almost 19%. This was mainly on account of a 21% increase in operating costs. The net effect was a reduction on the return on assets and return on equity.
- Operating costs as a percentage of NII were 78%, an increase from 72%. However, NII is still able to cover operating costs.
- Impairments went down by 11% in 2012, and as a result, impairments as a percentage of NII were 19%, down from 24% in 2011. This also shows that impairments can be covered by NII.

Together, operating costs and impairments were 98% of NII, a slight increase from 96% in 2011. This shows that the institution is sustainable, as NII can cover both operating costs

and impairments. The bank should seek, however, to reduce the percentage by managing costs more effectively.

3.2 Development Bank of Namibia Limited (DBN)

The Development Bank of Namibia was created in 2002 by the Development Bank of Namibia Act (No. 8 of 2002) by taking over the assets of the Development Fund of Namibia. The Bank was established as a public company, incorporated with share capital, under the Namibian Companies Act.

3.2.1 DBN's Mandate

The mandate of the Bank is to contribute to the economic growth and social development of Namibia and to the sustainable promotion of the welfare of the Namibian people. To carry out this mandate, the bank does the following: (a) mobilizes financial and other resources from the private and public sectors, nationally and internationally; (b) appraises, plans and monitors the implementation of development schemes, export projects and other economic programmes of national importance; (c) facilitates the participation of the private sector and community organizations in development schemes, export projects and other economic programmes of national importance; and (d) assists in the development of money and capital markets.

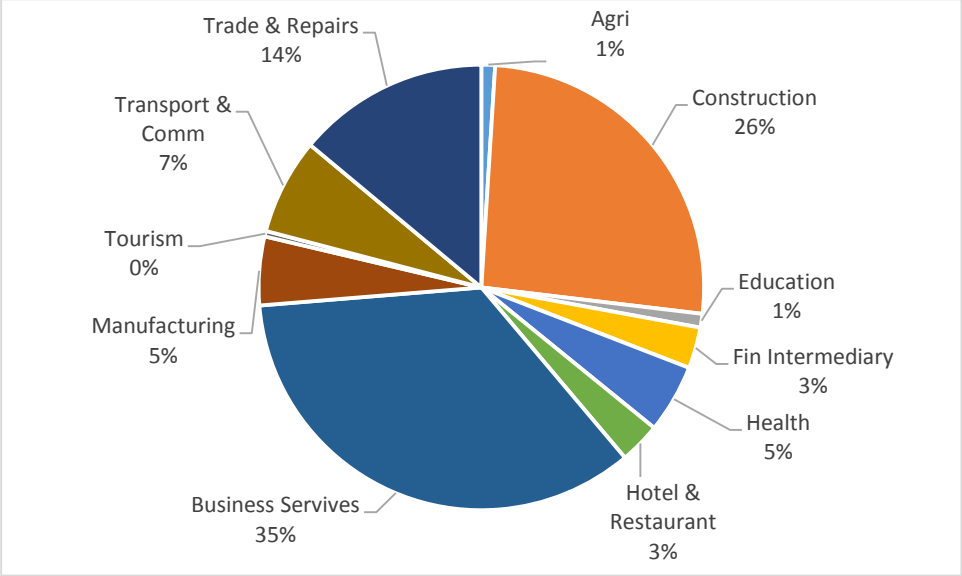
The bank largely provides finance for infrastructure projects and enterprise, in order to create employment opportunities in Namibia and to act as a catalyst for the mobilization of financial capital for the sustainable economic development of Namibia. This mandate, as will be seen in the following section, is broad.

3.2.2 Portfolio Analysis of DBN

In 2011-2012, the Bank financed projects in all fourteen regions of the country, in line with the government's effort to advance growth with equity. The projects financed fall into three main categories: infrastructure, the private sector, and the SME sector. The key areas of interest for the Bank are linked to those of Namibia's Fourth National Development Plan (NDP4), namely Manufacturing, Tourism (Services), Transport, Logistics and Communications. Operations in the private sector include manufacturing and the processing of natural resources, fishing, mining and tourism. During 2011 and 2012, the DBN approved loans valued at N$ 519.1 million, bringing the total approvals of loans from its inception to

the end of 2012 to N$ 2.9 billion. The breakdown of the total loans is shown in Figure 17 below.

Figure 17: Resources Distribution by Sector for DBN



Source: DBN 2012 Annual Report

Figure 17 shows that the Business Services, Trade and Repairs, and Construction sectors accounted for 75% of the total investment of N$519.1 million. Loans to the private sector made up 54.6% of the 45.4% loaned to the SME sector.

3.2.3 Corporate Governance and Risk Management for DBN

3.2.3.1 The Governing Legal Environment

The DBN board is constituted according to the provisions of the Development Bank of Namibia Act (No. 8 of 2002). The board reports to the Minister of Finance as its line ministry and shareholder representative. The board consists of seven members, three, plus the chairperson, appointed by the Minister of Finance and three others appointed by the shareholders of the bank other than the government. If the government is the only shareholder, then the Minister of Finance appoints all the board members. The Minister of Finance appointed the first Chief Executive Officer, but thereafter the CEO is appointed by the board of directors.

The bank does meet the King III requirements and the Namibian Code on Corporate Governance, although it is not required to do so as it is not a listed entity on the stock exchange.

The shareholder (i.e., the government, represented by the Minister of Finance) and the DBN have signed a governance agreement containing the shareholder's expectations in the form of predetermined objectives and key performance indicators, which ensures that the board of directors acts in accord with the shareholder's expectations.

3.2.3.2 The Board

Currently the board is made up of six non-executive Board members of whom all are independent, and all of whom are currently appointed by the Minister of Finance. In the event that other stakeholders take up equity in the Bank, the Minister will appoint directors proportionate to the government's shareholding. The CEO is the only executive director. The Board has established five board subcommittees: the Audit, Risk and Compliance Committee, the Credit and Investment Committee, the Asset and Liability Committee (ALCO) and the Human Capital and Remuneration Committee.

3.2.3.3 Risk Management

The board of directors has overall responsibility for the establishment and supervision of the Bank's risk management framework. They have established the Risk and Compliance Committee which is responsible for developing and monitoring the Bank's risk management policies. The Committee has responsibility and accountability for the following core risk functions: internal and external audit, and enterprise-wide risk management through monitoring and managing the financial risks relating to the operations of the bank. The Committee produces internal risk reports which analyse exposures by degree and magnitude of risks. These risks are measured against the board-approved risk appetite of the bank using the sustainability model, which also includes market risk, pricing risk, credit risk, investment risk, liquidity risk, operational risk and cash flow interest rate risk.

Notwithstanding the risk management tools in place, the Bank has experienced an increase of non-performing loans of 159%, which translates to N$129.4 million, between 2011 and 2012.

3.2.4 Business Model of DBN

Since its establishment, the activities of DBN have always been funded through shareholders' equity and specific government allocations to support targeted lending. The composition of the total funding during the two years under review is shown in Table 65 below.

Table 65: Funding and Lending for DBN (Million N$)

	2012 N$ Million	Breakdown (%)	2011 N$ Million	Breakdown (%)
Long-term	17.4	63.5	---	0.0
Short-term	10.0	26.5	---	0.0
Sub-total	27.4	100.0	---	0.0
Equity	1,984.4		1,583.3	
Total Funding	2,011.8		1,583.3	
Lending	1,459.7		1,354.0	

Source: DBN 2012 Annual Report

Table 65 shows that DBN, at 63.5% long-term total funding in 2012, has predominantly long-term sources of shareholder funding, generally from government grants and government equity capital injections. The only external funding is made up of overdrafts available from (but not utilised to date) local financial institutions. This business model, though sustainable, shows that Bank has not yet leveraged its balance sheet to mobilise external capital, other than from government. It must, however, be noted that in the long term the business model followed by DBN (where there are very few external resources being mobilised by using the bank's balance sheet) may result in a lack of resources if and when the government of Namibia decides to stop further funding or to reduce funding because of the perceived adequacy of the DBN's ability to raise its own external funding, the government's obligations to support other DFIs or the constraints on the fiscus. For this reason, DBN needs to make use of its equity or strong balance sheet to mobilise external resources.[39]

3.2.5 Financial Performance of DBN

Table 66 indicates that during the period under review, the DBN expanded its lending through increased share capital from the Government of Namibia in 2012. As a result, both assets and equity increased by about 30% in 2012. The financial performance was sound and the ratio of equity to total assets was very high at 98%.

[39] Currently the gearing ratio is very low, which gives the Bank the ability to mobilise external resources.

Table 66: Statement of Financial position DBN

	2012 N$ Million	% change	2011 N$ Million
Assets			
Loans and advances	1389.0	12.0	1237.0
Other Non-current Assets	126.0	-26.0	171.0
Current Assets	**515.0**	164.0	**195.0**
Total Assets	2030.0	27.0	1603.0
Liabilities and Equity			
Equity	1984.0	25.0	1583.0
Liabilities			
Short term liability	46.0	130.0	20.0
Total liabilities	46.0	130.0	20.0
Total Equity and Liabilities	**2030.0**	27.0	**1603.0**
Statement of Comprehensive Income			
Net Interest Income	132.0	48.0	89.0
Profit for period	92.0	163.0	35.0
Operating expenses	51.0	28.0	40.0
Net impairment of loans and advances	78.0	271.0	21.0
Key ratios			
Return on Assets	5.0		2.0
Return on Equity	5.0		2.0
Net Profit margin	70.0		39.0
Operating expenses as % of NII	39.0		45.0
Impairment as % of NII	59.0		24.0
Current ratio	11.0		10.0
Working capital	469.0		175.0

Sources: DBN 2012 Annual Report

Table 66 also gives a summary position of the bank's financial performance on selected key indicators:

- Net interest income over the period grew by 48%. This healthy growth led to an increase in the net profit margin from 39% in 2011 to 70% in 2012. The growth in profits was also attributable to the prudent management of operational costs, as evidenced by the reduction of the ratio of operating costs to net interest income from 45% in 2011 to 39% in 2012;
- Impairments as a percentage of net interest income increased from 24% to 59%. This was the result of the introduction of a new impairment model under the new Credit and Equity Investment Policy, which resulted in additional provisions being raised;

- Nevertheless, operating expenses and impairments combined accounted for 98% of net interest income, showing that the Bank is sustainable on operating income;
- The balance sheet management of the Bank seems relatively conservative with very little debt, all of which was in the short-term form. As a result, ROA and ROE were both not high at 5%; and
- While the DBN was able to demonstrate its conservative lending, the bank has not yet decided to leverage its balance sheet to mobilise resources from the international capital market, local markets or ICPs.

In summary, the Bank is financially sustainable, although in the medium to long term it needs to pay attention to both the mobilisation of external resources and the management of the credit portfolio, so that the possibility of any increase in NPLs (which stood at 14% in 2012 and 6.26%: 2011) is reduced.

3.3 National Housing Enterprise (NHE)

The National Housing Enterprise (NHE) is a wholly state-owned enterprise, established by the National Housing Enterprise (Act 5 of 1993). The Enterprise was established as a parastatal of the Ministry of Regional and Local Government and Housing to provide innovative housing solutions to national housing needs. It replaced the National Building and Investment Corporation (NBIC) and took over its loan book.

3.3.1 Mandate of NHE

The NHE's mandate is to contribute to the economic growth and social development of Namibia. It also provides for development of the Namibian people by enabling communities and individuals to house themselves, through countrywide access to loans, investment opportunities, serviced land, and the advice and support that they may need to acquire or erect a shelter of an acceptable standard and at a cost affordable to them.

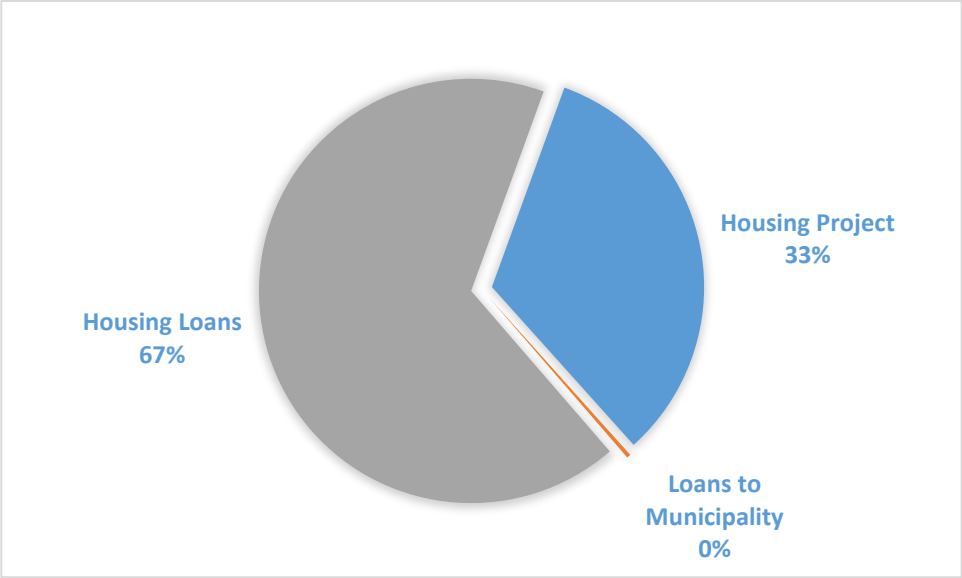
The NHE achieves its mandate through:

- Mobilising financial and other resources from both the private sector and the public sector;
- Appraising, planning and monitoring the implementation of development schemes;
- Facilitating the participation of private sector and community organisations in development schemes; and
- Assisting in the development of the money and capital markets.

3.3.2 Portfolio Analysis of NHE

Of the total available resources of N$599.7 million in 2012, 67% was allocated to individual customers, 0.03% to municipalities, and 33% was invested in property (project houses). Figure 18 below shows the distribution of the resources among the three key segments.

Figure 18: Resources Distribution by Sector



Source: NHE 2012 Annual Report

Figure 18 shows that the bulk of the financial support went to individual private clients, followed by property development, mainly of houses, which is carried out by the National Housing Enterprise. The Enterprise's mandate is thus narrow and focused.

3.3.3 Governance and Risk Management for NHE

3.3.3.1 The Governing Legal Environment

The NHE is a wholly government-owned institution whose accountability to the Ministry of Regional and Local Government, Housing and Rural Development was formalised by the NHE Act (No 5 of 1993). The Enterprise has adopted a scheme of corporate governance and risk management.

3.3.3.2 The Board

The board has five non-executive directors, all appointed by the Minister of Regional and Local Government, Housing and Rural Development, in accordance with the NHE Act. The board is chaired by a non-executive director and meets quarterly. It has overall control over the company and monitors the activities and decisions of executive management. In order to

ensure a separation of powers, nobody may be simultaneously Chairman and Chief Executive Officer.

3.3.3.3 Risk Management

Currently, the NHE does not have a risk management framework. It is nevertheless NHE subject to the SOE Governance Council (SOEGC). As well, the Enterprise is equipped with fully integrated software. This software allows the enterprise to manage its risk portfolio, back-end financial accounting and reporting functions, as well as front-end activities such property sales, sales administration, document tracking, renovations, progress billings, sales receivables, warranty periods, tenancy agreements, tenancy receivables and utility billings. This means that the NHE is able to make fully-informed management decisions. Despite the lack of a risk management framework, the Enterprise managed to maintain its NPL portfolio ratio at 9% until 2012, when it rose to 10%.

3.3.4 Business Model for NHE

In the past, NHE was financed by the Namibian, German and Chinese governments, but this is no longer the case. The NHE borrows money from the financial sector and it is also authorized to take deposits. Additional resources are generated from the developing and financing of new houses through various housing projects carried out by the Enterprise. The composition of the total funding over the two years under review is shown in Table 67.

Table 67: Funding and Lending for NHE (Million N$)

	2012 N$ Million	Breakdown (%)	2011 N$ Million	Breakdown (%)
Long-term	29.9	32.2	32.8	32.5
Short-term & OD	62.6	67.8	68.1	67.5
Sub-total	92.7	100.0	100.9	100.0
Equity	497.7		494.4	
Total Funding	560.4		595.3	
Lending & Invest.	599.8	6.9↑	561.4	

Source: NHE 2012 Annual Report

Table 67 shows that the NHE has predominantly short-term sources of external funding (67.8% of total external funding in 2012 was short-term) and has mainly borrowed money from the financial sector. This business model is not sustainable since the Enterprise's lending and projects are likely to be long-term owing to the nature of the economic sector being supported. Given the fact that the Enterprise needs to roll over its short-term financing

periodically, there is a funding risk as the Enterprise may not be able to recall its investment or housing if its liabilities were recalled at short notice.

Table 67 also shows that, in 2012, the Enterprise had a low gearing ratio at 25.25%. What this means is that the NHE can still increase its loan and investment portfolio by mobilising more external resources from the market, using its balance sheet. For this reason, the Enterprise needs to revisit its business model, with a view to increasing its external resources and its ratio of long-term to short-term funds.

3.3.5 Financial Performance of NHE

The NHE has not received any financial support from the Namibian government since its initial capitalisation. However, the Central Government recently pumped N$85 million into the NHE for the 2011/12 fiscal year. Although welcome, it is just a small fraction of the funding needed, as far as the speeding-up of housing delivery is concerned. For instance, the NHE undertook to develop 200 houses on un-serviced land in Windhoek, an initiative which cost N$35 million. At that rate, the N$85 million capital injection could only construct approximately 485 houses. This is a shortfall from the target of 1,200 houses per annum. Thus, meeting the annual target would require financial resources in the region of N$500 million per annum.

The NHE is scheduled to receive a capital injection of N$1 billion under the Targeted Intervention Programme for Employment and Economic Growth (TIPEEG) dispensation. Of that, N$131 million is earmarked for land servicing while N$898 million will be put towards the construction of low-income housing units. While this is a good initiative, one wonders why this money is being earmarked for the direct funding of housing development instead of strengthening the balance sheet of the Enterprise.

Table 68: Statement of Financial position NHE

	2012 N$ Million	% change	2011 N$ Million
Assets			
Project houses and work in progress	197.0	44.0	137.0
Other Non-current Assets	346.0	(7.0)	371.0
Current Assets	135.0	(10.0)	150.0
Total Assets	**678.0**		**658.0**
Liabilities and Equity			
Equity	498.0	**1.0**	494.0
Liabilities			
Short term liability	140.0	15.0	122.0
Non-current liabilities	40.0		42.0
Total liabilities	180.0		164.0
Total Equity and Liabilities	**678.0**		**658.0**
Statement of Comprehensive Income			
Net Interest Income	38.0	(24.0)	50.0
Profit for period	(22.0)	(120.0)	(10.0)
Operating expenses	61.0		65.0
Net impairment of loans and advances	(8.0)		2.0
Key ratios			
Return on Assets	(3.0)		(152.0)
Return on Equity	(4.0)		(2.0)
Net Profit margin	(58.0)		(20.0)
Operating expenses as % of NII	161.0		130.0
Impairment as % of NII	21.0		4.0
Current ratio	1.0		1.2
Working capital	(5.0)		28.0

Source: NHE 2012 Annual Report

The financial position of the Enterprise, as shown in Table 68, can be summarised as follows:

- During the period under review, Net Interest Income decreased by 24%. This, coupled with the increase in impairments, led to a reduction in profit for the year by 120%.
- Project houses and work in progress increased by 44%, leading to an improvement in return on assets from -152% to -3%. This increase in project houses and work in progress was partially financed by short-term liabilities, as can be seen by the 15% increase in short-term liabilities. This put pressure on liquidity, which shifted from N$28 million to a negative working capital position of N$ 5 Million. This creates liquidity risk; and

- Operating expenses as a percentage of NII stood at 161% in 2012, worse than the 130% of 2011.

All these clearly show that NII is not able to cover operating expenses, making the Enterprise unsustainable in the medium to long term.

3.4 The Environmental Investment Fund of Namibia (EIF)

The Environmental Investment Fund (EIF) is a financial institution wholly owned by the Government of Namibia. It was established by the Environmental Investment Fund of Namibia Act (No 13 of 2001). The Environmental Investment Fund is classified as a state–owned enterprise whose main objective is to procure funds for the maintenance of an endowment that will generate a permanent stream of income for use in the protection of the environment and the prudent management of natural resources.

3.4.1 The EIF's Mandate

The mandate of EIF is to mobilise financial resources for direct investment in environmental protection and natural resource management activities and projects. The Fund is not only meant to support conservation activities but also supports a broader investment portfolio by providing economic opportunities and a stake in the use of natural resources to the poorest sectors of the society.

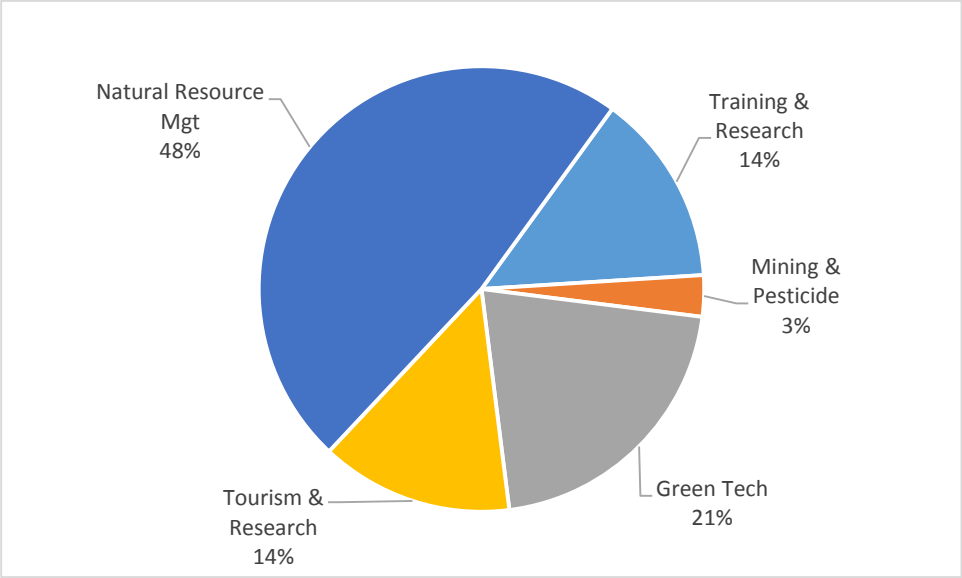
The ultimate goal is to improve the economic well-being of this economic sector and therefore reduce the possibility of people pursuing activities that degrade Namibia's fragile environment and waste natural resources.

The government of Namibia is expected to provide the EIF with a secure source of long-term funding for environmental and natural resource projects and activities with Namibian control, direction and priority setting.

3.4.2 Portfolio Analysis EIF

Since its inception, the EIF has approved 27 projects, awarding grants amounting to N$7.2 million. Natural Resource Management accounted for 51.4% of the total grants disbursed and Green Technology and Low-Carbon Development for 21%. The remaining funds were divided among sectors such as Training and Research, Tourism and Research and Mining and Pesticides. Figure 19 shows the distribution of resources by focal area.

Figure 19: Resources Distribution by Sector for EIF



Source: EIF 2012/13 Annual Report

Most of the grants went to the natural resource sector, which is in line with the Fund's original mandate. The distribution of resources also shows that the EIF's mandate is narrow and that the management is maintaining its focus.

3.4.3 Corporate Governance and Risk Management for EIF

3.4.3.1 The Governing Legal Environment

The EIF's foundational Act (2001) establishes the regulatory policy of the Fund, the basis for the operations of the board and the CEO, and the powers of the Minister of Environment and Tourism, who is the legislating Minister.

3.4.3.2 The Board

Currently, EIF is managed by a gender-balanced board consisting of five members and appointed by the Minister of Environment and Tourism. The board meets four times a year, or as necessary, to consider all matters relating to the overall control, business performance and strategy of the Institution.

The Board has established committees consisting of non-executive directors, to which it has delegated some of its functions. These committees include the Technical Advisory Panel, which advises the board on technical matters. The members of the panel in conjunction with selected committee members (e.g. from the technical, Monitoring and Evaluation, and funding and investment committees) appraise and recommend proposals for the Board's approval.

3.4.3.3 Risk Management

The board of directors is responsible for risk management. It is in charge of reviewing the effectiveness of the institution's system of internal control, including internal financial control, which is designed to provide reasonable, but not absolute, assurance regarding (a) the safeguarding of assets against unauthorized use or disposition and (b) the maintenance of proper accounting records and the reliability of financial information used within the business or for publication. As well, the Fund needs to put in place a risk management framework which will safeguard the resources provided by the Fund.

Business Model of EIF

The EIF's activities are mainly funded through grant resources from the government of Namibia, coupled with expected donor support. At the inception of the Fund the government of Namibia provided approximately N$15 million in its budgetary allocations. International donors were expected to provide N$21 million. The EIF Act also gives the Minister of Environment and Tourism the power to impose levies to provide resources for the EIF. While this principle is sound, it might not be sustainable in the long term, especially when one considers the trend of governments world over to reduce the funding of DFIs. The composition of the total funding over the two years under review as is shown in Table 69 below.

Table 69: Funding and Lending for EIF (Million N$)

	2013 N$ Million	Breakdown (%)	2012 N$ Million	Breakdown (%)
Long-term	---			
Sub-total	---			
Equity	48.6	32.4	36.7	
Total Funding	48.6		36.7	
Lending & Invest.	4.4	42.0	3.1	

Source: EIF 2012 Annual Report

Table 69 shows that all the EIF activities primarily funded by equity. Although there was a significant increase in the level of government equity contribution between 2012 and 2013, it is unlikely to increase significantly over the short to medium term. Furthermore, this business model is not sustainable. The Fund needs to come up with a viable business model which will strengthen its balance sheet and enable it to mobilise external resources from the market.

3.4.5 Financial Performance of EIF

EIF is a relatively new institution and has been in existence for only four years, some of which were devoted to setting up the institution. For this reason the only complete set of data available, on which the analysis is based, was for the financial year 2012 and 2013.

Table 70 shows that during 2012 and 2013, EIF posted an increase in total assets from N$38 million in 2012 to N$51 million in 2013, and this increase was mainly attributed to a 35% increase in short-term deposit investments. In addition, the Fund also experienced a corresponding increase of 32% in equity, which was mainly due to an increase in government contribution.

Table 70: Statement of Financial position for EIF

	2013 (N$ Million)	% change	2012 (N$ Million)
Assets			
Non-current assets	1.0		0.7
Current Assets	50.0		37.0
Total Assets	51.0	35.0	38.0
Liabilities and Equity			
Equity	49.0	32.0	37.0
Liabilities			
Short term liability	2.0	67.0	1.2
Long term liability	-		-
Total liabilities	2.0		1.0
Total Equity and Liabilities	51.0		38.0
Statement of Comprehensive Income			
Grant received	20.0	18.0	17.0
Surplus (deficit) for the year	12.0	(25.0)	16.0
Operating expenses	9.6		2.4
Key ratios			
Return on Assets	23.5		42.5
Return on Equity	24.5		43.2
Net Profit margin	60.0		94.0
Operating cost as % of revenue	48.0		14.0
Current ratio	25.0		30.8
Working capital	48.0	34.0	35.8

Source: EIF 2013 Annual Report

Table 70 summarises the financial performance of EIF as follows:

- EIF appears to be a stable institution with net assets of N$51 million. This is an increase of 35% from the previous year. Net working capital is high, at N$ 48 million, which is an increase of 34% from the previous year;

- Profitability is also positive, with Return on Assets and Return on Equity both above 20%; and
- Operating expenses as a percentage of grants received is sitting at 48%, showing that revenue covers operating costs.

In conclusion, though the EIF's financial position appear to be sustainable, it should be noted that without the grants revenue, the institution would not survive. For this reason, the EIF needs to find a business model which would both sustain the institution in the medium–to-long term and fulfil its mandate.

3.5 SME Bank Limited, Namibia (SME Bank)

The SME Bank was founded by the Government of Namibia through the Companies Act, after the dissolution of the Small Business Credit Guarantee Trust (SBCGT). 65% of the Bank is owned by the Government of Namibia through the Ministry of Trade and Industry, and 35% by the private sector (foreign investors). The Bank is a joint venture in the form of a public-private partnership.

3.5.1 SME Bank's Mandate

The core mandate of the Bank is to provide affordable access to finance, especially to the Small and Medium-Size Enterprises (SMEs) sectors in Rural Communities and to Micro-Enterprises and Previously Disadvantaged Individuals (PDIs). The Bank also acts as a conduit for government-sponsored programmes. Although the mandate of the Bank is skewed towards financing SMEs, it offers various other services to individuals and companies, such as retail banking, corporate banking, and treasury and investment. All these services are offered because the bank has a full commercial banking licence.

3.5.2 Portfolio Analysis for SME Bank

As noted above, the SME Bank mostly focuses on the SME sector. This sector is traditionally and generally perceived as high-risk, and requires a developmental approach whereby it will be supported with medium- to long-term funding and mentorship.

In terms of its portfolio performance, within a period of one and a half years the Bank has managed to mobilise resources from over 5000 clients who have opened deposit accounts with the Bank. The Bank has also assisted over seven hundred SME clients since inception with a total of N$40 million worth of loans. The Bank is expected to increase its level of

assistance to SMEs with the expected injection of N$630 million of resources by the government.

3.5.3 Corporate Governance and Risk Management for SME Bank

3.5.3.1 The Governing Legal Environment

The Bank is wholly owned by the Government of Namibia and is governed by the Companies Act, under which the Bank was established, and the Bank of Namibia Banking Institutions (Act No. 2 of 1998), as amended. Sections 10 to 13 of the Banking Institutions set out in part the essential requirements for the authorisation process, which includes among other things:

- capital requirements as specified in section 28 of the Act;
- fitness and properness of shareholders, directors, and officers of the bank; and
- the structure and shareholding of the Company.

3.5.3.2 The Board

Currently the Board of Directors of the SME Bank has seven board members, one of whom is the executive director; the remaining six are non-executive directors. Board members are appointed subject to Central Bank ratification. The board meets at least four times per year to deal with policy, as well as operational issues which require board input.

3.5.3.3 Risk Management

The board of directors of SME Bank is responsible for risk management. The board is in charge of reviewing the effectiveness of the institution's system of internal control, including internal financial control, which is designed to provide reasonable, but not absolute, assurance regarding (a) the safeguard of assets against unauthorized use or disposition and (b) the maintenance of proper accounting records and the reliability of financial information used within the business or for publication. The Bank has put in place both a governance and risk management framework and a risk management unit, which is charged with identifying, monitoring, managing and mitigating risks. Since the Bank is relatively young, it was not possible for the project team to gauge the effectiveness of the bank's risk management.

3.5.4 SME Bank's Business Model

SME Bank, as both a DFI and a commercial bank, is expected to fund its activities through resources mobilised from shareholders' equity, government budget, deposits, and the capital market. Table 71 shows the composition of funding over the two years under review.

Table 71: Funding and Lending for SME Bank

	2013 N$ Million	Breakdown (%)	2012 N$ Million	Breakdown (%)
Long-term	---		---	
Short-term	256.0	100.0	2.0	100.0
Sub-total	256.0	100.0	2.0	100.0
Equity	98.0		130.0	
Total Funding	354.0		132.0	
Lending & Invest.	255.0	443↑	47.0	

Source: SME Bank 2012 Management Report

Table 71 shows that during the period under review, the Bank was mainly funded through short-term deposits, which stood at 100% of external funding. This funding was coupled with shareholders' equity from the Government of Namibia and the private sector. This funding structure is not sustainable if the Bank follows its mandate of providing medium- to long-term funding to SMEs as short-term funding is likely to introduce liquidity risk and ultimately funding risk.

3.5.5 Financial Performance of SME Bank

As there were no audited accounts or financial statements available from the Bank, the analysis of financial performance was not carried out.

4 Co-ordination, Regulation and Supervision of DFIs in Namibia

4.1 Co-ordination

Currently, Namibia has five development finance institutions, including Agribank, the Development Bank of Namibia, the Namibia Housing Enterprise, the Environmental Investment Fund of Namibia, and the SME Bank Limited.[40] As indicated in Table 72 below, two of these institutions fall under the Ministry of Finance, while each of the remaining three under a separate parent Ministry.

[40] SME Bank, by virtue of its mandate, is a DFI.

This situation, with DFIs having different reporting lines, clearly shows the lack of an overarching policy for coordinating these institutions. Furthermore, this lack of coordination of DFIs introduces a number of problems, which include: (a) mandate duplication among DFIs, and (b) inefficient use of public resources, as they are thinly spread among different DFIs.

Table 72: Co-ordination, legal and Regulation of DFIs- Namibia

Institutions	Legal and ownership	Co-ordinator	Regulator
1. Agricultural Bank of Namibia (Agribank)	• Landbank Act No. 13/1944, amended through Act No. 5 of 2003 • Wholly owned Government	• Ministry of Finance	• Own Act
2. Development Bank of Namibia (DBN)	• Development Bank of Namibia Act 8 of 2002 • Wholly owned Government	• Ministry of Finance	• Own Act
3. National Housing Enterprise (NHE)	• National Housing Enterprise Act, 1993 • Wholly owned Government	• Ministry of Regional and Local Government and Housing	• NAMFISA
4. The Environmental Investment Fund of Namibia (EIF)	• EIF Act of Parliament No 249, 2001 • Wholly owned Government	• Ministry of Environment and Tourism	• Own Act
5. SME Bank Limited, Namibia (SME Bank)	• Companies Act • Majority owned by the Government (65%)	• Ministry of Trade and Industry	• Bank of Namibia

Sources: Land bank Act No. 13/1944, Development Bank of Namibia Act 8 of 2002, National Housing Enterprise Act, 1993, EIF Act of Parliament No 249, 2001

4.2 Regulation and Supervision

Table 72 also shows that of the five development finance institutions discussed in this chapter, four (Agribank, the EIF, DBN and the NHE) are exempt from the provisions of the Banking Institutions Act (Act No. 2 of 1998) and are governed by their own separate Acts. The other DFI, SME Bank, is the only one which is regulated by the Bank of Namibia under the Banking Institutions Act. There is clearly no common regulatory policy framework for the DFIs.

5 Conclusion

While access to finance in Namibia is better than in other SADC Member States, it is still very limited, owing to the structure of the Namibian economy. On the one hand, there is pervasive rural poverty, a growing population of urban dwellers who suffer from widespread unemployment, and low population density. On the other hand, the existence of a considerably affluent population segment and a corporate business sector provides steady profit opportunities for existing institutions. Consequently, the financial system has organized itself to serve these segments of the economy and has so far not ventured away from the existing clientele. The Government has been working to bridge the financing gap, especially in the areas of social and economic development. This is being done in a targeted manner through the execution of the Namibia Financial Sector Strategy (NFSS) mentioned above.

Key findings on the development finance system of Namibia are that:

- Namibia has a relatively well-developed financial sector. However, despite this, the country still has a huge development finance gap. DFIs have a role to play in the filling of this gap;;
- Most DFIs currently operating in Namibia are well capitalised, with government actively supporting their efforts;
- Despite the support from the Government, there is no uniform statutory approach to establishing DFIs in Namibia, which can be attributed to the different legislation under which each of the DFIs has been established;
- With the exception of AgriBank, the mandates of the DFIs are generally broad and they exhibit a certain level of mandate overlap;
- Namibian DFIs do not have mandates to fund projects outside the country;

- While the funding models for AgriBank and DBN are in line with typical development finance models, the rest appear not to be. Further, all the DFIs in Namibia appear to have very low gearing ratio and this may be attributed to a lack of resource mobilisation strategy on the part of some of the DFIs;
- Only three DFIs are financially sustainable, one is relatively new, and the remaining one is not financially sustainable;
- DFIs lack uniform risk-management frameworks;
- Some aspects of corporate governance are not consistent with best practice;
- There is no overarching policy framework for coordinating the activities of DFIs in Namibia. Although the government is the sole shareholder in all five DFIs, each institution reports to a different line ministry: the Ministry of Agriculture, the Ministry of Environment and Tourism, the Ministry of Finance, and the Ministry of Regional, Local Government, Housing and Rural Development; and
- Despite one DFI being regulated by the Central Bank of Namibia, generally there is a lack of regulatory framework for DFIs, with the result that there is no uniform regulation of these specialised financial institutions.

COUNTRY STUDY 8: SEYCHELLES

The SADC DFRC Project Team of Dr. Lufeyo Banda and Dr. Herrick Mpuku held discussions in Seychelles (31 March - 2 April 2014) for the SADC DFI Scan study. The summary review below is based on the collected information and the discussions with representatives from the Ministry of Finance, the Central Bank and the Development Bank of Seychelles, the Seychelles Business Finance Agency, the Small Enterprise Promotion Agency (SEnPA) and Seychelles Housing Financing Corporation.

1 Background on Seychelles

The Seychelles is a tiny country, comprising 115 islands covering a wide geographical area in the Indian Ocean, northeast of Madagascar. With a small population of only about 90,000 people (2011 estimate), the Seychelles has one of the highest Human Development Indices in the SADC region, while ranking 57th globally. The Seychellois economy is heavily dependent on the global economic environment. Tourism dominates the economy and is the main employer. Fishing is the country's most important export sector, accounting for over 80% of export revenues, although it contributes only 11% of employment.

Table 73: Key Figures for Seychelles

Capital	Victoria
Exchange Rate: 1 US$ =	12.01 Seychelles Rupee (Rs)
Population ^	87 785
Population growth rate (%) ^	0.39
Urban population (% of total) ^	54.01
Urbanisation rate (%) ^	1.11
GDP per capita (US$) ^	11 758.04
GDP growth rate (%, real) ^	2.80
GNI per capita, Atlas method (current US$) ^	11 640
Population less than US$2 per day~	1.84
Population below national poverty line *	...
Gini co-efficient ~	65.77
HDI (Global Ranking)"	57
HDI (Country Index Score) "	...
Unemployment rate (%) *	5.45
Bank branches per 100 000 ^	37.21
Lending Interest Rate ^	12.19
Deposit Interest Rate ^	3.30
Credit % of GDP ^	38.83
Inflation	7.1
Ease of Doing Business Ranking (out of 185 countries)	74

Sources: ^ World Bank's World Development Indicators (2012), ~ World Bank PovcalNet: an online poverty analysis tool, various years; = www.coinmill.com on 26 August 2013; "UNDP's International Human Development Indicators (2012); * African Economic Outlook, various years; ! World Bank's Doing Business Survey Data (2013)

As indicated in Table 73, GDP growth slowed considerably in 2012, down to 2.8%, as a result of the global financial crisis and a slowdown in the tourism sector. The economy is expected to recover and grow by 3.2% in 2013 and by 2.8% in 2014. Inflation has fluctuated considerably in the past few years as a result of the float of the rupee in 2008 and the pass-through effect. Rising from about 5.3% in 2007, the rupee peaked at 37% in 2008, and by 2010 had dropped to a rate of –2.4%, owing to the stability of commodity prices, the adjustment of monetary policies and the emergence of more conservative bank lending. In

2011, the average rate of inflation was 2.6%, and the rate fluctuated through 2012 to end the year at 7.1%.

2 Access to finance – Seychelles

The Seychelles has a relatively well-developed financial system. Nine banks are listed on the Central Bank of Seychelles website, together with 12 'class A' exchange bureaux and 12 'class B' exchange bureaux. Seychelles has four development finance institutions: the Development Bank of Seychelles, the Seychelles Business Finance Agency (SBFA), the Housing Finance Company and the Small Enterprise Promotion Agency (SEnPA). The Seychelles also has four domestic insurance companies, five non-domestic insurance companies and multiple insurance intermediaries. The two largest banks have a 69.5% share in the financial system's total assets.

Table 74: Access to Finance - Seychelles

#	Indicator	%	SSA Region
1	% of firms using banks to finance investment		---
2	Proportion of investment financed internally (%)		---
3	Proportion of investment financed by banks (%)		---
4	Proportion of investment financed by suppliers of credit (%)		---
5	Proportion of investment finance by equity or stock sale (%)		---
6	% of firms identifying access to finance as a major constraint		---

Source: Surveys (http://www.enterprisesurveys.org), The World Bank.

Although there is a lack of data from the World Bank Enterprise Surveys, access to finance in the Seychelles is said to be moderate. The International Monetary Fund reports that there are 37.21 commercial bank branches per 100 000 adults and 67.39 ATMs per 1 000km2. Outstanding loans from commercial banks as a percentage of GDP were 22.0% in 2012. The levels of commercial banks lending to individuals and business are also low and this is reflected by most of the banks' assets being held in government securities. Low access to finance is compounded by the Seychelles' ranking of 167th out of 185 countries in the World' Bank's 'ease of getting credit' scale in 2013, falling two places from the previous year's rank of 165th.

As part of the country's private sector development strategy to access finance, the government of the Seychelles has worked with the International Finance Corporation to create a credit information system by putting in place the necessary regulations. The

government, through the World Bank, is also currently conducting a financial sector development implementation programme, within which development finance institutions' role is also being considered. It is expected that some of the issues which will be covered by this study will inform the World Bank study, specifically on issues relating to DFIs. The rest of this section discusses in detail the four development finance institutions currently operating in Seychelles.

3 Analysis of Development Finance Institutions of Seychelles

As noted above, the Seychelles has four development finance institutions: the Development Bank of Seychelles (DBS), the Housing Finance Company (HFC), the Small Enterprise Promotion Agency (SEnPA) and the SME Bank. Table 75 below gives an overview of the DFIs and the economic sectors they support.

Table 75: Sectoral Analysis of DFIs in Seychelles

Sector	Institution
Agricultural	DBS
Industry	DBS
Housing	HFC, DBS
Micro financing and SMEs	SenPA, SBFA, DBS
Other	SenPA

Source: Annual Reports

Although Table 75 shows that some DFIs operate within the same economic space, their mandates are distinct. For instance, the DBS provides loans for housing projects that are meant for commercial purposes, whilst the HFC offers subsidised loans, in line with Government's social housing policy, for residential purposes. Similarly, SEnPA used to offer small loans to start-ups and SMEs, but currently its responsibilities are geared towards the marketing and support of SMEs, whilst the SBFA offers financial assistance to SMEs.

3.1 Development Bank of Seychelles (DBS)

The Development Bank of Seychelles (DBS) was established in 1977 under Decree No.21, as a joint venture between the government and other shareholders, specifically Caisse Française de Coopération, the European Investment Bank, DEG, Standard Chartered Bank and Barclays Bank. In the bank's 36 years of operation, changes have taken place, particularly with Standard Chartered Bank shares being taken over by Nouvobanq and the government acquiring the shares of DEG. Despite the changes to the shareholding, 55.5%

of the Bank is still owned by the government and the remainder by international institutions and a commercial bank.

3.1.1 DBS Mandate

According to Decree No. 21 of 1977 which established the Bank, its purpose is to provide medium- and long-term finance, to promote the economic development of the country and to assist the government in furthering the aims of the Seychelles National Development plans, by financing projects emanating from such plans and promoting industrial efficiency in Seychelles.

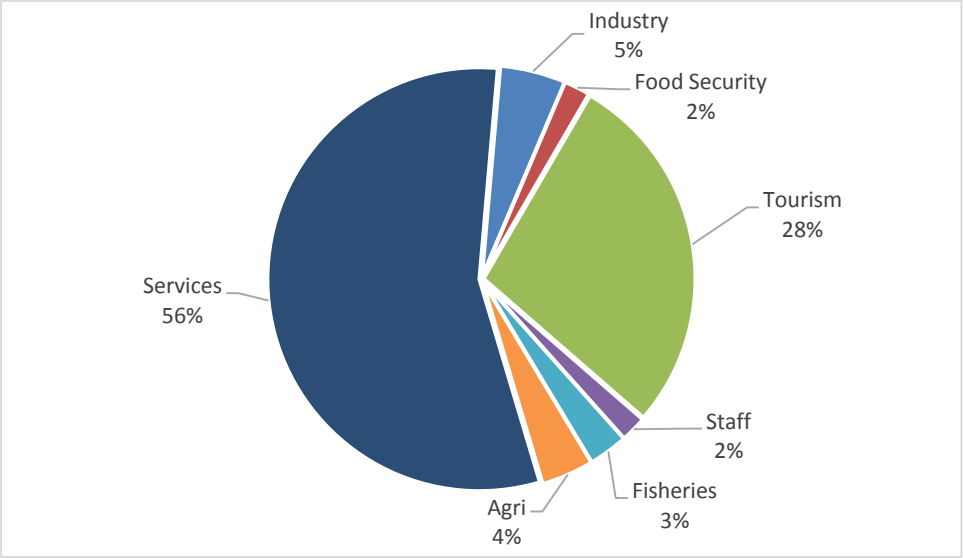
The Bank's main objective is to finance new modernization and expansion projects in the fields of agriculture, fisheries, industry, service and tourism, and the construction of commercial buildings, including rental accommodation, offices, storage and shop premises. All these activities are funded from resources obtained from the government and the private sector.

3.1.2 Portfolio Analysis of DBS

The DBS's development portfolio is made up of loans and advances provided directly to borrowers by the bank. These loans and advances are categorised as loans and are carried at amortised cost, which is defined as the fair value of cash. Third-party expenses, such as legal fees incurred in securing loans, are treated as part of the cost of the transaction.

As at the end of 2012, the DBS developmental loan and advances book amounted to a total of Rs474.7 million, of which service loans constituted 55.9%, tourism 28%, agriculture 3.8%, fisheries 3%, food security loans 1.8%, industry 4.9%, and staff loans 2.2%. Figure 20 below shows the distribution of resources by sector.

Figure 20: Resources Distribution by Sector for DBS



Source: DBS 2012 Annual Report

Figure 20 shows that the Bank has a broad mandate.

3.1.3 Corporate Governance and Risk Management for DBS

3.1.3.1 The Governing Legal Environment

The Bank has a board that is responsible for all of the Bank's policy decisions and oversees the performance of management. The board is elected in accordance with Decree No. 21. Supervision of the DBS is subject to specific sections of the Financial Institutions Act of 2004, as well as directives of the Central Bank of Seychelles.

3.1.3.2 The Board

Currently the board of DBS has eight non-executive members and a Chief Executive Officer. All board members have been appointed by the President of Seychelles and they represent various sectors of the economy; emphasis is placed on their expertise. In 2010, for the sake of operational efficiency, the Bank experienced a complete change in membership of the board, apart from one director who was a previous chairperson of the bank.. Another major change in the Bank was the setting up of the Audit Committee and the Remuneration Committee. The internal audit now reports to the board through the Audit Committee.

3.1.3.3 Risk Management

Prior to 2010, DBS did not have a proper risk management structure. The Bank therefore decided in 2010 to set up the Risk Unit, which would assist the Board to identify risk and propose ways to mitigate it. The Risk Unit falls under the Secretariat Unit and is supervised

by the Risk Committee, which reports to the board on all matters of risk concerning the Bank. However, despite the establishment of a risk management framework, the Bank's loan impairments have continued to increase, rising from 27% in 2011 to 32% in 2012. This problem could partly be attributed to lack of capacity.

3.1.4 DBS's Business Model

The activities supported by DBS are mainly funded through shareholders' equity, funds borrowed from both local and international markets and resources managed by the Bank. The Bank also administers a number of developmental funds which consist of credit guarantee schemes such as the MAF (GIZ) fund, the SFA fund, the Agricultural Development Fund, the Seychelles Fisheries Fund, and the Concessionary Loans Scheme Fund. The composition of total funding mobilised by the Bank over the two years under review is shown in Table 76 below.

Table 76: Funding and Lending for DBS

	2012 Rs Million	Breakdown (%)	2011 Rs Million	Breakdown (%)
Long-term	252.1	86.4	308.4	89.4
Funds under Mgt.	39.6	13.6	36.3	10.6
Sub-total	291.7	100.0	344.8	100.0
Equity	253.0		223.3	
Total Funding	544.7		568.1	
Lending & Invest.	426.8	↓2.1	435.8	

Source: DBS 2012 Annual Report

Table 76 shows that the Bank, at 86.4% long-term funding to total external funding in 2012, has a mainly long-term sources of external funding. This business model is sustainable since the Bank's resources are likely to be long-term owing to the nature of the economic sector supported by the Bank. The Bank also has a wide resource base which includes both local and private financial institutions as well as local bonds. The Government of Seychelles, in addition to providing equity capital, also provides guarantees on loans contracted by the Bank. While this is commendable, the government needs to go further by allowing the DBS to handle bigger projects concerning infrastructure and industry.

3.1.5 Financial Performance of DBS

A look at the financial position of Development Bank of Seychelles reveals that total assets decreased slightly by 4% from 2011 figures. This was mainly the result of the decrease in

loans outstanding to customers by 3.2% and a decrease in deposits with government by 23%. Table 77 gives DBS's financial statement for 2012.

Table 77: Statement of Financial position for DBS

	2012 Rs Million	% change	2011 Rs Million
Statement of Financial position			
ASSETS			
Non-current assets	446		439
Current Assets	104		135
Total Assets	550	-4	574
Liabilities and Equity			
Equity	253		223
Short term liabilities	6		6
Long term liabilities	291		345
Total liabilities	297		351
Total Equity and Liabilities	550		574
Statement of Comprehensive Income			
Net Interest Income	34	13	30
Profit for the year	17.00	-85	111.00
Operating expenses	7	-50	14
Provision for doubtful debts	11	38	8
Key ratios	%		%
Return on Assets	3.1		19.3
Return on Equity	6.7		49.8
Net Profit margin	50.0		370.0
Debt/ Equity ratio	54.0		50.5
Loan impairments as % of Net Income	32		27
Operating expenditure as % of Net Income	21		47
Impairment & operating expenditure as % of NII	53		73

Source: DBS 2012 Annual Report

The Table also shows that net interest income increased by 13% despite a reduction in loans outstanding. However, profit for the year decreased by 85%. This was mainly on account of an increase in provision for bad debts. The other factor in the drop in profitability in 2012 was that there was an extraordinary gain in 2011 from debt forgiveness, amounting to R100 million.

Loan impairments as a percentage of NII are 32%, which is an increase from 27% in 2011, and shows that NII can cover impairments. Further, operating expenses as a percentage of NII were 21%. These costs can also be covered by NII. Impairments and operating expenses

therefore account for 53% of NII, demonstrating sustainability as NII is able to cover both these costs.

3.2 Seychelles Housing Finance Corporation (HFC)

The HFC is fully owned by the Seychellois government. It was established in 2003 and officially incorporated as a limited company under the Companies Act (2004) following the merger of the Seychelles Housing Development Corporation and a former property management company (PMC). In September 2013, the HFC underwent a transformation that saw the PMC split off again so that the two entities now operate independently although they co-operate in their operations. For example, the HFC is the financier, offering construction and end-user finance for housing development, home purchase and home improvements under the government's social housing policy, whereas the PMC is the developer, focusing on the construction, management and maintenance of the government's social housing stock.

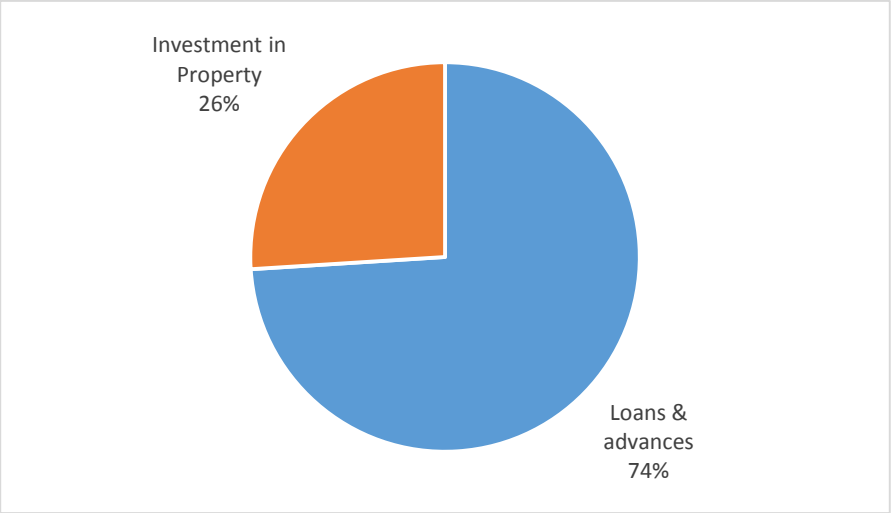
3.2.1 HFC's Mandate

The HFC was created to promote and devise financial mechanisms to raise financial resources for housing development on behalf of the government. Its objective is to ensure the equitable provision of living accommodation to the people of Seychelles by the sale, lease or rental of flats and houses in accordance with the policy of the government. It is also responsible for managing and maintaining buildings and other property on behalf of the government. Furthermore, the HFC provides utility services for the rental of flats and houses.

3.2.2 Portfolio Analysis of HFC

The Seychelles Housing Financing Company contributes about one-third of all credit to the private sector, through subsidised lending for housing. The subsidy provided by the Company covers loans across the entire social spectrum, and at the end of 2012, the HFC had a total portfolio of outstanding loans and advances amounting to SR482.1 million and a total investment in property of SR169.1 million. Figure 21 shows that the portfolio HFC is narrow and focused towards the provision of social housing for residential purposes only.

Figure 21: Portfolio Distribution by Sector for HFC



Source: HFC 2012 Annual Report

According to Figure 21, 74% of the subsidy is issued in the form of loans and advances to individual citizens; the remaining 26% is used by the Company through various investments in property. This shows that the mandate of the Company is narrow, focusing mainly on the financing of housing and property development.

3.2.3 Corporate Governance and Risk Management for HFC

3.2.3.1 The Governing Legal Environment

The Company is incorporated as a limited liability company and its governance system is based on a number of laws such as the Companies Ordinance Act of 1977 and the Public Enterprise Monitoring Act of 2009.

3.2.3.2 The Board

The day to day management of the HFC rests with a Managing Director appointed by the President of the Republic. Unless otherwise designated by the President, the Chairman of the Board is the Principal Secretary of the ministry responsible for housing. The board is responsible to the Minister, and currently it consists of a maximum of six directors including the Managing Director; all are appointed by the President.

3.2.3.3 Risk Management

Responsibility for the general administration of the company's risk management rests with the board of directors which is assisted by the managing director through the loans department. The loans department's functions involve gathering personal information about loan applicants to ensure that informed decisions can be made as to the creditworthiness of

the borrower and the probability of repayment. They also provide guidance to prospective loan applicants who have problems qualifying for loans. Despite this, the major challenge for the HFC is the recovery of loans, which shows that the HFC needs to review its loan approval process and to adopt a risk management framework to reduce the risk of defaults.

3.2.4 Business Model of HFC

The HFC's activities are mainly funded from shareholders' funds, which during the period under review increased by 17% from SR812.4 million in 2011 to SR953.1 million in 2012. The remaining activities are financed through loans from local commercial banks. Table 78 shows the composition of the total funding during the period under review.

Table 78: Funding and Lending for HFC

	2012 Rs Million	Breakdown (%)	2011 Rs Million	Breakdown (%)
Long-term	142.4	98.8	166.9	95.1
Short-term	1.8	1.2	8.7	4.9
Sub-total	144.2	100.0	175.5	100.0
Equity	953.1		812.4	
Total Funding	651.2		672.2	
Lending & Invest.	651.2	↓16	772.2	

Source: HFC 2012 Annual Report

The Company, at 98.8% long-term funding to external funding (2012), has almost entirely long-term sources of external funding. Table 78 also shows that the Company has a low gearing ratio which gives the institution room to mobilize resources from both local and international markets. This business model is sustainable except for the issue of the Company mobilizing resources from banks. Mobilization of resources from banks exposes the Company to call-back term loans from government-owned commercial banks and this in turn may create liquidity problems for the Company in the medium to long term.

3.2.5 Financial Performance of HFC

During the period under review, the Company experienced an increase in total assets of 11%, mainly on account of increase in investment in property and account receivables. The financial position of the HFC is given below in Table 79.

Table 79: Statement of Financial position HFC

	2012 Rs Million	% change	2011 Rs Million
Assets			
Loans and advances	482.0		511.0
Other Non-current Assets	615.0		503.0
Current Assets	48.0		21.0
Total Assets	1,145.0	11.0	1,035.0
Liabilities and Equity			
Equity	953.0		812.0
Liabilities			
Short term liability	89.0		82.0
Long term liability	103.0		141.0
Total liabilities	192.0		223.0
Total Equity And Liabilities	1,145.0		1,035.0
Statement of Comprehensive Income			
Net Income	44.0	22.0	36.0
Non-interest income	59.3		46.9
operating expenses	(39.0)		(36.0)
Profit before credit impairment	19.0		11.0
(Charge)/ Write back of credit impairment	(5.0)		6.0
Profit before tax	15.0	-16.0	17.0
Tax	(1.0)		(3.0)
Profit after tax	13.7	-5.0	14.4
Key ratios	%		%
Return on Assets	1.2		1.4
Return on Equity	1.4		1.8
Net Profit margin	31.0		40.0
Operating expenses as % of NII	89.0		100.0
Current ratio	0.5		0.3
Working capital	-40.7	-33.0	-61.0

Source: HFC 2012 Annual Report

Table 79 shows that net interest income of the Company increased by 22% on account of an increase in interest income. However, profit after tax decreased slightly by 5%. This was because of a reduction in other income of 67%. There was also a charge for credit impairment in 2012 but not in 2011.

Operating expenses accounted for 89% of NII. This means that NII can cover operating expenses. As for credit impairments, these accounted for 11% of NII. Therefore, NII is able to barely cover both operating expenses and credit impairment. There is, nevertheless, need for improved cost control to ensure a margin of safety.

In addition, while the Company's total assets increased by 11%, its net working capital decreased by 33%, remaining in the negative. The Company is therefore not able to meet its

short-term obligations when they fall due as the current ratio is only 0.5; this creates a liquidity risk.

3.3 Small Enterprise Promotion Agency (SEnPA)[41]

The Small Enterprise Promotion Agency Act (2004) provided for the establishment of the Agency (SEnPA) to be responsible for, amongst other things, promoting small enterprises and the development of craft and cottage industries in collaboration with the Ministry responsible for industry

3.3.1 SEnPA's Mandate

The Agency is the first point of contact for all matters relating to small enterprises in the Seychelles. The objective of SEnPA is to improve the business environment and facilitate entrepreneurship in small enterprises and to provide the necessary structures for their sustainable growth.

SENPA implements government policy on small business development, including small-scale farming and agro processing, as a means of promoting small enterprises. It also implements the government's policies and strategies relating to crafts and cottage industries and supervises the construction, and ultimately the management, of the infrastructure relating to any micro-enterprise centre projects. It also identifies, and proposes solutions to, the obstacles to sustainable development in its various areas of focus, and provides training and other business advice to small enterprises.

3.3.2 Portfolio Analysis for SEnPA

As indicated in the preceding section, activities covered by SEnPA mainly include cottage industry and small business registration; retail management of kiosks and outlets; small business aftercare and advisory services; organizing training programmes for entrepreneurs; business promotion; marketing services; and the sourcing and administration of small business raw materials. SEnPA does not provide varied financial support to the SMEs and as a result does not have a portfolio of assets.

[41] Even though SEnPA does not currently provide credit, its activities support development finance and as such it can be treated as a DFI.

3.3.3 Corporate Governance and Risk Management for SEnPA

3.3.3.1 The Governing Legal Environment

The governance of the Agency is based on laws such as the Small Enterprise Promotion Agency Act and Public Enterprise Monitoring Act of 2009.

3.3.3.2 The Board

The day to day management of SEnPA rests with a managing director appointed by the board of directors. The board is appointed by the President and reports to the Minister of National Development.

3.3.3.3 Risk Management

Responsibility for the general administration of the risk management of the company rests with the board of directors assisted by the Chief Executive Officer. It must be noted that it was not possible to ascertain whether the Agency had a risk framework in place or not.

3.3.4 SEnPA's Business Model

SEnPA's activities are mainly funded through government subventions and rentals obtained from small-scale entrepreneurs occupying incubation units. Even without full data, it is reasonable to assume that SEnPA's current business model, in which it is almost entirely dependent on government funding, is not sustainable. It is important that SEnPA reviews its model as soon as possible if it is to remain financially sustainable in the medium to long term.

3.3.5 Financial Performance of SEnPA

SEnPA's dependence on government subventions is not sustainable, and the problem is compounded by lack of information. The 2008 accounts were only certified in October 2013, and those for 2009-2012 have only just been submitted. The audit of the 2009 accounts has commenced but is not yet completed.

These delays in processing information by SEnPA have meant that there is no data available on which an analysis of the financial performance of the Agency could be based. Furthermore, the delay in getting the annual statements of audited accounts creates a serious financial risk for the Agency.

3.4 The Seychelles Business Finance Agency (SBFA)

The SBFA is a wholly government-owned Agency which was created through the Seychelles Business Finance Agency Act (No. 20 of 2013) to replace the Concessionary Credit Agency. The Agency operates under its own law, with its own administration and lending criteria. The SBFA's role is to provide key support for the activities undertaken by small enterprises so that they can contribute to the realization of a stable and vigorous economy.

3.4.1 SBFA's Mandate

The principal objectives of the Agency are to provide financial assistance by way of concessionary loans to small business enterprises in order to promote the development of the industries undertaken by such small business enterprises and to develop the marketing competitiveness of such enterprises at a local and international level. The Agency is expected to meet its objectives by granting loans and providing services in relation to the finance, management, administration or organisation of industry.

3.4.2 Portfolio Analysis for SBFA

Data was not available for this analysis because the institution was only recently established as a stand-alone development finance institution after delinking the SME funding activities from the Development Bank of Seychelles.

3.4.3 Corporate Governance and Risk Management for SBFA

Again, because of the newness of the institution, data was not available for this analysis.

3.4.4 SBFA's Business Model

In keeping with objective of helping build small enterprises, the government elevated the Small Business Financing Agency (SBFA) into a fully-fledged micro-finance agency. It was expected that the Agency would fund its activities with resources mainly obtained from the government of Seychelles, as in the case of SEnPA. The government has agreed to increase the budget for the agency from SCR 20 million to SCR 30 million. In addition, the government has also agreed with both Nouvobanq and the Seychelles Saving Bank that they each contribute an additional SCR 5 million towards the SBFA in the form of concessionary loans. This will allow the lending threshold of the SBFA to double to SCR 300,000.

Table 80: Funding and Lending for SBFA

	2012 Rs Million	Breakdown (%)	2011 Rs Million	Breakdown (%)
Long-term	5.0	100.0	---	
Short-term	0.0	---	---	
Sub-total	5.0	100.0	---	
Equity	30.0		---	
Total Funding	35.0		---	

Source: Government of Seychelles 2013 Annual Budget

According to Table 80 above, SBFA would finance its activities using long-term funding from both local commercial banks and government subventions. Table 80 also shows that SBFA has exclusively (100% in 2012) long-term sources of external funding. This business model is sustainable in the short to medium term since the Bank's resources are likely to be long-term owing to the nature of the small business sector. However, it must be noted that this business model will only become sustainable in the long term if the Agency attains a position where it can mobilise its own external resources using its own balance sheet.

4 Co-ordination, Regulation and Supervision of DFIs in Seychelles

4.1 Co-ordination

There are currently four DFIs operating in the Seychelles: the Seychelles Development Bank, the Small Enterprise Promotion Agency, the Seychelles Business Finance Agency and the Seychelles Housing Finance Corporation. Two of these DFIs, namely DBS and SBFA, report to the Ministry of Finance, Trade and Investment. The HFC on the other hand reports to the Ministry of National Development and the Ministry of Land Use and Habitat. SEnPA also reports to the Ministry of National Development and to the Ministry of Finance. It is clear that there is no overarching coordinating policy framework for DFIs in the Seychelles. This will inevitably result in mandate creep and a multiplicity of DFIs. Table 81 gives the legal basis, coordinating ministry and regulator for all the DFIs.

Table 81: Co-ordination, legal and Regulation of DFIs- Seychelles

Institutions	Legal and ownership	Co-ordinator	Regulator
1. Seychelles Development Bank	• DBS Decree No.21, 1977 • Majority owned by Government (55%)	• Ministry of Finance, Trade and Investment	• Seychelles Central Bank
2. Seychelles Housing Finance Company (HFC)	• Companies Act, 2004 • Wholly owned by the State	• Ministry of National Development. and the Ministry of Land Use and Habitat	• Seychelles Central Bank
3. Small Enterprise Promotion Agency (SEnPA)	• The Small Enterprise Promotion Agency Act, 2004 • Wholly owned by the State	• Ministry of National Development & Ministry of Finance.	• Own Act
4. The Seychelles Business Finance Agency (SBFA)	• Seychelles Business Finance Agency Decree No. 20 of 2013 to replace the Concessionary Credit Agency • Wholly owned by the State	• Ministry of Finance, Trade and Investment	• Own Act

Sources: DBS Decree No.21, 1977, Small Enterprise Promotion Agency Act, 2004, Seychelles Business Finance Agency Decree No. 20 of 2013

4.2 Regulation and Supervision

Table 81 shows that two of the DFIs, the Small Enterprise Promotion Agency and the Seychelles Business Finance Agency, are regulated by their parent ministries using their own Acts. On the other hand, the regulatory oversight of the Development Bank of Seychelles and the Housing Finance Corporation has shifted from the Ministry of Finance for DBS and the Ministry of National Development and the Ministry for Land Use and Habitat for HFC and they are now under the regulatory supervision of the Central Bank of

Seychelles. The Central Bank carried out its first offsite supervision of DBS and HFC in 2010, but no onsite supervision was carried out.

As a first step towards effective supervision of these institutions, the Central Bank commissioned a special audit to be conducted by independent auditors. The purpose of the exercise was to obtain a detailed overview of the HFC and DBS in order to allow for the effective adoption of a risk-based approach to the supervision of these institutions. Following the audit in 2010, the Central Bank of Seychelles has conducted fully-fledged onsite and offsite supervision of DBS and HFC. Although this move is commendable, the Central Bank of Seychelles needs to take into account the AADFI PSGRS so as to make sure that the concerns of the DFIs are covered in the regulatory policy framework.

5 Conclusion

The financial system in the Seychelles is characterized by: (a) very limited bank lending to the private sector compared with other countries at a similar level of development; (b) the important role played by development finance institutions; (c) excess liquidity in the banking system and limited demand for credit, (d) a lack of domestic private sector participation in the capital of financial institutions; and (e) the absence of a level playing field between public and private institutions.

Key findings on the development finance system of Seychelles are:

- The Development Finance Institutions in the Seychelles consist of four institutions: a development bank (DBS) that is majority government-owned; a parastatal institution (HFC) that is essentially an instrument of government policy in the housing sector; a Small Enterprise Promotion Agency that is also a policy institution mainly for supporting the development of SMEs; and the Seychelles Business Finance Agency, which also financially supports SME development.
- Some of the DFIs currently operating in Seychelles are not well capitalised;
- As with development finance systems in other SADC member states, the Seychelles lacks a uniform statutory approach to establishing DFIs, as can be seen from the different Acts under which the DFIs have been established;
- With the exception of the DBS, the DFIs have narrow mandates with a high level of mandate overlap;

- None of the Seychelles DFIs have a regional mandate, i.e., to fund projects outside the country;
- Three of the DFIs (DBS, HFC, and SBFA) have business models that are in line with the development finance institution framework, while SEnPA's business models is not and requires modifications;
- Two of the four DFIs reviewed under this section are financially sustainable and two are not;[42]
- The DFIs have weak corporate governance structures;
- There is a lack of a uniform risk management framework for the DFIs;
- There is no standard practice with regard to shareholding representation on the boards of DFIs. Mostly board members are appointed by the President;
- There is no overarching policy framework for coordinating activities of DFIs in the Seychelles. While the government is the sole shareholder of all four, the DFIs report to different line ministries, the Ministry of Finance, the Ministry of National Development and the Ministry of Land Use and Habitat; and
- Although two of the DFIs are now regulated by the Central Bank, the other two are not. Coupled with this, there is no regulatory framework for DFIs and DFI regulation is therefore weak.

[42] The non-sustainability of the two DFIs is mainly caused by their dependence on government subvention.

COUNTRY STUDY 9: SOUTH AFRICA

Dr. Lufeyo Banda and Dr. Herrick Mpuku of the SADC DFRC Project Team held discussions in South Africa on 24 January and 1-4 April 2014 for the SADC DFI Scan study. The summary review below is based on discussions with representatives from the Treasury, the Reserve Bank, the Governor of the Central Bank, the Land Bank, the Development Bank of Southern Africa and the Economic Empowerment Fund, coupled with the information from questionnaires and annual reports.

1 Background on South Africa

South Africa is the second largest economy in Africa and is classified by the UN as a middle-income country. South Africa has a well-developed transportation infrastructure, legislation that is largely supportive of private investment, a world-class financial sector and a well-diversified economy. Its stock exchange ranks among the top 20 in the world and is the largest on the African continent. Historically dominated by mining (South Africa is a significant producer of platinum, gold and chromium), the service sector now dominates the economy, employing 65% of the labour force.

Table 82: Key Figures for South Africa

Capital	Pretoria
Exchange Rate: 1 US$ =	10.24 South African Rand (R)
Population ^	51 189 307
Population growth rate (%) ^	1.18
Urban population (% of total) ^	62.43
Urbanisation rate (%) ^	1.89
GDP per capita (US$) ^	7 507.67
GDP growth rate (%, real) ^	1.34
GNI per capita, Atlas method (current US$) ^	7610
Population less than US$2 per day~	31.33
Population below national poverty line *	45.0
Gini co-efficient ~	63.14
HDI (Global Ranking)"	121
HDI (Country Index Score) "	0.629
Unemployment rate (%) *	22.93
Bank branches per 100 000 ^	10.71
Lending Interest Rate ^	8.75
Deposit Interest Rate ^	5.44
Credit % of GDP ^	80.36
Inflation	7.1
Ease of Doing Business Ranking (out of 185 countries)	39

Sources: ^ World Bank's World Development Indicators (2012), ~ World Bank PovcalNet: an online poverty analysis tool, various years; = www.coinmill.com on 26 August 2013; "UNDP's International Human Development Indicators (2012); * African Economic Outlook, various years; ! World Bank's Doing Business Survey Data (2013).

The country has also enjoyed growth since the first democratic elections in 1994, which instituted extensive social security programmes such as social grants, child support, pensions, housing, basic services and others for the majority of the population. For the first time in the country, considerable public infrastructure investment was extended to the whole country. Even so, South Africa continues to be the least equal economy in Africa, with a Gini coefficient estimated to be 63.14 in 2012. Unemployment continues to be

unmanageably high at roughly 22.93% in 2012. StatsSA reported that, in 2013, 4.7 million people between the ages of 15 to 64 were unemployed but seeking and available for work. Employment in the informal sector is large (12.72% in 2011). Public confidence is low, as evidenced by the recurring service delivery protests and labour union strikes.

2 Access to finance – South Africa

South Africa has a sophisticated banking industry that serves the upper-income segments of the population well. The country has 32 registered banks, 18 of them foreign. Of these 32 banks, four (Absa Bank, First National Bank, Nedbank and Standard Bank) dominate the banking sector. According to the 2012 FinScope survey, 67% of the South African adult population have bank accounts and 72% are financially included in terms of using some financial products or services from the formal sector. Just over 19% of the population is financially excluded and does not use either formal or informal financial products. Interestingly, only 2% of adults rely exclusively on banking services; 40% use a combination of formal and informal mechanisms to manage their financial needs.

Access to finance has dramatically improved following the signing of the Financial Sector Charter (FSC) in 2003. This agreement was a result of the Black Economic Empowerment Act, which required certain key industries in South Africa to promote transformation in their ownership and management structures so that they reflected the population distribution in the country. This was part of the transformation agenda introduced after the 1994 democratic elections. The FSC also promoted access to financial services for those who had been previously excluded. Table 83 below summarises access to finance in South Africa by entrepreneurs.

Table 83: Access to Finance – South Africa

#	Indicator	%	SSA Region
1	% of firms using banks to finance investment	34.8	18.0
2	Proportion of investment financed internally (%)	68.5	78.4
3	Proportion of investment financed by banks (%)	25.8	9.9
4	Proportion of investment financed by suppliers of credit (%)	3.9	3.8
5	Proportion of investment finance by equity or stock sale (%)	0	3.7
6	% of firms identifying access to finance as a major constraint	15.5	41.9

Source: Enterprise Surveys (http://www.enterprisesurveys.org), The World Bank.

While access to finance by individuals has improved tremendously, the same cannot be said when it comes to entrepreneurs accessing finance from banks. For instance, the World Bank

Enterprise Survey data (see Table 83) shows that only 34.8% of entrepreneurs in South Africa use banks to finance their investments. Although this is second only to Mauritius in the region, it is still low by world standards. The World Bank Enterprise Survey data also indicates that only 25.8% of total required investment was financed by the banks, 3.9% through trade financing, with the bulk of 68.5% investment financed internally by entrepreneurs. The fact that most investment in South Africa is financed by entrepreneurs' own resources clearly shows the financing gap existing in South Africa. Roughly 33% of entrepreneurs in South Africa identified access to credit as a constraint on entrepreneurship. This could partly be explained by the fact that bigger banks in South Africa have tended to steer away from risky markets, or markets which they do not understand. There are, however, a number of development finance institutions which the government has created through various Acts of Parliament, for the express purpose of making finance available to entrepreneurs. These DFIs will be discussed in more detail in the following section.

3 Analysis of Development Finance Institutions of South Africa

Since 1994, the development finance system has been restructured to reflect the new policy orientations of the ANC-led government. The restructuring process has involved closing certain DFIs such as the SA Housing Trust and the Local Authorities Loan Fund. It has also involved transforming others, such as the Land Bank, the Industrial Development Corporation and the Development Bank of Southern Africa. New institutions have also been created, such as the National Housing Finance Corporation (NHFC), the Khula Finance Enterprise Corporation and the National Empowerment Fund.

Of the six development finance institutions alluded to in the preceding section this study managed to assess only four. This was mainly because of lack of information from the NHFC and Khula Finance Enterprise.

In order to avoid duplication of spending, the development finance system has been reorganized so that each DFI focuses on its niche market. This is illustrated in Table 84 below:

Table 84: Sectoral Analysis of DFIs in South Africa

Niche Market	Institution
Agricultural	Land bank
Industry	IDC, NEF
Infrastructure	DBSA
Micro financing and SMEs	NEF

***Source*:** Annual Reports for Land Bank, IDC, NEF, and DBSA

In addition to the above institutions, there are also a number of provincial development corporations, mostly former homeland corporations. To date there has been little progress in transforming these corporations, with no national regulatory framework yet in place. Some of the provinces, such as the Eastern Cape, have taken the initiative and established transitional provincial finance institutions. But the future of these corporations and their role in the development finance system remains uncertain.

3.1 The Land Bank

The Land Bank is a DFI wholly owned by the South African government. It operates as a development finance institution within the agricultural and agri-business sector. Its activities are regulated by the Land and Agricultural Development Bank Act (No. 15 of 2002) and the Public Finance Management Act (No. 1 of 1999). The Bank provides a range of financial products to its clients in the agricultural sector. The products cater for both wholesale and retail financing for commercial and developing famers, co-operatives and other agriculture-related business.

3.1.1 The Land Bank Mandate

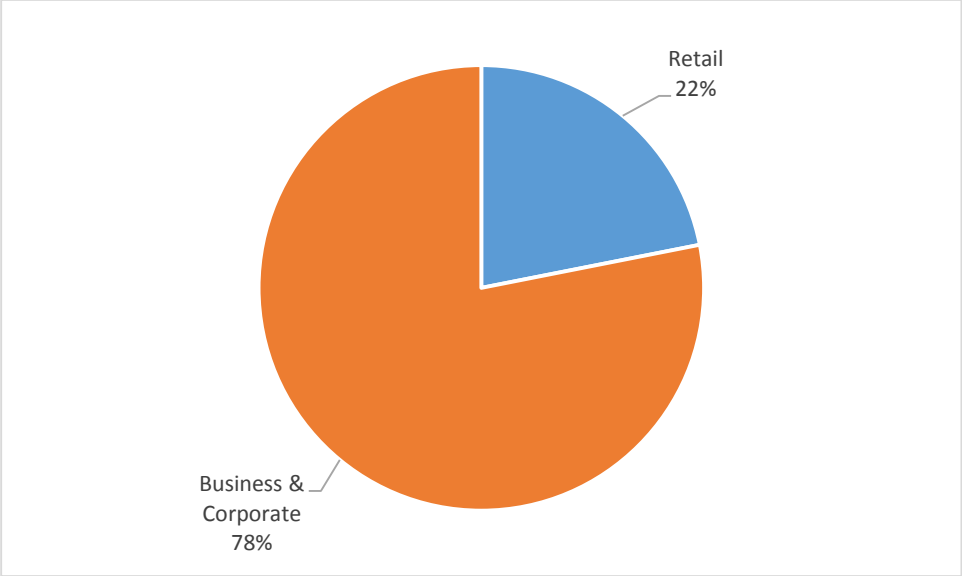
The Bank is a specialist agricultural bank with a mandate to provide financial services to the commercial farming sector and to agribusiness, and to make available new, appropriately-designed financial products that would facilitate access to finance by new entrants to agriculture from historically disadvantaged backgrounds.

The Bank is expected to achieve its objectives by: (a) providing financial services that will promote and facilitate access land ownership by previously disadvantaged individuals for the development of farming enterprises and for agriculture purposes; (b) facilitating and mobilizing private sector finance in the agricultural sector; and (c) providing financial services and such other assistance as may be deemed necessary to fulfil its mandate.

3.1.2 Portfolio Analysis for the Land Bank

During the period under review the Bank's net loans and advances increased significantly from R15.0 billion in 2011 to R21.6 billion in 2012. This represents an increase of R6.6 billion (44.0%). The gross-performing loan book also increased by 54.4%, from R13.6 billion to R21.0 billion. Business & Corporate Banking and Retail contributed R6.5 billion and R867.1 million respectively towards this increase. Figure 22 shows the portfolio distribution of the loans for Retail and Business & Corporate Banking according to sectors (industries) defined by the Bank.

Figure 22: Resources Distribution by Sector for Land Bank



Source: The Land Bank 2012 Annual Report

According to Land Bank 2012 annual report, out of the R21.6 billion loan book, only R752 million fell under the development finance portfolio. This shows a lack of commitment to development by the bank.

3.1.3 Corporate Governance and Risk Management for the Land Bank

3.1.3.1 The Governing Legal Environment

The framework for the Land Bank governance consists of both external regulations and codes and internal principles. The governance framework enables the board of directors to provide risk oversight and counsel to ensure that regulatory requirements and risk tolerance levels are adhered to.

The bank complies with the governance requirements contained in the Land Bank Act and the PFMA. It also subscribes to the principles of the Protocol on Corporate Governance in the Public Sector published by the Department of Public Enterprises.

3.1.3.2 The Board

The bank has a two-tier governance structure consisting of the board of directors and the executive management. The two bodies are separate and no person, except the Chief Executive Officer (CEO) and the Chief Financial Officer (CFO), serves as a member of both.

The Minister of Finance appoints the Land Bank's board of directors, with most of them serving in non-executive capacities. The board must have directors with appropriate skills, knowledge and experience to ensure that the bank maintains a high standard of corporate governance.

As at the end of the financial year in 2012, the Board had twelve members: eleven independent non-executive directors and one executive director. The Board is chaired by an independent non-executive director who is supported by an independent non-executive deputy chairperson, an additional nine independent non-executive directors and the CEO.

The board has delegated some of its responsibilities to the following committees: the Audit Committee, the Risk Committee, the Credit Risk Committee, and the Remuneration Committee.

3.1.3.3 Risk Management

Risk management and compliance principles continue to be soundly embedded throughout the Land Bank's business model. Updates in the enterprise risk management framework have recently been successfully implemented. Remedial measures have also been put in place to address certain areas of concern. Specific developments relating to risk management include:

- Implementation of the King III Risk Management Plan and use of an integrated annual report disclosure checklist;
- Design and approval of a risk appetite framework for the bank and new thresholds for the next financial reporting period, which have been finalized;

- Approval of a Financial Intelligence Centre Act compliance framework and implementation of internal rules; and
- Approval of a credit risk scoring model and a pricing model for loan facilities.

The Bank has, as a result of these measures, experienced a decrease in non-performing loans by R254.6 million (15%) from R1.7 billion in 2011 to R1.4 billion in 2012. This was mainly the result of collections and restructuring initiatives. The percentage of non-performing loans over the total loan book declined from 11.1% in 2011 to 6.4% in 2012, whilst the performing book improved from 89% in 2011 to 93.6% in 2012. The increase in the performing loan book has contributed significantly to the growth in interest income (for more details see section 3.1.5 below).

3.1.4 Land Bank Bank's Business Model

The Bank's activities are financed predominantly from two main sources: capital from government and capital markets. In the past few years the Land Bank's net capital resrves declined significantly owing to bad debt write off. However, lately things have improved and the government has injected further capital. The composition of total funding over the period under review is shown in Table 85 below.

Table 85: Funding and Lending for Land Bank

	2012 R Million	Breakdown (%)	2011 R Million	Breakdown (%)
LT	1,688.0	9.1	1,346.0	10.8
ST	16,865.0	90.9	11,120.0	89.2
Sub-Total	18,553.0	100.0	12,466.0	100.0
Equity	5,834.0		5,626.0	
Total Funding	24,387.0		15,092.0	
Lending & Invest.	23,192.0	45.6↑	16,156.0	

Source: Land Bank 2012 Annual Report

Table 85 above shows that the Bank has predominantly short-term funding. Even the funding mobilized from related parties is all through short-term financial instruments, repayable within a year. These consist mainly of promissory notes and bonds. This business model is not sustainable since the Bank's lending is likely to be long-term. It is also likely to introduce funding risks as the bank may not be able to recall its loans or investment when the short-term funding instruments are recalled by the creditors.

Given that the Bank is highly geared, the situation is even worse, which may also partly explain why so much of its external funding has a short maturity period.

3.1.5 Financial Performance of Land Bank

During the 2012 financial year, the Land Bank received R750.0 million as part of recapitalization, bringing the guarantee amount to R1.0 billion as at the 31st of March 2012. A further R200.0 million was received on the 30th of April. It is anticipated that the Land Bank will continue to receive further recapitalization and guarantees in the medium term because of its strategic role in development and food security. Support from government and the bank`s own initiatives have seen the Land Bank`s core earnings improve in recent times.

Table 86: Statement of Financial position Land Bank

	2012 R Billion	% change	2011 R Billion
Assets			
Total Assets	24,222.1	41.2	17,148.0
Liabilities and Equity			
Equity	4,830.7	24.7	3,873.7
Liabilities			
Total Liabilities	19,391.4		
			13,274.8
Total Equity and Liabilities	24,222.1		17,148.5
Statement of Comprehensive Income			
Net Interest Income	673.1	31.7	511.2
Profit after tax	232.9	-5.7	246.8
Operating expenses	543.0	14.0	476.6
Impairment costs	3.6	97.1	125.1
Key ratios	%		%
Return on Assets	1.0		1.4
Return on Equity	2.4		3.2
Net Profit margin	35.0		48.0
Operating cost as % of revenue	81.0		93.0
Impairment costs as % of NII	1.0		24.0
Total operating costs and impairments as % of NII	81.0		118.0

Source: Land Bank 2012 Annual Report

In a challenging economic environment, the Land Bank Group achieved a profit of R161.4 million in 2012, compared to the restated profit of R265.0 million reported in the prior year. The restatement relates to a valuation error identified post year end on a funding liability (floating rate note) that had been understated by R22.7 million and the year profit correspondingly overstated. Overall, the group`s profit declined by 39.1% in the period

under review. However, when a R137.5 million impairment write-back in 2011 (from a cash guarantee from the Department of Rural Development and Land Reform) is excluded, the group`s profit increased by R33.9 million (26.6%). The increase in profit is mainly attributable to the significant growth in the loan book, combined with a borrowing plan which maintained the cost of funding within reasonable levels. The bank`s total gross loan book increased by 46.8% to R22.4 billion (2011: R15.3 billion), of which the performing portion grew by 54.5% to R21.0 billion.

Using a few key selected financial indicators, Table 86 summarizes the financial performance of Land Bank as follows:

- Net interest income increased significantly by 31.7%, following significant growth in the loan book, thereby generating more interest revenue and a containment of borrowing costs;
- Total assets grew by 41.2%, also as a result of the increase in the loan book, with the resultant effect a growth of 24.7% in net assets;
- The net profit margin decreased from 48% to 35%, mainly on account of the 14% increase in operating costs. Operating costs as a percentage of NII decreased from 93% in 2011 to 81% in 2012. This demonstrates that operating expenses can be met from NII; and
- Impairments decreased significantly, by 97.1%, following efficient running of the loan book. As a result, impairments as a percentage of NII decreased from 24.0% to 1.0%. Again, this shows that impairments can be covered by NII.

Impairments and operating costs combined, as a percentage of NII, were 118.0% in 2011, decreasing to 81.0% in 2012. With the reduction in impairments, the bank has become sustainable as it can now cover both costs and impairments.

3.2 National Empowerment Fund (NEF)

The National Empowerment Fund was established through the National Empowerment Fund Act (No. 105 of 1998), which set out a wide range of objectives aimed at the promotion and facilitation of black economic equality and transformation.

The NEF's key objectives can be summarised under three thematic headings:

(a) Transformation: this is undertaken by providing historically disadvantaged persons with the opportunity to directly or indirectly acquire shares or interest in state-owned commercial enterprises that are being restructured or in private business enterprises;

(b) Enterprise Support: this takes several forms:

   i) promoting and supporting business ventures pioneered and run by historically disadvantaged persons;

   ii) encouraging development of a fully-inclusive competitive and effective financial market; and

   iii) contributing to job creation.

(c) Promoting savings, investments and meaningful economic participation by historically disadvantaged persons.

3.2.1 The NEF Mandate

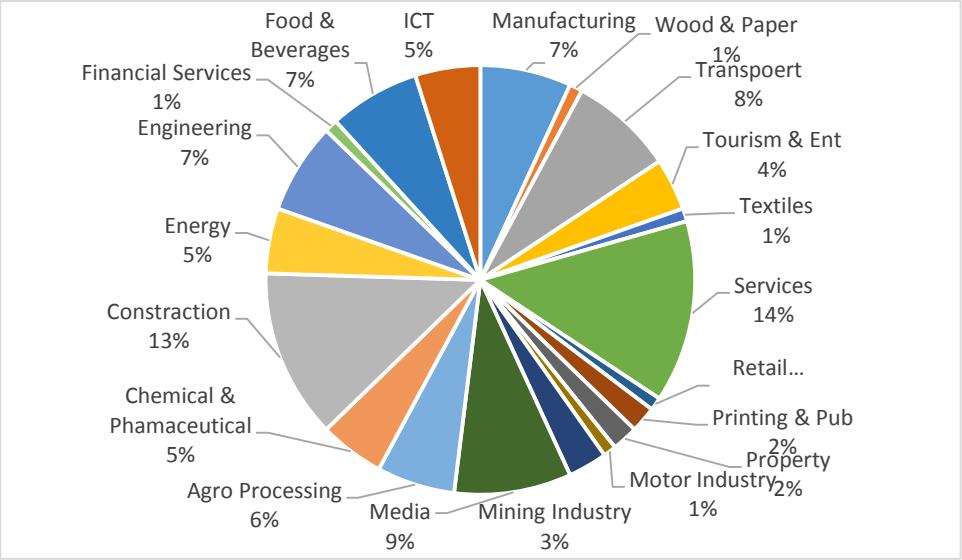
The NEF reports to the Minister of Trade and Industry. The NEF is meant to be an investment catalyst to support broad-based black economic empowerment (BBBEE) through asset management, fund management and strategic projects.

The NEF has two different funds, differentiated by the complexity and size of the funding applications they handle. The iMbewu fund is designed to promote the creation of new businesses and the provision of expansion capital to early-stage businesses. It aims to cultivate a culture of entrepreneurship by offering debt, quasi-equity and equity finance from R250 000 to R5 million (in exceptional cases up to R20 million for procurement contracts) for all entrepreneurial products. The corporate fund provides complex investment debt and equity solutions, from R5 million to R100 million, for all products. The NEF's asset management division provides retail savings products to groups of broad-based black beneficiaries, based on the transfer of state-allocated investments from government to the NEF. The objective is to encourage a savings and investment culture among black people.

3.2.2 Portfolio Analysis of NEF

The NEF's total loan book as at 31 March 2012 amounted to R2.7 billion. This represents the development loans since NEF's inception, and the distribution of these loans according to economic sector is shown in Figure 23 below.

Figure 23: Portfolio of Loans by Sector for NEF



Source: NEF 2012 Annual Report

Figure 23 shows that despite funding constraints, the fund approved 98 transactions, worth R1.2 billion in 2012, of which R620 million was disbursed to 73 black economic empowerment businesses. This constitutes the second-highest level of investment approvals and disbursements since its inception in 2004.

3.2.3 Corporate Governance and Risk Management for NEF

3.2.3.1 The Governing Legal Environment

The NEF's founding legislation is the National Empowerment Act (No. 105 of 1998, also called "the NEF Act"). The NEF governance system is subject to a number of laws, such as the National Empowerment Act (No. 105 of 1998), the Public Finance Management Act (No. 1 of 1999) (PFMA), the National Treasury Regulations (these take precedence at all times) and the King III Protocol on Corporate Governance in the Public Sector (2002).

3.2.3.2 The Board

The NEF is governed by a board of trustees, which is currently made up of eleven non-executive trustees. While the board approves policy, it works closely with the Chief Executive Officer and his colleagues on the senior management team, who are charged with the implementation of policy. The President of the Republic of South Africa is responsible for appointing the board of trustees and the chairman. The board of trustees in turn is empowered to appoint the Chief Executive Officer, with the approval of the Minister of Trade and Industry.

The board can delegate some of its responsibilities to board committees and the CEO. It has established five committees: the Audit Committee, the Board Investment Committee, the Human Capital and Remuneration Committee, the Risk and Portfolio Management Committee, and the Social and Ethics Committee, which was only established in May 2012.

3.2.3.3 Risk Management

The Board of Trustees, through the Risk and Portfolio Management committee under the direction of the Chief Risk Officer, has established a compliance framework and process. This framework allows the NEF to be aware of all current legislation with which it has to comply. The framework is presented to the Executive Committee and the Risk and Portfolio Management Committee on a biannual basis for monitoring and review.

3.2.4 The NEF Business Model

The Fund's activities are funded through revenue received from the Department of Trade and Industry and other revenue from dividends, from investments, and from interest received from banks and from originated loans. This funding is coupled with shareholding from SOCEs that is accounted for in its balance sheet while waiting for distribution. The composition of the total funding of NEF at the end of 2012 was R5.3 billion and the distribution of this capital is shown in Table 87 below.

Table 87: Funding and Lending for NEF

	2012 R Million	Breakdown (%)	2011 R Million	Breakdown (%)
Long-term	---		---	
Short-term	---		---	
Sub-total	---		---	
Equity	5,259.0		5,280.6	
Total Funding	5,259.0		5,280.6	
Lending & Invest.	2,698.0	29.8↑	2,078.0	

Source: NEF 2012 Annual Report

Table 87 shows that the NEF did not mobilise any resources from the private sector during the period under review, and that all its resources came from grants from the Government of South Africa, dividends and interest income. Table 87 also shows that all loans and investment activities were funded out of cash balances. Excess cash is managed through a cash management process, where short-term cash requirements and excess cash are placed with the South African Reserve Bank as required by the Public Financial Management Act.

The table also shows a decrease in funding in 2011/12; this was mainly the result of the phasing out of the budgetary allocations to fund operational costs. This business model is not sustainable and for this reason the government needs to consider sufficiently capitalising the institution that it is able to mobilise its own resources from the market and self-finance its operations. Alternatively, the government could consider merging the NEF with the Industrial Development Corporation (IDC).

3.2.5 Financial Performance of NEF

Although the Fund has been operating since 2004, their activities have not yet developed to a level at which a proper analysis of its performance can be made. The annual report of 2012 shows that the National Empowerment Fund's asset base remained flat at approximately R5.3 billion in both 2011 and 2012. In addition to this dismal performance, the fund has temporarily suspended new approvals subject to a review of the sustainability of its funding model. Despite funding constraints, the fund approved 135 transactions worth R1.3 billion in 2012/13, of which R946.5 million was disbursed to 87 black economic empowerment businesses. This constitutes the highest level of investment approvals and disbursements since its inception in 2004.

As mentioned, the NEF has a balance sheet with net assets of ZAR 5.3 billion, giving it a strong liquidity position as shown by the current ratio of 57.7 and the net working capital of ZAR 2.5 billion. The NEF is also able to meet its operating expenses from operating revenue as operating expenses only account for 15%. Impairments account for 31% of revenue. The two together only add up to 46%, making the Fund sustainable.

Table 88: Statement of Financial position NEF

	2012 R Million	% change	2011 R Million
Assets			
Non-current assets	2,763.0		2,557
Current Assets	2,540.0		2,759
Total Assets	5,303.0	0	5,316
Liabilities and Equity			
Equity	5,259.0	0	5,280
Liabilities			
Short term liability	44.0	26	35
Long term liability	-		-
Total liabilities	44.0		35
Total Equity and Liabilities	5,303.0		5,315
Statement of Comprehensive Income			
Revenue	335.0	-7	360
Surplus (deficit) for the year	-6.0	-108	75
Operating expenses	51.0		57
Impairments	105.0		103
Key ratios	%		%
Return on Assets	-0.1		1.4
Return on Equity	-0.1		1.4
Net Profit margin	-2.0		21
Operating cost as % of revenue	15.0		16
Impairments as % of revenue	31.0		29
Operating costs & Impairments as % of revenue	47.0		44
Current ratio	57.7		78.8
Working capital	2,496.0	-8	2,724.0

Source: NEF 2012 Annual Report

Although the NEF is financially sustainable, it must be pointed out that as long as NEF's main source of funding remains government subvention, the financial position of the Fund is in the long-term unsustainable. For this reason, the shareholders need to review the business model of the NEF and consider fully capitalising the institution with the aim of making it self-financing.

3.3 Development Bank of Southern Africa

The Development Bank of Southern Africa (DBSA) is a development finance institution wholly owned by the South African government. It was established in 1983 to perform an economic development function within the constitutional dispensation of the time. Through the Development Bank of Southern Africa Act, 1997, the roles and functions of the Bank have since been transformed in line with the new constitutional and economic dispensation. It now aims to promote socio-economic development and growth in both South Africa and

the Southern African region within the integrated financial development system. Furthermore, there are plans to amend the DBSA Act, 1997, so as to extend its mandate beyond the SADC region to any national territory on the African continent and its oceanic islands.

3.3.1 DBSA's Mandate

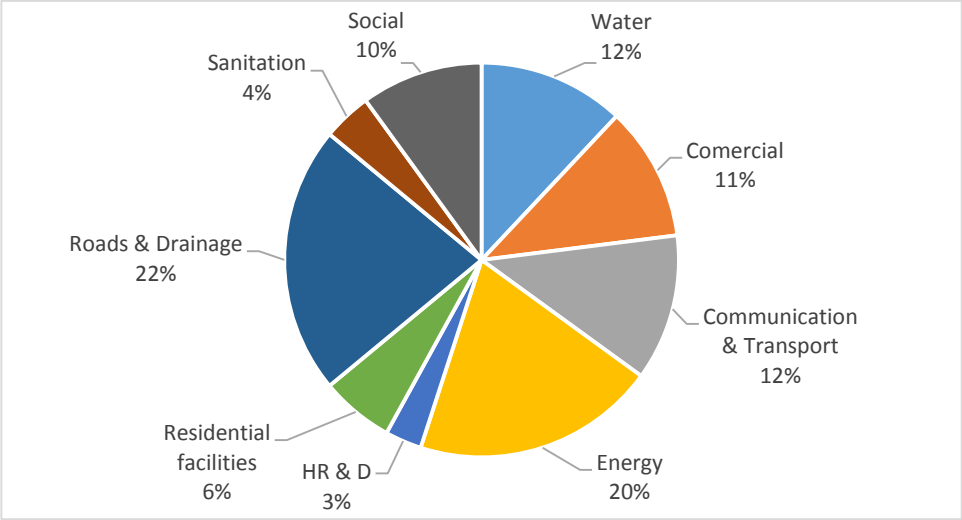
The DBSA's primary purpose is to promote sustainable economic development and growth, human resource development and institutional capacity building by mobilising financial and other resources from public and private sectors (locally and abroad) for sustainable development projects and programmes in South Africa and the Southern African region. To this end the bank plays multiple roles as financier, adviser, partner, implementer and integrator to mobilise finance and expertise for development projects.

DBSA's financial assistance tends to be granted as a complement to other sources of loan or equity capital, in order to ensure the implementation of development projects or infrastructure programmes. The DBSA board has established, as a guideline that a maximum of one-third of loan commitments should be extended to SADC countries outside South Africa, with the remaining two thirds reserved for South Africa itself. The DBSA has no international credit rating but the rating bureau Fitch IBCA in South Africa has applied a domestic credit rating of A1+ (short-term) and AAA (long-term), which are the highest possible ratings that a financial institution can obtain.

3.3.2 Portfolio Analysis of DBSA

In 2012, the DBSA total loan book increased by 7%, from R38.7 billion in 2011 to R41.4 billion at the end of 2012, and this was mainly attributed to the Investment Banking Division and International Division increasing their loan books by 23.3% and 28.3% respectively. The loan book of the South Africa Operations Division declined by 7%. Both Investment Banking and the International Division continue to benefit from high-value transactions such as the Housing Impact Fund, the Zambian National Road Fund Agency and the Zimbabwean National Road Administration. The South Africa Operations Division was affected by the decline in demand for loan products from metropolitan municipalities (metros), owing to a shift in funding towards the bond market and a higher appetite for metro business by commercial banks. Figure 24 below depicts DBSA's sector split of loan book as at 31 March 2012.

Figure 24: Resources Distribution by Sector for DBSA



Source: DBSA 2012 Annual Report

Figure 24 shows that of the total loan book of R41.4 billion for developmental loans, the Roads &Drainage sector accounted for the bulk of the loans or investments, followed by Energy, with the remainder split between a number of sectors. This portfolio distribution clearly shows that the mandate of the Bank is broad and that there is still an element of mandate overlap with other development finance institutions currently operating in South Africa, such as the National Housing Corporation.

3.3.3 Corporate Governance Arrangements - DBSA

3.3.3.1 The Governing Legal Environment

The constitution and conduct of the DBSA Board of Directors are governed primarily by the DBSA Act and further regulated by the Public Finance Management Act (No. 1 of 1999), sections 284 to 303 of the Companies Act (No. 61 of 1973), and Principles of the King III Code.

3.3.3.2 The Board

In line with the recommendations of the King III Code, the DBSA has a unitary board structure. The board currently consists of 14 members. Twelve of these are independent non-executive directors and one is a non-executive director, representing the National Treasury, while the Chief Executive Officer is the sole executive director. The Board also recommended in 2012 that the Chief Financial Officer be appointed to the board as an executive director.

The DBSA board is governed by a board charter, signed between the Minister of Finance and the board, which outlines the principal provisions of the DBSA Act, the fiduciary responsibilities of directors, the relationship with executive management, and matters of policy that the shareholder and the board ought to follow in order to ensure good corporate governance.

The DBSA Act also authorizes the board to appoint any subcommittees necessary to carry out its fiduciary responsibilities, without diminishing the board's legal responsibility. To this end the DBSA board has six permanent committees: the Audit and Risk Committee, the Finance Committee, the Board Credit and Investment Committee, the Development Planning Committee, the Human Resources and Nominations Committee, and the Strategic Mandates Committee, the last of which was added in 2012. During the year under review, a Special Board Subcommittee was also established to coordinate and manage the transitional period following the resignation of the Chief Executive Officer. The subcommittee only met twice and was then disbanded.

3.3.3.3 Risk Management

As the primary source of infrastructure financing in South Africa and, to some extent, the SADC region, and given its funding sources, the DBSA's board recognized the need for the institution to develop, as a priority, a sound management philosophy around its twin objectives of financial sustainability and development impact. It was recognized that, as a development institution, the DBSA would be expected to support projects with higher levels of risk. As a result, the requirement for "sound banking principles" made it mandatory that risk management policies and practices be put in place for project assessments.

During the re-structuring of the DBSA, a Risk Management Unit was created in late 1996 and located within the bank's Finance Complex. Its mission was to develop risk management to a level of recognized excellence. The DBSA has carried out its risk management prudently and this is reflected in the low level of non-performing loans as a percentage of the gross loan book. Although there was a marginal increase in NPL during the period under review, from 4.18% at the end of 2011 to 4.9% in 2012, mainly on account of the Investment Banking Division (where a number of private sector clients became non-performing because of the difficult economic environment), the general quality of DBSA's loan portfolio has remained good by DFI standards, with the ratio of NPL at around 5% of gross book debt.

3.3.4 DBSA's Business Model

The DBSA has been a financially self-sustaining DFI, with no financial support from government through grants or capital injections, since 1994. This position has been reviewed, however, because of the declining financial performance of the Bank.

The main source of funding of the Bank is the public and private sectors (locally and abroad) and net interest income, which accounts for more than 85% of operating income. The main drivers of operating income are infrastructure loans which are disbursed at national and regional level.

The total funding of DBSA at the end of 2012 was R51.0 billion, and the composition of that funding is shown in Table 89.

Table 89: Funding and Lending for DBSA

	2012 R Billion	Breakdown (%)	2011 R Billion	Breakdown (%)
Long-term	33.5	100.0	28.2	100.0
Short-term	---		---	
Sub-total	33.5	100.0	28.2	100.0
Equity	17.5		17.8	
Total Funding	51.0		46.0	
Lending & Invest.	41.4		38.8	

Source: DBSA 2012 Annual Report

Table 89 shows that the DBSA's funding profile benefits from a adequate capital and stable medium-to-long-term funds from the domestic capital markets (accounting for 70% of total funds at March 31, 2012) and lines of credit (accounting for 19% of total funds at the same date). Its long-term funding ratio of roughly 100% compares very well to a development banking business model. Liquidity is considered to be adequate. At March 31, 2012, cash and available-for-sale liquid securities covered more than 100% of funds maturing within one year. This position was partly owing to the rating agencies, which have assisted in improving the bank's capacity to borrow at more competitive rates. Furthermore, DBSA has enjoyed ongoing support from the government of South Africa. For instance, in 2009 the government provided the DBSA with R 15.2 billion (about $2.1 billion) in debt guarantees and it has stated its commitment to increasing DBSA's callable capital by an equivalent amount in order to replace the guarantee. The DBSA business model is sustainable in the medium to long term, as it prudently matches the maturity of its liabilities and assets and uses its strong balance sheet to mobilise external resources.

3.3.5 Financial Performance of DBSA

Up to 1994, DBSA received budget transfers, but under its current mandate it is obliged to operate without recourse to government funding beyond its initial capital, although the callable capital facility is available if the Bank is unable to meet its obligations.

Table 90 shows that while total assets of the Bank grew by 10%, profit from operations declined by 138%, from R 286 Million to a loss of R 108 Million. This was because of impairments, which increased by 116%. The return on assets and return on equity followed a similar trend, both decreasing from positive amounts to negative ones.

Table 90: Statement of Financial position DBSA

	2012 R Million	% change	2011 R Million
Assets			
Total Assets	52,337	10.0	47,397.0
Liabilities and Equity			
Equity	17,528	-2.0	17,851.0
Liabilities			
Total liabilities	34,809		29,546.0
Total Equity and Liabilities	52,337		47,397.0
Statement of Comprehensive Income			
Net Interest Income	1697	3.0	1642.0
Profit from operations	(108.00)	-138.0	286.0
Operating expenses	279		757.0
Impairments	495	116.0	229.0
Key ratios	%		%
Return on Assets	-0.2		0.6
Return on Equity	-0.6		1.6
Net Profit margin	-6.0		17.0
Operating cost as % of revenue	16.0		46.0
Impairments as % of revenue	29.0		14.0
Operating costs & Impairments as % of revenue	46.0		60.0

Source: DBSA 2012 Annual Report

Table 90 also shows that the DBSA managed to contain operating costs, which decreased by 63% in 2012. Operating costs as a percentage of NII decreased from 46% to 16%, showing that they can be covered by operational income. Impairments as a percentage of NII increased from 14% to 29%, but could still be covered by NII. Together, costs and impairments decreased from 60% to 46%, demonstrating that the DBSA is sustainable as it can easily cover its costs from its income.

3.4 The Industrial Development Corporation of South Africa (IDC)

The IDC is a state-owned development finance institution, established in 1940 by an Act of Parliament (Industrial Development Corporation Act (No. 22 of 1940)). It was established to spearhead the development of domestic industrial capacity, especially in light of the shortages of manufactured goods experienced as a result of the disruption of trade between Europe and South Africa during the Second World War.

Following the country's first democratic elections in April 1994, the IDC Act was amended to bring it in line with the government's constitutional obligations and its developmental objectives in the SADC region. Today the IDC acts as a catalyst for development in all sectors of industry in South Africa. Since 1994, the IDC has also engaged in projects in the wider SADC region. Its objective is to dedicate between 20% and 40% of its loan book to other SADC countries and the rest to South Africa.

3.4.1 The IDC'S Mandate

In 1995, the Industrial Development Corporation Amendment Act was passed, confirming the IDC as an industrial financing institution in South Africa. In 1997, the government further clarified the role of the IDC emphasising, among other things, the need to support black entrepreneurial activities, assure affirmative action within the IDC organisational structure, and extend its activities to the wider SADC region.

The main objectives of the IDC are: to raise the rate of sustainable growth and development in the manufacturing sector of South Africa by promoting a high rate of industrial investment, to promote and sustain employment creation and the incidence of labour intensive development, and to engage in initiatives aimed at spatial development and increased economic activity and investment among SADC members.

IDC policy stipulates that private sector partners in industrial financing should make a substantial financial commitment to projects. In general, the IDC advances a third of the project costs. The contribution of the IDC takes the form either of loans or equity financing.

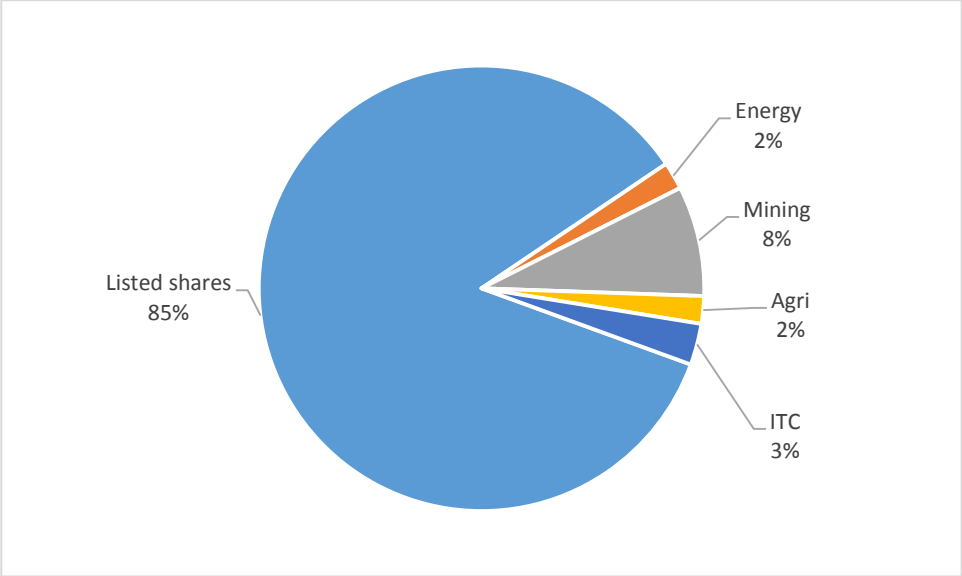
3.4.2 Portfolio Analysis of IDC

The IDC has a strong balance sheet, with most of the value of its assets concentrated in five large investments.[43] According to the IDC plan, investments allow the corporation to (a)

[43]SASOL, BHP Billiton, Arcelor Mittal, Kumba Iron Ore, Mozal.

have a strong balance sheet which gives it the ability to raise funding at attractive rates; (b) receive dividend flows from these investments, which in turn gives IDC the ability to cross-subsidise its financing activities; (c) invest in high-risk, early-stage projects with the potential to grow significantly in the future and ensure the corporation's long-term financial sustainability; and (d) create specific funding schemes with customised risk/return profiles that address specific development outcomes, often at concessionary rates.

Figure 25: Resources Distribution by Sector-IDC South Africa



Source: IDC 2011 Annual Report

The IDC's total investment book in 2011 amounted to R66.9 billion. Listed shares (equity investments) represent 85% (R57 billion) of this book and only 15% (R9.9 billion) was dedicated to developmental loans. Figure 25 indicates the IDC's sector split of its investment book as at 31 March 2011.

Figure 25 also shows the tension between financial performance and development financing faced by the IDC. It is clear that the management of IDC tends to concentrate the allocation of resources on safe activities such as commerce and to focus investment loans to large corporations. This makes the institution hardly distinguishable from commercial banks in its operational objectives. It appears that the IDC considers a high financial return the most important indicator of corporate success.

3.4.3 Corporate Governance and Risk Management for IDC

3.4.3.1 The Governing Legal Environment

The corporate governance framework for the IDC is guided by and complies with a number of laws, such as the Industrial Development Corporation Act (No. 22 of 1940 (IDC Act)), the Public Finance Management Act, (No. 1 of 1999 (PFMA)), treasury regulations, the Companies Act (No. 71 of 2008) and the principles of good corporate governance contained in the King Report on Corporate Governance for South Africa 2009 (King III).

3.4.3.2 The Board

The Corporation has a unitary board structure, with one executive and thirteen non-executive directors. This enables the board to obtain the desired level of objectivity and independence in board deliberations and decision-making. The board is assisted by board committees.

The size of the board is dictated by section 6 (2) of the IDC Act, which permits a minimum of five and a maximum of fifteen directors to be appointed by the shareholder. The positions of Chairman and Chief Executive Officer are separately held, with a clear division of duties. As at 31 March 2012 there were fourteen directors of whom thirteen were non-executive directors.

The board has a charter setting out its mission, role, duties and responsibilities, and, in particular the leadership of the board, the directors' fiduciary duties, the induction of new directors, and the methods for evaluating of directors. In addition the board has also established five standing committees: the Investment Committee, the Human Capital and Nominations Committee, the Audit Committee, the Risk and Sustainability Committee, and the Governance and Ethics Committee, all of which are ultimately accountable to the board and whose terms of reference have been approved by the board.

3.4.3.3 Risk Management

The IDC has instituted a robust enterprise risk management (ERM) process, founded on a framework that is shareholder value-based, organisationally embedded, supported and assured, and reviewed on a continuous basis. The objectives of this framework are to embed a uniform approach to ERM at the IDC and to identify and assess all the risks that could affect the achievement of the Corporation's objectives, its employees, reputation, business processes and systems, as well as its financial and environmental performance. It also serves to ensure that these risks are dealt with at an acceptable level.

To this end, IDC's Risk Management Framework lays out guiding principles for the IDC's management of risk, based on the principles embodied in the Public Finance Management Act (No. 1 of 1999 (PFMA)), the Public Sector Risk Management Framework published by the National Treasury, the Enterprise Risk Management Framework published by the Committee of Sponsoring Organisations (COSO) of the Treadway Commission, the International Guideline on Risk Management (ISO 31000), King Report on Corporate Governance for South Africa 2009 (King III).and Batho Pele principles. The principles outlined in the framework are incorporated in risk-management related policies and procedures that support the Corporation's ERM framework. An assessment of the risks IDC faces is undertaken annually. This process strives to identify critical risks the Corporation may face in order to enable the Corporation to formulate appropriate risk strategies and action plans to address these risks.

As can be seen from the preceding section, the risk management framework of the Corporation is sound. Nevertheless, IDC's level of impairments has been increasing gradually in recent years, with the ratio of impairments as a percentage of NII increasing from 17.3% in 2011 to 18.2% in 2012. This is attributed to the Corporation's increased willingness to undertake risk with respect to distressed clients and ailing industries, such as the textiles industry. It also reflects the IDC's increased focus on early-stage projects and start-up companies.

3.4.4 IDC Business Model

The IDC's funding requirements are sourced mainly from international development agencies and from commercial facilities through the IDC's relationships with commercial banks. For instance, the IDC Mini Group's general funding requirements for 2012 amounted to R12.5 billion (2011: R7.7 billion), mainly consisting of financing advances of R8.5 billion and borrowing redemptions of R3.8 billion. These requirements were partly met out of R5.8 billion of internally-generated funds, namely repayments received and profits. New borrowings were increased to R7.1 billion for the year.

Table 91 below shows the total funding of the Corporation during the two years under review.

Table 91: Funding and Lending for IDC in Billion Rands

	2012 R Billion	Breakdown (%)	2011 R Billion	Breakdown (%)
Long-term	8.0	46.8	4.5	32.4
Short-term	9.8	53.2	9.4	67.6
Sub-total	17.1	100.0	13.9	100.0
Equity	89.1		88.3	
Total Funding	106.9		102.2	
Lending & Invest.	108.6	4.6↑	103.8	

Source: IDC 2012 Annual Report

Table 91 shows that the corporation, at 53.25% short-term funding to total external funding in 2012, has mostly short-term sources of external funding. This business model, for a development finance institution, is not sustainable since the Corporation's equity and loans are likely to be long-term owing to the nature of the industrial sectors supported by the Corporation. The Corporation will need to roll over its short-term financing periodically so as to avoid the risk of maturity transformation caused by short-term funding supporting long-term investment.

3.4.5 Financial Performance of IDC

As indicated in the previous sections, the IDC's mandate is to promote and finance industrial projects in South Africa and the African continent. During 2011/12, the IDC made a profit of R3.3 billion, a 22% increase from the previous year, largely as a result of increased dividend income and gains from the disposal of mature investments. Furthermore, a strong balance sheet enabled the IDC to approve a net R16.2 billion funding in the form of developmental loans over the two years under review. This funding supported the objectives of the New Growth Path and the Industrial Policy Action Plan.

Table 92 shows the financial position of the IDC.

Table 92: Statement of Financial position IDC

	2012 R Million	% change	2011 R Million
Assets			
Total Assets	116,218.0	6.0	109,657.0
Liabilities and Equity			
Equity	89,065.0	1.0	88,273.0
Liabilities			
Total liabilities	27,153.0		21,384.0
Total Equity and Liabilities	116,218.0		109,657.0
Statement of Comprehensive Income			
Revenue	4584.0	30.0	3524.0
Profit after tax	2193.0	69.0	1298.0
Operating expenses	2957.0	37.0	2162.0
Key ratios	%		%
Return on Assets	1.9		1.2
Return on Equity	2.5		1.5
Net Profit margin	48.0		37.0
Operating cost as % of revenue	65.0		61.0

Source: IDC 2012 Annual Report

Table 92 also shows that the bank is in a strong financial position, based on the following financial indicators:

(a) A strong position with net assets worth ZAR 89,065 million, which is an improvement of 1% from the previous year. This was driven by the 6% increase in total assets and led to an increase in return on assets and return on equity from 1.2% to 1.9% and 1.5% to 2.5% respectively;

(b) A revenue growth of 30%, which led to a 69% increase in profit after tax. This was in spite of the 37% increase in operating costs; and

(c) A revenue increase of operating costs as a percentage from 61% to 65%. In both years, revenue was able to cover operating costs, demonstrating sustainability.

4 Co-ordination, Regulation and Supervision of DFIs in South Africa

4.1 Co-ordination

Table 93 below shows that that of the four DFIs listed, two are coordinated by the Ministry of Finance and two by the Ministry of Trade and Industry. This shows a lack of an overarching coordination policy framework for DFIs in South Africa. Lack of an overarching policy framework may have contributed to the mandate overlaps currently being experienced by the DFIs in South Africa.

Table 93: Co-ordination, legal and Regulation of DFIs- South Africa

Institutions	Legal and ownership	Co-ordinator	Regulator
1. Land Bank of South Africa	• Land and Agricultural Development Bank Act No. 15 of 2002 • Wholly owned by the State	• Treasury of South Africa	• Public Finance Management Act No. 1 of 1999, as amended (PFMA)
2. The Development Bank of Southern Africa (DBSA)	• DBSA Act, No. 13 of 1997 • Wholly owned by the State	• Treasury of South Africa	• Public Finance Management Act No. 1 of 1999, as amended (PFMA)
3. National Empowerment Fund (NEF)	• National Empowerment Fund Act No 105 of 1998 • Wholly owned by the State	• Trade and industry	• Public Finance Management Act No. 1 of 1999, as amended (PFMA)
4. Industrial Development Corporation	• IDC Act (Act No 22 of 1940, as amended in 1994 • Wholly owned by the State	• Trade and Industry	• Public Finance Management Act No. 1 of 1999, as amended (PFMA)

Sources: Land and Agricultural Development Bank Act (No. 15 of 2002), DBSA Act, No. 13 of 1997, NEF Act No 105 of 1998

4.2 Regulation and Supervision

Table 93 shows that none of the DFIs in South Africa are regulated by independent regulators. All the DFIs are regulated by their own respective Acts and are also subject to the provisions of the Public Finance Management Act (No. 1 of 1999 (PFMA)), which establishes best practice in financial management, focusing mainly on outputs and the responsibilities of state-owned entities (SOEs).

The difficulty with the Public Finance Management Act is that it introduces the possibility of a conflict of interest for the government, who in this case acts both as the owner of the institutions and the regulator. For this reason it is important that DFIs are regulated by an independent regulatory body.

5 Conclusion

South Africa, the economic powerhouse of the region, has two DFIs which have mandates spanning several SADC countries. Three of the DFIs are historically tied to the form of industrialisation and accumulation which prevailed during the apartheid era. However, following democratic elections in South Africa in 1994, all three institutions have undergone major restructuring. Part of this relates to the narrowing of their fields of operational focus from general all-purpose financing to specific mandates (e.g., industry, infrastructure, and agriculture), while at the same time widening their geographic reach into the SADC region and Africa.

Key findings on development finance system of South Africa are:

- South Africa has a relatively well-developed financial sector. However, the country still faces a substantial development finance gap. The role of DFIs in bridging this gap can be complementary to that of commercial banks;
- Most DFIs currently operating in South Africa are well capitalised, with government actively supporting them;
- Despite government support, there is no uniform statutory method of establishing DFIs in South Africa, with each DFI being established by a different Act of Parliament;
- With the exception of the Land Bank, the mandates of the DFIs are generally broad and they exhibit a high level of mandate creep;
- As indicated above, two of the DFIs (IDC and DBSA) have a mandate to fund projects outside the country;
- While the business model of the DBSA is in line with development finance models, this does not appear to be so in the case of the other DFIs. This situation creates a high probability of the maturity transformation of assets;
- Of the four DFIs discussed, three are financially sustainable;
- Of the three financially sustainable DFIs, two have clearly shown a mandate drift toward commercial operations;
- the DFIs have weak corporate governance structures;
- the DFIs have no uniform risk management framework;
- There is no standard practice with regard to shareholding representation on the boards of DFIs. Mostly board members are appointed by the Ministers;

- There is no overarching policy framework for coordinating the activities of the DFIs in South Africa. This can be seen by the fact that while the government is the sole shareholder of these institutions, the DFIs report to different line ministries: the Ministry of Agriculture; the Ministry of Finance; and the Ministry of Trade and Industry; and
- None of the DFIs in South Africa are regulated, which indicates the lack of a regulatory policy framework for development finance institutions.

COUNTRY STUDY 10: SWAZILAND

The SADC DFRC Project Team of Dr. Lufeyo Banda and Dr. Herrick Mpuku held discussions in Swaziland 7– 8 November 2013 for the SADC DFI Scan study. The review below is based on information collected through questionnaires, annual reports and discussions with representatives from the Ministry of Finance, the Central Bank, the Swaziland Development and Savings Bank, the Swaziland Development Finance Corporation and the Swaziland Industrial Development Company.

1 Background on Swaziland

Swaziland is a small, mainly rural, country, with a relatively high gross national income, making it a middle-income country. In 2012, Swaziland's economic growth remained one of the lowest in sub-region, despite a marked increase in revenues from the Southern Africa Customs Union. Real GDP growth, at -0.3%, reflected subdued global recovery, structural bottlenecks and the delayed impact of the fiscal crisis. Even though the country started implementing the Investor Road Map implementing it, the overall investment climate poses challenges to growth, with the country ranking 123 out of 185 in the Ease of Doing Business ranking. This problem is compounded by persistent skills shortages and mismatches.

Table 94: Key Figures for Swaziland

Capital	Mbabane
Exchange Rate: 1 US$ =	10.25 Swazi Lilangeni (SZL)
Population ^	1 230 985
Population growth rate (%) ^	1.54
Urban population (% of total) ^	21.25
Urbanisation rate (%) ^	1.38
GDP per capita (US$) ^	3 043.50
GDP growth rate (%, real) ^	-0.3
GNI per capita, Atlas method (current US$) ^	2 860
Population less than US$2 per day~	60.4
Population below national poverty line *	69.2
Gini co-efficient ~	51.49
HDI (Global Ranking)"	141
HDI (Country Index Score) "	0.536
Unemployment rate (%) *	22.54
Bank branches per 100 000 ^	7.23
Lending Interest Rate ^	8.75
Deposit Interest Rate ^	2.47
Credit % of GDP ^	21.06
Inflation	7.1
Ease of Doing Business Ranking (out of 185 countries)	123

Sources: ^ World Bank's WDI (2012), ~ World Bank PovcalNet: an online poverty analysis tool, various years; = www.coinmill.com on 26 August 2013; "UNDP's International HDIs (2012); * African Economic Outlook, various years; ! World Bank's Doing Business Survey Data (2013).

A key challenge for the Swazi economy is job creation in value-adding sectors. Subsistence agriculture employs approximately 70% of the population. The manufacturing sector has diversified since the mid-1980s. Sugar and wood pulp were formerly major earners of foreign exchange. However, the wood pulp producer closed in January 2010, and sugar is now the main export earner. Mining has declined in importance in recent years, with only coal mines and stone quarries remaining active. Customs revenues plummeted because of

the global economic crisis and a drop in South African imports. The resulting decline in revenue has pushed the country into a fiscal crisis. Swaziland is looking to other countries, such as South Africa, for assistance. It continues to struggle to meet its monthly financial obligations, including funding government programmes. With an estimated 22.54% unemployment rate, Swaziland needs to increase the number and size of small and medium enterprises, and to mobilise more resources to support them.

Despite Swaziland's middle-income status, poverty levels remain high, and this is reflected by the UNDP Human Development Index for Swaziland which has remained low (ranking 141 out of 187 countries).

2 Access to finance -Swaziland

The banking industry plays a key role in the economy. The Swaziland banking sector consists of three commercial banks: South Africa's Nedbank, Standard Bank and First National Bank (FNB). Swaziland's financial system also has at least six development finance institutions: the SwaziBank, the Swaziland Industrial Development Company (SIDC), the Swaziland Development Finance Corporation (FINCORP), the Swaziland Building Society, the Small Enterprise Development Company (SEDCO), and Tibiyo Taka Ngwane. There is also a small capital market with almost no market liquidity.[44] Table 95 below shows current levels of access to finance by entrepreneurs.

Table 95: Access to Finance - Swaziland

#	Indicator	%	SSA Region
1	% of firms using banks to finance investment	7.7	18.0
2	Proportion of investment financed internally (%)	75.8	78.4
3	Proportion of investment financed by banks (%)	12.0	9.9
4	Proportion of investment financed by suppliers of credit (%)	5.6	3.8
5	Proportion of investment finance by equity or stock sale (%)	0	3.7
6	Availability of financial services	58.6	94 (int)
7	% of firms identifying access to finance as a major constraint	32.9	41.9

Sources: Enterprise Surveys (http://www.enterprisesurveys.org), The World Bank,
The Global Competitiveness Report 2011-2012 © 2011 World Economic Forum

According to the World Bank Enterprise Surveys, only 7.7% of entrepreneurs use banks to finance their investments. Table 95 also shows that, of the total investment required, only

[44] (According to Beck et al. (2008), turnover ratios are as little as 0.04% in Swaziland compared to about 60.6% in South Africa.

12.0% was financed by the banks, 5.6% through trade credit lines, and the bulk (75.8%) of investment was internally financed by the entrepreneurs. This shows the finance gap which specialised development finance institutions should fill. This study reviews the status of these specialised institutions with the view of coming up with policy options for developing the DFIs.

3 Analysis of Development Finance Institutions of Swaziland

Swaziland has several distinct types of DFIs, some of which are sophisticated multinational investment institutions. Table 96 shows the sectors covered by each of these DFIs.

Table 96: Sectoral Analysis in Swaziland

Sector	Institution
Agricultural	Swazibank, FINCORP, SIDC
Industry	Swazibank, SIDC
Micro SMEs	Swazibank, FINCORP
Housing	Swazibank.

Source: Annual Reports

Table 96 shows the three development finance institutions covered in this study: the Swaziland Industrial Development Company (SIDC), FINCORP, and the Swaziland Development and Savings Bank (SDSB). Each of these institutions operates with a different management structure, market philosophy, and client focus. However, it is clear from Table 96 that although Swaziland is a relatively small country, it has several DFIs whose mandates overlap. Size alone makes it difficult for a DFI to be sustainable if required to concentrate in a single sector.

3.1 Swaziland Development and Savings Bank (SDSB)

The Swaziland Development and Savings Bank (SDSB) is a wholly government-owned development finance institution and quasi-commercial bank established and governed by the Swaziland Development and Savings Bank Order (No. 49 of 1973 as amended in 1993). The SDSB is administered, managed and controlled subject to this Order and the provisions of the Financial Institutions Order (1974).

3.1.1 SDSB's Mandate

SDSB's mandate is to promote Swaziland's economic development with maximum participation from the country's citizens. It is also responsible for developing the country's commercial and industrial sectors. SDSB is also allowed to carry out the following activities:

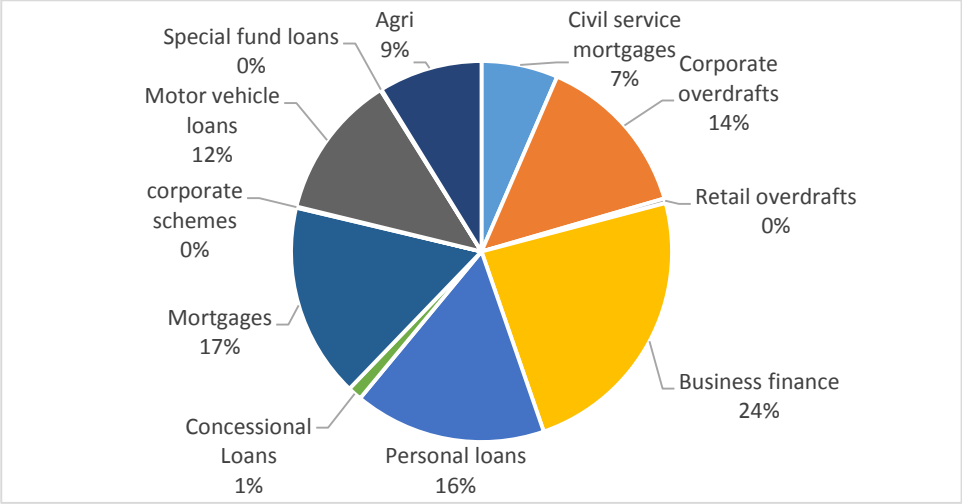
to participate in the equity of other domestic financial institutions, to mobilise domestic savings by accepting deposits under special savings schemes, to promote agricultural and rural industries, to train Swazi citizens, to provide improved housing and health facilities within Swaziland, to develop land and construct buildings and to finance trade, business and industry. Loan advances are made to the following sectors: agriculture, manufacturing, construction, commerce, and housing.

Some of the banks' activities are supplemented by the Swaziland Building Society and the Swaziland Industrial Development Company, which provide term lending for, respectively, mortgage finance and industrial development.

3.1.2 Portfolio Analysis of SDSB

During the financial year ending 31 March 2012, the total loan portfolio of SDSB stood at E 1,152 million. The bulk of the loan portfolio (56.6%) was split between business finance, which accounted for 23.8%, mortgage loans (16.5%), and personal loans (16.3%). The remaining 43.4% of loans was split among the remaining sectors. The distribution of the portfolio by sector is shown in Figure 26.

Figure 26: Resources Distribution by Sector – Swazibank



Sources: Swazibank 2012 Annual Report

Figure 26 shows the Swazibank's mandate is broad and that although the bank has followed it in supporting agriculture, the resource distribution clearly shows that that there has been a mandate drift or extension, creating the possibility of overlaps with other DFIs.

3.1.3 Corporate Governance and Risk Management for SDSB

3.1.3.1 The Governing Legal Environment

The SDSB is required to comply with various laws setting out governance requirements. Principal among these are the King's Order No. 49 of 1973 as amended by the King's Order No. 15 of 1993, and the Financial Institution Order. Those involved in the bank include:

- Shareholders, who directly or indirectly appoint directors, management, the audit committee, internal auditors, and external auditors. As the company is a separate legal persona, the shareholders do not attract personal responsibility for the liabilities of the company, except in exceptional circumstances.
- The Board of Directors, who manage the bank and carry the ultimate responsibility for ensuring the success of the enterprise. They are required to comply with the Financial Institution Order.

3.1.3.2 The Board

The Board of Directors consists of the chairman, who is non-executive and not a civil servant, and six members, five of whom are not public servants, but have skills in banking, financial, commercial or agricultural matters. All members of the board are appointed by the Minister of Finance. The managing director (MD), who is also the Chief Executive Officer of the Bank, is also appointed by the Minister in consultation with the Cabinet standing committee and board of directors.

3.1.3.3 Risk Management

Risk management for the SDSB is carried out by the Risk and Compliance Department. The Risk and Compliance Department identifies, evaluates and monitors financial risks in close co-operation with the Bank's operating units. The board provides policies for overall risk management, as well as covering specific areas, such as foreign exchange risk, interest rate risk, credit risk, the use of derivative and non-derivative financial instruments, and the investment of excess liquidity. Using this risk management framework, the Bank has experienced a decrease in the institution's gross non-performing loan ratio from 13.8% in 2011 to 11.2% in 2012.

3.1.4 SDSB's Business Model

The Bank's activities, as shown in Table 97, are funded mainly through shareholders' equity, funding from institutional investors such as IDC South Africa, and customer deposits.

Table 97: Funding and Lending for SDSB

	2012 E Million	Breakdown (%)	2011 E Million	Breakdown (%)
Long-term	453.2	26.5	378.0	28.8
Short-term	655.8	73.5	600.6	71.2
Sub-total	1,109.0	100.0	1,312.1	100.0
Equity	435.5		385.3	
Total Funding	1,544.5		1,697.4	
Lending & Invest.	1,213.3	2.1↓	1,238.8	

Source: Swazibank 2012 Annual Report

Table 97 shows that the Bank, at 73.5% short-term funding to total external funding in 2012, has mostly short-term sources of external funding at its disposal. Most of the Bank's lending (65%) was long-term in 2012.

This situation poses a funding risk, as the Bank may not be able to recall its term loans in the event that it fails to roll over or mobilise enough short-term deposits. For this reason the current business model of the Bank is not sustainable.

3.1.5 Financial Performance of SDSB

During the period studied, the Bank's total assets increased by 1%. This was on account of increases in loans and advances to customers and in investment securities. Net interest income increased by 8% in the wake of the increase in loans and advances. Despite economic challenges, the Bank made a profit of roughly a million Emalangeni, rising from E10.4 million in 2011 to E11.3 million in 2012.

Table 98: Statement of Financial position for SDSB

	2012 E Million	% change	2011 E Million
Statement of Financial position			
ASSETS			
Total Assets	1,718	1	1,699
Liabilities and Equity			
Equity	436		385
Liabilities			
Short term liability	868		811
Long term liability	414		503
Total liabilities	1,282		1,314
Total Equity and Liabilities	1,718		1,699
Statement of Comprehensive Income			
Net Interest Income	78.0	8	72.0
Profit for the year	39.0	-3	40.0
Impairments	9.0	-25	12.0
Operating expenses	136.0	16	117.0
Key ratios	%		%
Return on Assets	2.3		2.4
Return on Equity	8.9		10.4
Net Profit margin	50		56
Operating expenses as % of NII	174		163
Impairments as % of NII	12		17
Operating costs and impairments as % of NII	186		179

Source SDSB 2012 Annual Report

Table 98 also shows that although the Bank experienced an increase in net interest income, this did not lead to an improvement in profitability, as the net profit margin decreased slightly, from 56% to 50%. This was due to the net effect of an increase in operating costs of 16%, and a decrease in impairments of 25%. Operating costs amounted to 174% of net interest income, and impairments to 12%. The bank is therefore unsustainable as it is not able to cover its costs from interest income alone.

3.2 The Swaziland Industrial Development Company (SIDC).

The Swaziland Industrial Development Company (SIDC) was formed in 1987 as a joint venture between the Government of the Kingdom of Swaziland and major international finance institutions such as the DEG (Germany), CDC (the UK), FMO (the Netherlands), Proparco of France and the IFC (World Bank). These financial institutions sold their shareholdings in 2008 to the Swaziland National Provident Fund (SNPF) and Intenueron Investment Trust. As a result, the current shareholding of the Company is: the Swaziland

Government (34.95%), SNPF (31%), and Intenueron Investment Trust (30.95%), with the balance of 3.1% split evenly between Standard Bank Swaziland, and Nedbank Swaziland.

3.2.1 SIDC's Mandate

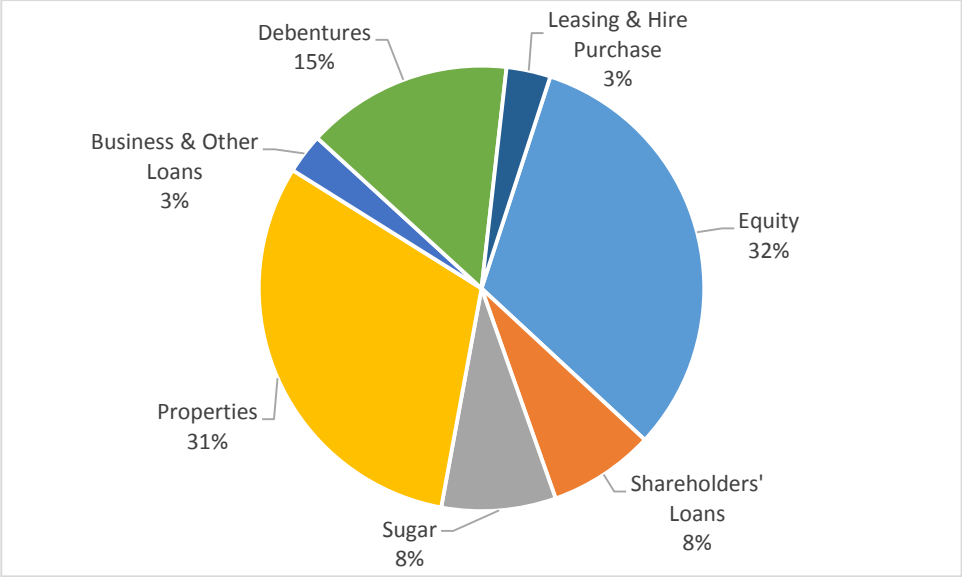
SIDC has a mandate to contribute directly to the achievement of the Swaziland Government's developmental goals. This is to be achieved through mobilizing and providing development finance, which is sourced from both domestic and international sources. The resources are used to support both expanding and new business ventures. The products offered by SIDC include loans, equity participation, lease financing, leasing of property including factory shells, and advisory services. The loan portfolio has been decreasing following the difficulties experienced in securing funding for the company.

3.2.2 Portfolio Analysis of SIDC

As of June 2012, SIDC[45] reported a net investment position (investments and loans) of E604.7 million. This excludes a specific provision of E28.9 million reported as at 30 June 2012. According to the loan portfolio review, the loans were funded by an E81.8 million loan from the Swaziland Government/AfDB, E12.1 million from Norsard, E40.1 million from Swazi Bank, and E9 million from the National Industrial Development Corporation. SIDC's investments were divided into E187.8 million in properties, E192.7 million i in equity and E224.3 million loans and advances. Figure 27 below shows the distribution of the investment and loans of the Company as of 30 June 2012. This distribution shows that that the mandate for the SIDC is broad and that the bulk of the resources of the Company, which amounted to 31.9% of its investment, was dedicated to equity investment and 30.0% to properties. The remaining 37.1% were used for loans and advances, distributed as follows: 7.7% to shareholders, 15.0% to debentures, 8.3% to the agricultural sector, focusing on sugar, 2.9% to business and other loans, and 3.2% to leasing and hire purchase.

[45] The analysis of the portfolio is based on SIDC as a stand-alone company and as a group.

Figure 27: Resources Distribution by Sector – SIDC



Source: SIDC 2012 Annual Report

3.2.3 Corporate Governance and Risk Management for SIDC

3.2.3.1 The Governing Legal Environment

SIDC, which is a development finance institution established under the Companies Act, is guided by and complies with the corporate governance requirements of the Companies Act and the recommendations of the King III Report.

3.2.3.2 The Board

The Board of Directors controls the operations of the SIDC, and has the ultimate responsibility for it. Currently the SIDC has eight non-executive board members and one ex-officio member, all appointed by shareholders, some for a definite period and some an indefinite period of time. The board meets at least four times a year and the meetings are chaired by a non-executive director.

3.2.3.3 Risk Management

A decentralised system is in place, with risk management in the hands of the executive. The Risk and Audit Committee, a subcommittee of the board, has ultimate responsibility of ensuring that risk is adequately managed. It is highly recommended that the institution adopt a formal risk management framework and also create a unit to deal with risk.

3.2.4 SIDC's Business Model

The Company's activities are funded through shareholders and funding from Norsad, Asian Development Bank and Government of Swaziland. The composition of the total funding over the two years under review is shown in Table 99 below.

Table 99: Funding and Lending for SIDC

	2012 E Million	Breakdown (%)	2011 E Million	Breakdown (%)
Long-term	142.9	100.0	148.7	100.0
Short-term	--	--	--	--
Sub-total	142.9	100.0	148.7	100.0
Equity	487.9		469.3	
Total Funding	630.8		618.0	
Lending & Invest.	642.6	1↓	648.9	

Source: SIDC 2012 Annual Report

Table 99 shows that the Company has exclusively (100% in 2012) long-term sources of external funding. This business model is sustainable in medium to long term as the on-lending and the various investment activities in which the Corporation is involved in are likely to be dominated by long-term financing. The Corporation is able to match the funding of its investment (assets) with long-term funding (borrowing).

3.2.5 Financial Performance of SIDC

The Swaziland Industrial Development Company is currently going through a difficult time and this is illustrated by the Company's financial performance during the two years under review (see Table 100 below).

Table 100: Statement of Financial position for SIDC

	2012 E Million	% change	2011 E Million
Statement of Financial position			
Assets			
Total Assets	705.0	3.0	685.0
Liabilities and Equity			
Equity	488.0	4.0	469.0
Liabilities			
Total liabilities	217.0	0.5	216.0
Total Equity and Liabilities	705.0		685.0
Statement of Comprehensive Income			
Net Interest Income	18.0	20.0	15.0
Profit after tax	19.0	-42.0	33.0
Operating expenses	18.0	80.0	10.0
Impairment	4.0	-85.0	27.0
Key ratios	%		%
Return on Assets	2.7		4.8
Return on Equity	3.9		7.0
Net Profit margin	106.0		220.0
Operating cost as % of revenue	100.0		67.0
Impairment as % of NII	22.0		180.0
Operating & impairment as % of NII	122.0		247.0

Source: SIDC 2012 Annual Report

The annual report shows a minimal increase in assets, equity and liability of 3%, 4% and 0.5% respectively. This is partly attributed to a poor loan portfolio, which was written off in 2011, and the lack of success in resource mobilization.

The financial performance of the institution can be summarized as follows:

- Total assets grew marginally by 3%, leading to a similar marginal growth in net assets;
- Net interest income increased by 24%. However, profit after tax decreased by 43%, mainly because of operating costs increased by 77% (mainly as a result of repairs to and maintenance of investment properties) and because 2011 profits included significant fair value gains from the valuation of investment properties and those of 2012 did not. With this change, return on assets and return on equity decreased from 4.8% to 2.7% and 7% to 3.9% respectively;
- Operating costs 100% of NII, an increase from 67%. NII was thus only barely able to cover its operating costs in 2012. SIDC has a substantial property portfolio, and it would be advisable for them to consider the ratio of operating costs to net income,

as net income includes rental income and a significant portion of their costs relate to the property portfolio. Without the property-related costs, the operating cost to NII ratio would be 59.8%, showing that the company is in fact able to cover its costs; and

- Impairments as a percentage of NII were 22%, a significant decrease from 180%. NII was able to cover impairments in 2012.

Together, the revised operating costs and impairments added up to 122% of NII, a decrease from 247% in 2011. Though this is an improvement, NII was not able to cover these costs in either year, making the corporation unsustainable in the absence of other income.

3.3 Swaziland Development Finance Corporation (FINCORP)

FINCORP was established in 1996 as a national DFI to provide the Swazi people with access to sound and sustainable financial services. It is a registered private corporation. There are only two shareholders; the Swazi government holds 80% of the shares, and a local investment company, Tibiyo Taka Ngwane, holds the remaining 20%.

3.3.1 FINCORP's Mandate

One of FINCORP's main objectives is to improve access to credit and business development support for SMEs. FINCORP operates across all sectors of the economy, but the institution is only authorized to lend to locally-based, majority Swazi-owned SMEs. Its other objectives include:

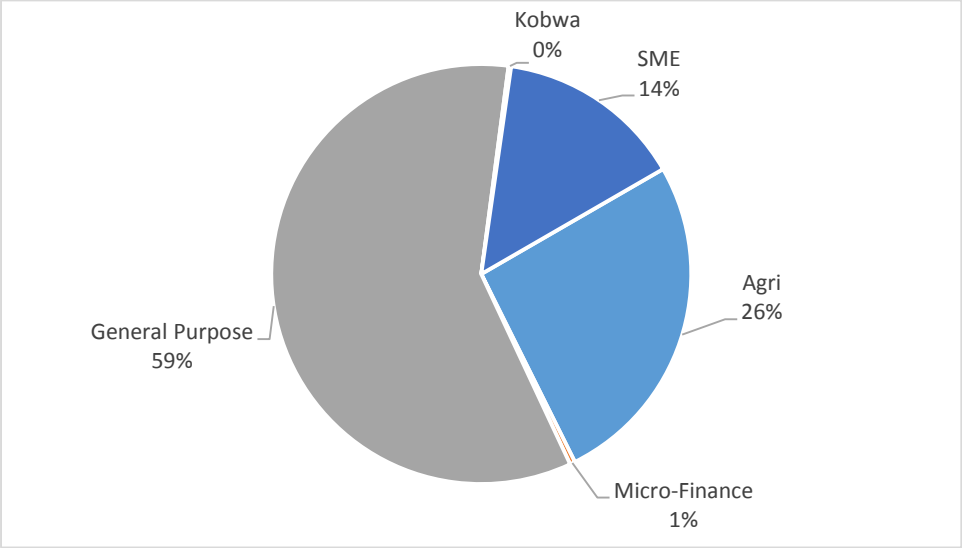
- financing and promoting the development of Swazi-owned enterprises;
- supporting the expansion of loan financing to SMEs and creating jobs;
- contributing to the eradication of poverty at a grassroots level; and
- supporting the provision of business advisory services, training, monitoring, technical transfers and the development of other products and services for SMEs.

3.3.2 Portfolio Analysis of FINCORP

Currently, FINCORP has a loan book of 492 million Emalangeni, and has, since its inception, approved over 60,000 loans. FINCORP initially made only uncollateralised loans, but has instituted a partially collateralised loan arrangement in order to manage risks in their portfolio better. This collateral requirement falls away when SMEs are able to provide a cession of proceeds or are willing to enter into a contract, in which case FINCORP requires only a 5% deposit. FINCORP has also recently introduced salary-based lending through its

subsidiary, FirstFinance. The subsidiary already has over 6000 clients, who use loans mostly for education, rural housing and electrification. A summary of these loans and other investments is shown in Figure 28 below.

Figure 28: Resources Distribution by Sector – FINCORP



Source: FINCORP 2012 Annual Report

The pie chart shows that of the total disbursement of E338.8 million in 2012, general purpose loans accounted for 59%, followed by 26% to the agricultural sector (11.2% agricultural loans and 14.8% sugar cane loans), 14.4% to SMEs, 0.004% to micro-lending, and 0.001% was granted to the Kobwa loan scheme. This shows that the mandate of the Corporation is broad and very similar to that of SIDC. It is worth noting that the resources disbursed SMEs are very small when one considers the core mandate of the Corporation, which is SME support.

3.3.3 Corporate Governance and Risk Management for FINCORP

3.3.3.1 The Governing Legal Environment

FINCORP was established under the Finance & Audit Act of 1967 and registered under the Companies Act. It is subject to the good governance requirements of the Companies Act of 2009, Public Enterprise Control and Monitoring Act of 1989, and the King III Code.

3.3.3.2 The Board

The corporation is governed by a board of directors composed of nine directors selected to ensure the wide range of skills and knowledge necessary to meet the Corporation's strategic objectives. The size of the board is dictated by the Public Enterprise Unit Act, which permits

a minimum of five and a maximum of nine directors to be appointed by the shareholders. The government appoints six and Tibiyo TakaNgwane appoints three directors. At present there are three female directors and six male directors. The chairperson of the board is appointed by the majority shareholder, in this case the Swazi government. The board appoints the company secretary. All the directors, with the exception of the managing director, are non-executive and non-independent, as they are appointed by the shareholders. The positions of chairperson and managing director are not held by the same person, so as to ensure a clear division of duties. The board members are not involved in the day-to-day operations of the business and do not draw any remuneration from FINCORP, other than the prescribed board fees.

The choice of directors with diverse backgrounds and expertise is intended to facilitate independent judgment and make the board's deliberations more effective. The skills mix at the end of 2012 included expertise in entrepreneurship development, chartered accountancy, financial management, supply chain management, law, industrial relations and marketing. While the board delegates its authority to management, it retains overall responsibility.

Two sub-Committees have been established: the Audit, Risk & Finance Committee (3 members) and the Remunerations Committee (5 members). The managing director sits on both committees as an additional member.

3.3.3.3 Risk Management

Risk management at FINCORP is a primary the responsibility of the managing director under the direct supervision of the Audit Committee. In a constantly-changing macroeconomic environment, increased emphasis has been placed on the ability of financial institutions to manage risk. FINCORP faces several inherent risks that could result in low business performance and a loss of assets; these require constant monitoring. FINCORP regards itself as committed to robust risk management. Despite the Corporation putting in place a risk management framework, the Corporation has experienced a high level of NPLs, which during the period under review declined by 7%, from 33% in 2011 to 26% in 2012. The level of NPLs is still high and the Corporation needs to reduce it to a manageable level of below 10%.

3.3.4 FINCORP's Business Model

FINCORP' activities are funded mainly through shareholders' equity and by institutional partners. These partners include AfDB, the OPEC Fund, the Swaziland National Provident Fund, Norsad, Kobwa Loan Fund, IDC South Africa, the Public Enterprise Unit, Standard Bank and Interneuron. Table 101 below shows the total composition of the funding during the two years under review.

Table 101: Funding and Lending for SIDC

	2012 E Million	Breakdown (%)	2011 E Million	Breakdown (%)
Long-term	169.1	83.0	170.4	75.5
Short-term	34.6	17.0	55.0	24.5
Sub-total	203.7	100.0	225.4	100.0
Equity	175.5		173.9	
Total Funding	379.2		399.3	
Lending & Invest.	371.1	16.5↑	318.5	

Source: FINCORP 2012 Annual Report

The table shows that the Corporation has predominantly (83%) long-term sources of external funding. The Corporation also has a diversified portfolio of funding sources, which includes private commercial banks, national and regional DFIs, and both local and international development funds. Their business model is sustainable as it allows the Corporation to match the maturity of its assets with the maturity of its borrowed funds (funding liabilities).

3.3.5 Financial Performance of FINCORP

FINCORP has reported improved financial results despite currently adverse economic conditions which have seen most businesses experiencing low business activity. Businesses which rely on government support for their products and services have particularly struggled as government has cut down on its spending. This is mostly attributable to the decline in Southern African Customs Union (SACU) revenue. Despite this, the Corporation has posted after-tax profits of E7.2million. This is a considerable improvement on last year's after-tax profits of E1.6million.

Table 102 shows a summary of financial position of the Corporation over the period under review.

Table 102: Statement of Financial position for FINCORP

	2012 E Million	% change	2011 E Million
Assets			
Loans and advances	358.0	17.0	305.0
Other assets	70.0	-48.0	135.0
Total Assets	428.0	-3.0	440.0
Liabilities And Equity			
Equity	176.0	1.0	174.0
Liabilities			
Total liabilities	252.0		266.0
Total Equity and Liabilities	428.0		440.0
Statement of Comprehensive Income			
Net Interest Income	29.0	-24.0	38.0
Profit for period	1.0	-17.0	1.2
Operating expenses	24		25.0
Net impairment of loans and advances	11.0		16.0
Key ratios	%		%
Return on Assets	0.2		27.0
Return on Equity	1.0		1.0
Net Profit margin	3.0		3.0
Operating expenses as % of NII	83.0		66.0
Impairment as % of NII	38.0		42.0
Operating exp. And impairment as % of NII	121.0		108.0

Source: FINCORP 2012 Annual Report

The following can be discerned from the table:

(a) Loans and advances increased by 17%. However, this increase did not translate into increased net interest income or the increased profitability of the corporation. Net interest income decreased by 24% and profit decreased by 17%;

(b) Operating expenses as a percentage of NII increased from 66% to 83%. However, NII can still cover operating expenses; and

(c) Loan impairments as a percentage of NII decreased slightly from 42% to 38%. NII is able to cover loan impairments.

With a combined total for loan impairments and operating costs of 121% of NII, the corporation is not able to sustain itself from operational income alone.

4 Co-ordination, Regulation and Supervision of DFIs in Swaziland

4.1 Co-ordination

As indicated in Table 103 below, all three DFIs in Swaziland, that is, the Swaziland Development and Savings Bank (Swazibank), the Swaziland Development Finance

Corporation (FINCORP) and the Swaziland Industrial Development Corporation (SIDC) are coordinated by the Ministry of Finance. Despite this, Swaziland does not have a policy framework for coordinating the DFIs.

The analysis also shows that SwaziBank carries functions as both a development and commercial bank, while FINCORP's activities are skewed towards microfinance and SIDC focuses mainly on large project finance.

Table 103: Co-ordination, legal and Regulation of DFIs- Swaziland

Institutions	Legal and ownership	Co-ordinator	Regulator
1. Swaziland Development and Savings Bank (SDSB)	• The King's Order in Council of 1973 as amended 1993 • Wholly owned by the State	• Ministry of Finance	• Central Bank of Swaziland
2. The Swaziland Industrial Development Corporation (SIDC)	• Companies Act • Majority owned by Government (34.9%)	• Ministry of Finance	• Financial Services Regulatory Authority (FSRA)
3. Swaziland Development Finance Corporation (FINCORP)	• Companies Act of 2009 • Majority owned by the State (80%)	• Ministry of Finance	• Financial Services Regulatory Authority (FSRA)

Sources: The King's Order in Council of 1973, Survey questionnaires

4.2 Regulation and Supervision

Table 103 also shows that while Swazibank is regulated and supervised by the Central Bank of Swaziland under the Financial Institutions Act (2005), FINCORP and SIDC are regulated and supervised the newly established Financial Services Regulatory Authority.

Once again, this situation demonstrates the lack of an overarching legal regulatory policy framework for all the DFIs currently operating in Swaziland. This will inevitably lead to inappropriate regulation for Swazibank, and weak regulation for the industry.

5 Conclusion

The Swaziland banking sector consists of three commercial banks (Nedbank, Standard Bank and FNB), a mutual building society (Swaziland Building Society) and a statutory bank (Swazibank).

Swaziland has excess liquidity in the banking sector, mainly owing to a lack of investment opportunities. This can be attributed to a number of factors. Not only has economic growth been poor, but banks also find it easier to invest in government bills or with South African parent companies.

Despite these constraints, very little effort is currently being made by commercial banks to reach a broader section of the population. Lack of competition allows them to maintain high interest margins and the products and services offered by the Swaziland banks are a subset of the products available in South Africa. Loan and mortgage products focus on middle- and upper-income earners and there has been little innovation.

The Swazi government has established a number of institutions to improve financial access for its citizens. The most important of those reviewed here are the Swaziland Development and Savings Bank, the Swaziland Development Finance Corporation, and the Swaziland Industrial Development Company.

Key findings on development finance system of Swaziland are:

- Swaziland has a relatively active development finance sector. Despite this, the country still experiences a huge development finance gap;
- Most DFIs currently operating in Swaziland are not well capitalised, with government offering only lukewarm support;
- There is also a lack of any uniform statutory method for establishing DFIs in Swaziland, as can be seen by the different foundational Acts of the various DFIs;
- All three DFIs have broad mandates and also exhibit a high level of mandate drift and overlap. This is inevitable in a small market;
- None of the DFIs currently operating in Swaziland has a regional mandate;
- While business models for FINCORP and SIDC are in line with the development finance business model, the Swazibank business model appear not to be.

Furthermore, all the DFIs in Swaziland have a low-to-medium gearing ratio. This is attributed to lack of resource mobilisation strategy on the part of the DFIs;

- None of the three DFIs in Swaziland is financially sustainable;
- The DFIs have strategic plans which are not adequately supported financially by government;
- The DFIs have weak corporate governance structures;
- The DFIs have weak, or no, uniform risk management frameworks;
- There is no standard practice with regard to shareholding representation on the boards of DFIs. Board members are usually appointed by the Ministers;
- Despite the fact that all three DFIs report to the Ministry of Finance, there is no overarching policy framework for coordinating the activities of DFIs in Swaziland.
- With one DFI being regulated by the Central Bank of Swaziland, and the other two by the newly established Financial Services Regulatory Authority, there is no overarching regulatory framework for DFIs in Swaziland.

COUNTRY STUDY 11: TANZANIA

The SADC DFRC Project Team of Dr. Lufeyo Banda and Dr. Herrick Mpuku held discussions in Tanzania on the 20th and 21st of January, 2014, for the SADC DFI Scan study. The following review is based on the information collected and discussions with representatives from the Central Bank, the Tanzanian Investment Bank and the National Development Corporation.

Background on Tanzania

Tanzania is a growing economy, straddling the East African and Southern African economic development communities. The country has experienced impressive growth rates over the past decade. After a brief dip as a result of the global downturn in 2010, Tanzania has recovered, with GDP growth at 7% in 2012 and 2013, and forecast to be 7.4% in 2014. The main driver has been performance in the services sector, but investments in the natural gas sector are also significant. The construction sector also performed well, comprising 8.8% of GDP in 2011, mainly driven by increases in residential and non-residential building, roads and bridges, and land improvement activities. Notwithstanding this impressive growth, Tanzania has suffered high inflation rates over the past few years, with inflation reaching 16.1% in 2012. According to African Economic Outlook, inflation is expected to drop to single digits in 2013 (7.9%) and 2014 (6.9%).

Table 104: Key Figures for Tanzania

Capital	Dodoma
Exchange Rate: 1 US$ =	1 615.48 Tanzanian Shilling (TZS)
Population ^	47 783 107
Population growth rate (%) ^	3.04
Urban population (% of total) ^	27.21
Urbanisation rate (%) ^	4.75
GDP per capita (US$) ^	608.85
GDP growth rate (%, real) ^	6.4
GNI per capita, Atlas method (current US$) ^	570
Population less than US$2 per day~	87.87
Population below national poverty line *	35.7
Gini co-efficient ~	37.58
HDI (Global Ranking)”	152
HDI (Country Index Score) “	0.476
Unemployment rate (%) *	4.30
Bank branches per 100 000 ^	1.95
Lending Interest Rate ^	15.46
Deposit Interest Rate ^	9.51
Credit % of GDP ^	24.82
Inflation	16.1
Ease of Doing Business Ranking (out of 185 countries)	134

Sources: ^ World Bank’s World Development Indicators (2012), ~ World Bank PovcalNet: an online poverty analysis tool, various years; = www.coinmill.com on 26 August 2013; “UNDP’s International Human Development Indicators (2012); * African Economic Outlook, various years;! World Bank’s Doing Business Survey Data (2013).

In addition, positive economic indicators, the reforms which have been undertaken by the government and stable political leadership have resulted in substantial multilateral and donor

support for the country's development agenda. Some of this support is specifically targeted at developing SMEs, infrastructure, housing etc.

Despite Tanzania's good economic performance, the country has been beset with a number of social challenges. For instance, even though the country's ranking in UNDP's Human Development Index showed some improvement from 0.398 in 2010 to 0.476 in 2012, poverty still remained high, suggesting that despite impressive macroeconomic achievements and sustained economic growth over the past few years, there has been very little impact on the incomes and well-being of the poor. Available evidence points to the weak redistributive aspect of growth, especially the weak linkages with rural areas where the majority of the population lives.

Another key challenge facing Tanzania is unemployment levels. Unemployment is currently estimated at 4.3 % and youth unemployment (people aged 15-24) stood at 14.9% in 2012. The rate is estimated to be as high as 24% amongst urban youth. Underemployment, although thought to be high, is not fully captured by official statistics. Over 76% of the labour force is engaged in small-scale, mostly rain-fed, subsistence agriculture. Thus the lack of requisite skills and long-term finance are both major constraints to the socioeconomic development of Tanzania.

2 Access to Finance-Tanzania

After two decades of economic liberalisation, Tanzania now has 45 commercial banks and many other private financial institutions. This has resulted in an expansion of credit to the private sector which in 2012 came to 17% of GDP. The private banking sector is sound and profitable, with capital adequacy ratios above regulatory standards.

Nevertheless, the gross domestic savings rate, which was estimated at 20% of the country's GDP in 2010, is an indication of a shallow financial system. The economy also faces major challenges in the area of access to finance by entrepreneurs and firms which require term funding. The lack of long-term funding is also attributable to the low level of development in the Tanzanian development finance institutions. Table 105 shows the finance gap currently existing in Tanzania.

Table 105: Access to Finance - Tanzania

#	Indicator		SSA Region
1	% of firms using banks to finance investment	11.8	18.0
2	Proportion of investment financed internally (%)	83.2	78.4
3	Proportion of investment financed by banks (%)	3.4	9.9
4	Proportion of investment financed by suppliers of credit (%)	1.0	3.8
5	Proportion of investment finance by equity or stock sale (%)	6.6	3.7
6	Availability of financial services	51.4	100(int)
7	% of firms identifying access to finance as a major constraint	44.8	41.9

Sources: Enterprise Surveys (http://www.enterprisesurveys.org), The World Bank,
The Global Competitiveness Report 2011-2012 © 2011 World Economic Forum

Table 105 shows that despite an increase in the number of banks in Tanzania, access to credit is low by regional and international standards. For instance, only 11.8% of firms use banks to finance investment. In addition, World Bank Enterprise Surveys data shows that of the total investment required, 3.4% was supplied by banks, 1.0% by trade credit suppliers, 6.6% through equity, and 83.2% was financed internally by the entrepreneurs. Furthermore, this low level of access to finance is reflected in the low international ranking of Tanzania of 100 out of 142 countries for availability of financial services. The analysis shows a huge financing gap which requires government intervention through such institutions as the Tanzania Investment Bank, the National Development Corporation, and the soon to be introduced Agricultural Development Bank (Agribank). As there was no information on Agribank of Tanzania, this study only reviewed two DFIs in detail.

3 Analysis of Development Finance Institutions of Tanzania

Two development finance institutions (DFIs) were selected for analysis. The Tanzanian Investment Bank (TIB) primarily serves the commercial market place and acts as both a credit and savings institution, and the National Development Corporation (NDC)i identifies projects which have a high inherent potential to enhance economic growth in the country, and leads in their development. The NDC is also expected to take the lead in Tanzania's collaboration with other SADC DFIs.

As it was not possible to meet with representatives from Agribank and the Small Industries Development Organisation (the other two DFIs of Tanzania) or obtain necessary information, these DFIs are not included in this study. Table 106 therefore shows only two DFIs surveyed and the economic sectors they cover.

Table 106: Sectoral Analysis in Tanzania

Sector	Institution
Agricultural	TIB
Industry	TIB, NDC
Infrastructure	TIB, NDC
Micro financing and SMEs	TIB

***Source*: TIB and NDC 2012 Annual Reports**

3.1 TIB Development Bank

The TIB Development Bank (TIB), which is 99.7% owned by the Government of Tanzania, was established by an Act of Parliament in 1970. At that time, the main objective of the Bank was to provide medium-to-long-term loans to investors in the commercial, agricultural, manufacturing, processing, construction, transport, tourism and mining sectors. However, because of economic hardships, including a war with Uganda and foreign currency fluctuations, the Bank became unable to service its obligations. To mitigate financial losses, TIB resorted to making short-term loans and to functioning like a commercial bank. The period from 1980 to 2003 was particularly difficult for the Bank.

In 2003, the IMF carried out its Financial Sector Assessment Programme and one of its recommendations was that long-term financing was critical to the development of the Tanzanian economy, especially in the rural areas. In 2010, the Government approved the transformation of TIB Development Bank into a development finance institution in a bid to improve access to long-term development finance. TIB was also empowered by the government to operate a special window for agricultural finance, with effect from July 2010. The government is committed to injecting additional capital to facilitate long-term development finance in the country.

3.1.1 TIB's Mandate

TIB is a development finance institution intended to address specific financial market deficiencies, specifically: the extension of term loans, the provision of technical advice and support to investors, the strengthening of an entrepreneurship culture and identification of viable business opportunities, the strengthening of the equity market, and the targeting of social and environmental issues. In addition, the Bank also offers commercial banking services which include trade financing and deposit taking.

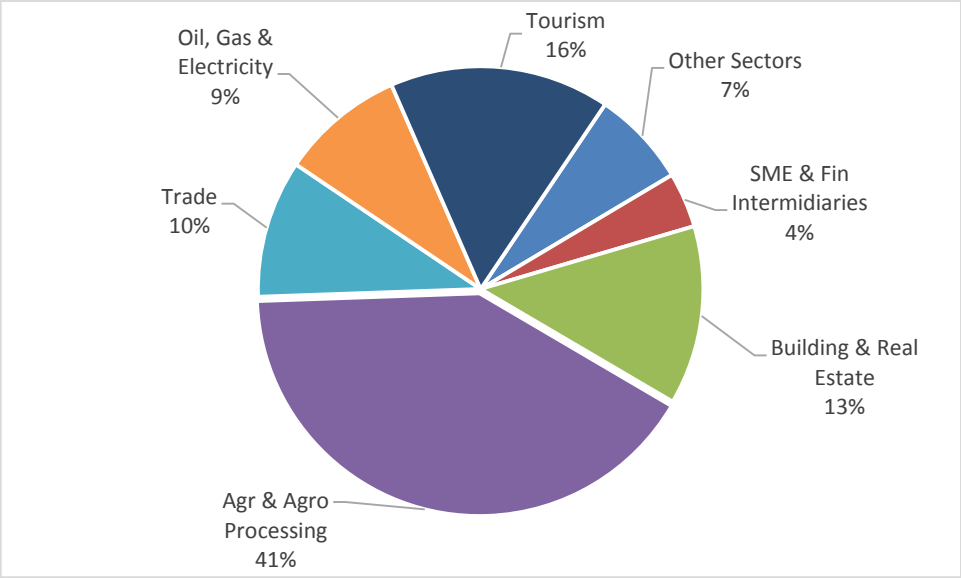
3.1.2 Portfolio Analysis of TIB

As at 31st December 2012, the bank had an "on balance sheet" gross loan portfolio amounting to TZS 246,430 million, a growth of 33% from TZS 184,830 million in 2011. Of this total, developmental term loans make up 68% and overdraft and individual loans account for 32%. The concentration of resources on term financing is in line with the bank's mandate to use term financing as a means to national development.

Total disbursements for development term loans were TZS 54,911 million in 2012, compared to TZS 59,833 million in 2011. The commitments at the end of 2012 amounted to TZS 38,958 million, compared to TZS 48,461 million at the end of 2011.

Figure 29 below shows that 41% of the bank's investment was devoted to agriculture and agro-processing, followed by tourism, hotels and restaurants at 16%, building, construction and real estate at 13%, trade at 10%, and oil and gas at 9%. , Miscellaneous 'other sectors' accounted for 7%, and SMEs and financial intermediaries 4% of the total portfolio.

Figure 29: Resources Distribution by Sector – TIB



Source: TIB 2012 Annual Report

Figure 29 shows the extensiveness of TIB's mandate. There is potential for mandate creep and duplication of the work of the other DFIs. Furthermore, the fact that only 24.6% of loans have been channelled towards developments loans indicates a mandate drift. For this reason, there is a need to define the mandates of TIB and the other DFIs clearly.

3.1.3 Corporate Governance and Risk Management for TIB

3.1.3.1 The Governing Legal Environment

The governance framework for TIB is premised on the Companies Act (2002), and the Banking and Financial Institutions Act (2006). These two instruments guide how the Bank conducts its business and complies with regulatory requirements. The frameworks provide for the establishment of a board of directors.

3.1.3.2 The Board

Currently the board of TIB consists of non-executive directors. The Board is composed of eight members, six of whom are non-executive and five of whom are independent. The tenure of the members is three years. The chairman of the board and the managing director are presidential appointees, and all other members are appointed by the Minister for Finance. The membership of the board therefore reflects the shareholding of the Bank (i.e., the Tanzanian government) but also has members who are not affiliated to any shareholder.

The board has established three board committees: the Board Executive Committee (BEC), the Board Audit and Risk Committee (BARC) and the Board Human Resources and Remuneration Committee (BHRRC).

3.1.3.3 Risk Management

Risk management for the Bank is guided by several principles, the most important being:

- The adoption of a Risk Management Framework for integrated risk management which applies across all business units and all risk types, in order to protect the bank's reputation;
- The assignment of appropriate responsibility and accountability for all risks and resulting returns;
- Comprehensive risk assessment, measurement, monitoring and reporting;
- An independent review; and
- Formal risk governance processes.

It should be noted that even though the Bank observes risk management practices, the NPL ratio is high at 23.4%. This is attributed to TIB having to deal with troubled infrastructure projects.

3.1.4 TIB's Business Model

Funding of the various activities carried out by TIB is mainly through resources generated from shareholders' equity and deposits. The Bank also administers government funds which are disbursed for special projects on behalf of the government. The establishment, design and approval of these special projects rests with the government, through the Ministry of Finance. All risks and rewards arising from special projects are directly channelled to the Ministry of Finance. The bank receives management fees and urgency fees from these projects at agreed rates depending on the nature and complexity of projects.

The composition of total funding and the total book value of investment over the two years under review are shown in Table 107 below.

Table 107: Funding and Lending for TIB

	2012 TZS Million	Breakdown (%)	2011 TZS Million	Breakdown (%)
Long-term	1.3	0.8	2.1	1.1
Short-term	159.4	99.2	184.2	98.9
Sub-total	160.7	100.0	186.3	100.0
Equity	173.9		115.6	
Total Funding	334.6		301.9	
Lending & Invest.	321.4	13.1	284.1	

Source: TIB 2012 Annual Report

Table 107 shows that the government's share capital has been contributing almost half TIB's total funding. In addition, the table shows that the Bank's sources of external funding is almost entirely short-term (99.2% in 2012) This business model is not ideal for a development finance institution as the investment portfolio of the Bank is likely to be composed of long-term investments owing to the nature of the sectors and financial instruments used by the Bank. There is therefore a risk of maturity transformation, where the Bank is unable to meet its obligations because it cannot recall its long-term investments.

3.1.5 Financial Performance of TIB

During the period under review, the bank recorded a profit before tax of TZS 8,548 million, with an actual profit of TZS 5,788 million. The government of Tanzania, in keeping with its development finance agenda, injected more capital into the bank, leading to a 50.4% increase in the bank's capital equity.

Despite the bank experiencing an increase in total assets by 10% during 2011 and 2012, its total liabilities declined by 14%. This was mainly caused by the decrease in the number of outstanding creditors. Table 108 below shows that financial health of TIB.

Table 108: Statement of Financial position TIB

	2012 (TZS Million)	% change	2011 (TZS Million)
Assets			
Total Assets	337,799.0	10.0	305,803.0
Liabilities and Equity			
Equity	173,859.0	50.0	115,602.0
Liabilities			
Total liabilities	163,940.0	-14.0	190,201.0
Total Equity and Liabilities	337,799.0		305,803.0
Statement of Comprehensive Income			
Net Interest Income	30,514.0	33.0	22,885.0
Profit before tax	8,257.0	43.0	5,788.0
Impairments	7,824.0	-5.0	8,219.0
Operating expenses	19,861.0	23.0	16,101.0
Key ratios			
Return on Assets	2.3		2.7
Return on Equity	4.5		7.1
Net Profit margin	26		36.0
Operating expenses as % of NII	65.0		70.0
Impairments as a % of NII	26.0		36.0
Impairments & Op. costs as % of NII	91.0		106.0

Source: TIB 2012 Annual Report

The key points to draw from this table are:

- The Bank experienced a 10% increase in total assets in 2012, owing to an increase in the loan portfolio. The increase in the loan portfolio was also responsible for a 33% increase in net interest income. As a result, profit before tax improved by 43%. This was in spite of operating costs increasing by 23%;
- In 2012, return on assets and return on equity decreased slightly as did the net profit margin;
- Operating costs were 65% of NII, down from 70% in 2011. NII was able to cover these costs in both years with an improved position in 2012; and
- Impairments were 26% of NII, down from 36%, and could also be covered by NII in both years.

Combined costs and impairments dropped from 106% of NII to 91%, making the bank sustainable in the short-to-medium term.

3.2 National Development Corporation of Tanzania (NDC)

The National Development Corporation (NDC) is public institution established in 1962 by an Act of Parliament No. 69 as an investment arm of the Government to coordinate and oversee a wide range feasibility studies and industrial investments, mainly of intermediate and capital nature.

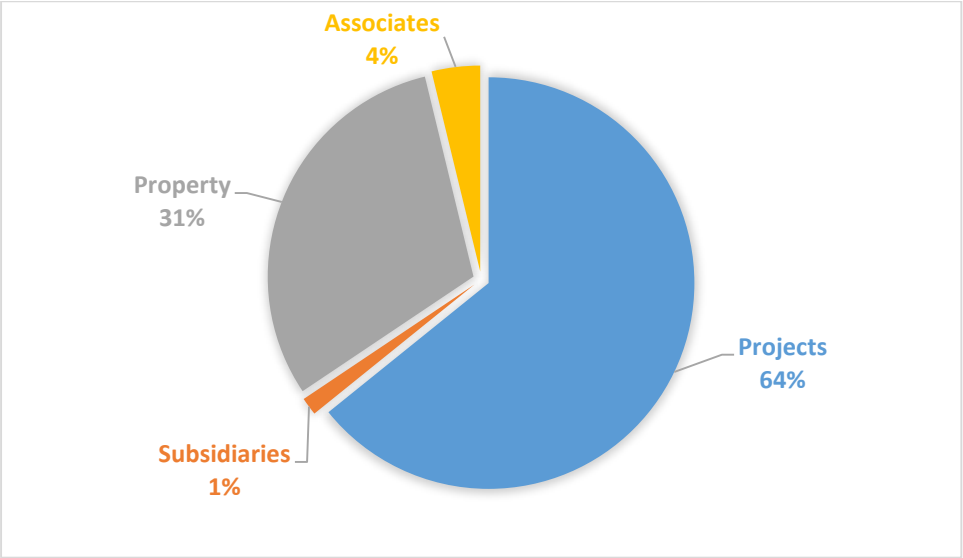
3.2.1 NDC Mandate

The National Development Corporation (NDC) is concerns itself with identifying and developing projects considered to be significant to the development and transformation of the national production structure and export mix. The NDC is collaborates with other SADC DFIs to pool resources and identify joint projects. It also provides other services, as necessary, to enhance industrial development, broaden people's economic participation and preserve national interests.

3.2.2 Portfolio Analysis of NDC

The NDC investment book, which totals roughly TZS71.2 billion, is mainly taken up by 22 projects which account for 64.2% of the total. Property investment accounts for 30.6% and investment in subsidiaries and associated companies accounts for the remaining 5.2%. Figure 30 below shows the portfolio distribution according to type of investment.

Figure 30: Portfolio of investment of NDC



Source: NDC 2012 Annual Report

Figure 30 shows that the bulk of NDC's investment is in a vareity of projects, such as power production (e.g. Mchuchuma-Katewaka Coal to Electricity Generation and Singida Wind Power), metallurgical and chemical industries (e.g. Liganga Iron Ore, Lake Natron Soda Ash, and the proposed Engaruka project), , biological industries (e.g. the Biolarvicide Factory), and agro-industries (e.g. rubber plantations and palm oil) Many of these projects are still being developed have not yet started to generate income for the Corporation.

3.2.3 Corporate Governance and Risk Management for NDC

3.2.3.1 The Governing Legal Environment

The National Development Corporation is required to comply with the provisions of Public Corporations Act, 1992, the Public Finance Act and Public Procurement Acts (2011) and other legislation. The NDC is governed by a board of directors, but day-to-day operations are managed by executive management.

3.2.3.2 The Board

The Corporation is governed by a board of directors made up of nine Directors (eight non-executive directors and one executive director). Only the managing director holds an executive position in the Corporation and there is only one representative from the Ministry of Industry and Trade, the NDC's line ministry. The board is charged with overall responsibility for the Corporation, including identifying key risk areas, considering and monitoring investment decisions, considering significant matters, and reviewing the performance of management's business plans and budget. The president appoints the chairman of the board and the managing director while board members are appointed by the Minister for Industry and Trade. In line with a performance agreement with the Minister, the board provides overall leadership and strategic direction for the Corporation, and is accountable for the NDC's performance.

The board has delegated some of its powers to its two functional committees, the General Function and Corporate Governance Committee and the Audit and Risk Management Committee. The board retains overall powers including the approval of major expenditures and policies.

3.2.3.3 Risk Management

The Corporation has a risk management policy, approved by the board specifically to assist the board in matters of corporate governance, in particular to review the Corporation's risk

profile, including the prioritization and assessment of risk. Everyone in the Corporation is required to be aware of risks inherent in the corporation. The board has also delegated its risk assessment and management responsibility to the Audit and Risk Management Committee.

3.2.4 NDC's Business Model

Initially, the NDC was established as a partially self-financing entity with powers to mobilize financial resources in any way it deemed appropriate. The institution used to rely on three sources of capital: (a) direct government subventions from the annual budget passed by Parliament, or grants from donors passed on to NDC by the government, (b) earnings from equity invested in subsidiary or associated companies, and (c) management fees paid by subsidiary companies.

Currently, real estate has become the single most important source of income for the Corporation, contributing nearly 90% of total annual revenue. This, however, is not enough to cover total operating costs, let alone development projects. The composition of total funding and the total book value of investment over the past two years shown in Table 109 below

Table 109: Funding and Lending for NDC

	2012 TZS Billion	Breakdown (%)	2011 TZS Billion	Breakdown (%)
Long-term	22.5	72.1	27.9	100
Short-term	8.7	27.9	---	---
Sub-total	31.2	100.0	27.9	100.0
Equity	100.9		91.2	
Total Funding	132.1		119.1	

Source: NDC 2012 Annual Report

Table 109 shows that the Corporation has predominantly (72.1% in 2012) long-term sources of external funding. It should be noted that short-term resources are mainly in the form of interest on long-term loans. It should be noted, however, that this funding currently comes from fiscal budget funds advanced by the Tanzanian government, through the Ministry of Finance and Economic Affairs and the Ministry of Industry and Trade, the build the Biolarvicide plant for malaria vector control. Therefore, though the business model matches the maturity of assets and liabilities, it is not sustainable in the medium–to-long term as the model is heavily dependent on the government support.

3.2.5 Financial Performance of NDC

No dividends were recorded for the 2011 and 2012 financial years. Rent from tenants of NDC's headquarters building (Bank of Africa, etc.) makes up a large portion of the corporation's rental income. It also gets other income, including interest, from investment in commercial bank deposits.

Table 110 shows that the corporation is using fiscal budget and its borrowing from government to invest in early stages of the projects which are both solicited (internally proposed) and unsolicited (brought in from outside). Thus, 2012 saw the Corporation increase its investment in projects by 18.2%, from TZS38.6 billion in 2011 to TZS 45.7 billion in 2012.

Table 110: Financial Performance of NDC

	2012 (TZS Billion)	% change	2011 (TZS Billion)
Assets			
Investments in projects	45.67	18.2	38.64
Other Non-current Assets	82.19		77.01
Current Assets	6.05		4.53
Total Assets	133.91	11.0	120.17
Liabilities and Equity			
Equity	100.97		91.15
Liabilities			
Short term liability	10.45		1.23
Long term liability	22,49		27.79
Total liabilities	32.94		29.02
Total Equity and Liabilities	133.91		120.17
Statement of Comprehensive Income			
Net Income	4.50		3.54
Operating expenses	4.23	25.0	3.39
Profit before tax	0.27	92.0	0.14
Income tax income	-		0.34
Profit after tax	0.27	-44.0	0.49
Key ratios	**%**		**%**
Return on Assets	0.2		0.4
Return on Equity	0.3		0.5
Net Profit margin	6.0		14.0
Operating expenses as % of NII	94.0		96.0
Current ratio	0.6		3.7
Acid test ratio	0.6		0.5
Working capital	-4,401.0	-234.0	3,294.0
Collection period (days)	113.0		101.0

Source: NDC 2012 Annual Report

The data on selected key indicators can be summarized as follows:

- Profit after tax decreased by 44%, mainly on account of tax income received in 2011;
- On the other hand, operating expenses increased by 25% in 2012;
- Operating expenses as a percentage of net income are at 94%, indicating that operating expenses can be covered by net income, but not easily; and there was an 11% growth in total assets. However, net working capital deteriorated by 234%. This shows that the corporation is unable to meet its short-term obligations in the event that they are called in. This is confirmed by the poor current ratio of 0.6.

The overall financial performance of NDC shows that this institution, though its income is mainly from rentals and government subventions, can still sustain its operations. This is based on the fact that the Corporation is able to cover its operational costs from rental income. It is nevertheless important that the shareholder review the business model of the institution with the view of making the Corporation self-financing.

4 Co-ordination, Regulation and Supervision of DFIs in Tanzania

4.1 Co-ordination

Table 111 shows that the two DFIs currently operating in Tanzania are coordinated by two different Ministries, namely the Ministry of Finance and the Ministry of Industry and Trade. This shows the lack of an overarching coordinating framework and might contribute to mandate overlaps between the DFIs.

Table 111: Co-ordination, legal and Regulation of DFIs- Tanzania

Institutions	Legal and ownership	Co-ordinator	Regulator
1. Tanzania Investment Bank (TIB)	• TIB Act of Parliament of 1970 (operating under Companies Act, 2002) • Majority owned by the State (99.7%)	• Ministry of Finance	• Central Bank of Tanzania
2. National Development Corporation of Tanzania (NDC)	• Act of Parliament of 1962, replaced by Public Corporations Act, 1992 • Wholly owned by the State	• Ministry of Industry and Trade	

Sources: Survey questionnaires, TIB Act of Parliament of 1970, NDC Act of Parliament of 1962

4.2 Regulation and Supervision

In Tanzania, as in other countries in the SADC region, all development finance institutions that existed prior to 1991 were established by independent acts of parliament and they were all government-owned. The objectives and the powers of these institutions were defined in their respective statutes. The current legislative system, as in the past, still lacks an apex supervisory body because of the separate legislation governing the DFIs. This position is clearly illustrated by the Table 111, which shows that while TIB is regulated by the Central Bank of Tanzania, the National Development Corporation of Tanzania is not.

5 Conclusion

Tanzania faces significant challenges to the development of its financial sector. Inclusion rates are extremely low, with only about 3.4% of enterprises having access to financial services and only 6.6% of entrepreneur investment financed through equity. To make matters worse, small business and agricultural financial needs are severely underserved, especially in rural areas, with the closure of rural branches of previously state-owned banks. Three Tanzanian development finance institutions have been established to help alleviate problems of accessing finance, especially development finance.[46] In this study only two DFIs have been reviewed, because SIDO (the Small Industries Development Organisation) did not provide any information to the consultant.

Key findings on the two development finance institutions in Tanzania are:

- Despite Tanzania having a sound financial sector with over 45 banks, there is still a complementary role for DFIs to play in dealing with the substantial finance gap;
- The two DFIs currently operating in Tanzania are not well capitalised, and the government has recently promised to recapitalise the TIB Development Bank;
- Despite the fact that all the DFIs are majority-owned by the government, there is still no uniform statutory method of establishing DFIs in Tanzania;
- The mandates of the DFIs are generally broad and they exhibit a high level of overlap;
- No DFI in Tanzania has a regional mandate;

[46] The government is also setting up a fourth DFI to be known as Agribank of Tanzania. This Bank is expected to be fully operational soon.

- While the business model of the NDC is suitable for a development finance model, that of the TIB Development Bank is not;
- Both DFIs are financially sustainable;
- The DFIs have weak or no strategic plans in line with national development plans;
- Corporate governance structures is relatively weak;
- The DFIs have weak or no uniform risk management framework in place;
- There is no standard practice with regard to shareholding representation on the boards of DFIs. Most board members are appointed by government Ministers;
- There is no overarching policy framework for coordinating the activities of the DFIs in Tanzania. This can be seen by the fact that the two DFIs report to different line ministries; and
- Despite the Central Bank of Tanzania being empowered by the Act to regulate development finance institutions, only one DFI is currently being regulated. This shows (a) lack of an overarching policy regulatory framework for DFIs, and (b) weak regulation of DFIs.

COUNTRY STUDY 12: ZAMBIA

The SADC DFRC Project Team of Dr. Lufeyo Banda and Dr. Herrick Mpuku held discussions in Zambia for the SADC DFI Scan study 7 and 8 November 2013. The following review is based on the information collected through questionnaire, annual reports and discussions with representatives from the Ministry of Finance, Central Bank and Development Bank of Zambia.

1 Background on Zambia

Zambia is a mineral-rich country and the largest producer of copper on the continent. With an average GDP growth rate of 5.6% over the past decade, Zambia has achieved relative macroeconomic stability, and in 2011 was reclassified by the World Bank as a middle-income country, with a GNI of between US$1006 and US$3975 a year. The economy grew by 7.3% in 2012, and was projected to grow by 7.5% in 2013 and 7.8% in 2014, making Zambia one of the world's fastest growing economies. Inflation was 7.3% in April 2013 and is expected to hover around this rate for the next two years. The country is increasingly a destination for foreign investment owing to its positive economic indicators and its burgeoning mining industry.

Table 112: Key Figures for Zambia

Capital	Lusaka
Exchange Rate: 1 US$ =	5.14 Zambian Kwacha
Population ^	14 075 099
Population growth rate (%) ^	3.19
Urban population (% of total) ^	39.61
Urbanisation rate (%) ^	4.30
GDP per capita (US$) ^	1 469.12
GDP growth rate (%, real) ^	7.3
GNI per capita, Atlas method (current US$) ^	1350
Population less than US$2 per day~	---
Population below national poverty line *	68.0
Gini co-efficient ~	0.65
HDI (Global Ranking)"	163
HDI (Country Index Score) "	0.448
Unemployment rate (%) *	12.90
Bank branches per 100 000 ^	4.40
Lending Interest Rate ^	12.15
Deposit Interest Rate ^	7.00
Credit % of GDP ^	18.55
Inflation	7.3
Ease of Doing Business Ranking (out of 185 countries)	94

Sources: ^ World Bank's WDIs (2012), ~ World Bank PovcalNet: an online poverty analysis tool, various years; = www.coinmill.com on 26 August 2013; "UNDP's International HDIs (2012); * African Economic Outlook, various years; ! World Bank's DB Data (2013).

In September 2012, Zambia launched its first US$750 million, 10-year Eurobond, which was the most successful bond launch in sub-Saharan Africa, with bids more than 15 times the amount on offer. The proceeds from the bond will be used to fund infrastructure, especially in the road and energy sectors. On 1 January 2013, the Zambian currency was rebased, and a new currency symbol, ZMW, was adopted. One Kwacha of the rebased currency (ZMW) is equivalent to 1 000 'old' Kwacha (ZMK). The intention was to

strengthen the currency by pegging its exchange rate against a basket of foreign currencies (US$, British Pound and Euro), and to provide a more usable value for transactions in local goods and services.

Zambia's population, measured at 14 million in the 2014, is very young, with 54% under the age of 18, partly as a consequence of the high prevalence of HIV/AIDS (16% of the population between the ages of 15 and 49). Most of the population is rural with only 39% living in urban areas. An urbanisation rate of 4.2% (compared with a 2.8% population growth rate) suggests that this will soon change. With only 11% of the working population estimated to be in formal employment, and an informal sector that comprises over 50% of the economy, government's fiscal capacity is restricted by the small tax base. Recent economic growth has exacerbated inequality. In 2013, the Gini coefficient was 0.65, up from 0.60 in 2006.

2 Access to finance - Zambia

Zambia's financial sector is among the fastest growing in the economy, exceeding 12% in 2013. The sector accounts for about 7% of GDP. However, although Fitch (credit rating agency) have warned that Zambia's credit growth may be so high as to risk stressing the banking system, financial sector growth is still expected to remain robust in the medium term.

The sector is still characterised by low financial intermediation, with limited access to financial services for the rural population and low-to-middle income earners, high costs of funds and an undeveloped money and capital market. In urban areas the banking network and branches are expanding, with increasing numbers of available ATMs. Table 113 depicts the access to finance situation.

Table 113: Access to Finance - Zambia

#	Indicator		SSA Region
1	% of firms using banks to finance investment	12.2	18.0
2	Proportion of investment financed internally (%)	80.5	78.4
3	Proportion of investment financed by banks (%)	6.5	9.9
4	Proportion of investment financed by suppliers of credit (%)	3.9	3.8
5	Proportion of investment finance by equity or stock sale (%)	2.1	3.7
6	Availability of financial services	51.4	100(int)
7	% of firms identifying access to finance as a major constraint	27.4	41.9

Sources: Enterprise Surveys (http://www.enterprisesurveys.org), The World Bank,
The Global Competitiveness Report 2011-2012 © 2011 World Economic Forum

As indicated in the preceding section, domestic financing is difficult to obtain, except for export-oriented production. Rather than lending, banks tend to absorb excess liquidity by purchasing treasury bills. Medium- and long-term borrowing are made impossible by high interest rates.

According to the World Bank Enterprise Survey's 2012 data, only 6.5% of investment was financed by the banks, 3.9% through trade credit lines, and 2.1% by equity or stock sales. These numbers show a financing gap which must be filled, at least partly, by specialised financial institutions such as DFIs. These institutions are discussed in more detail in the following sections.

3 Analysis of Development Finance Institutions of Zambia

In Zambia, the DFIs were established and funded by the government. As a result of deteriorating economic conditions and poor corporate governance, most of these institutions have been closed. The only exception is the Development Bank of Zambia (DBZ), which was recapitalised by government in 1994/95 and later restructured in 2002 through the DBZ Amendment Act (No. 11 of 2001). The Bank, as shown in the table below, has a broad mandate.

Table 114: Sectoral Analysis in Zambia

Sector	Institution
Agricultural	DBZ
Industry	DBZ
Infrastructure	DBZ
Micro financing and SMEs	DBZ

Source: DBZ 2012 Annual Report

3.1 Development Bank of Zambia (DBZ)

The Development Bank of Zambia (DBZ) is a development finance institution initially established as a joint venture between the Zambian government, parastatal financial institutions, on the one hand, and local, private and foreign bilateral and multilateral institutions on the other hand. The government of Zambia and the parastatal financial institutions initially constituted the 'A' shareholders and held 60% of the shares while the 'B' shareholders held the balance of 40%. The Bank was incorporated under the DBZ Act (No. 35 of 1972) and started its operations in 1974.

During the past decade, DBZ has been restructured and scaled down considerably in response to poor management and an increase in bad debt. However, assets have since risen from US$ 28.2 million in 2010 to US$ 75.8 million in 2012.

Currently the Government of the Republic of Zambia holds 95.897% of the bank's shares, and multilateral financial institutions and foreign development Finance institutions hold the remaining 3.283%.

3.1.1 DBZ's Mandate

DBZ's mandate is to support the Zambian government's economic development strategies for growth, wealth creation, job creation, poverty reduction, infrastructure development and the improvement of service delivery.

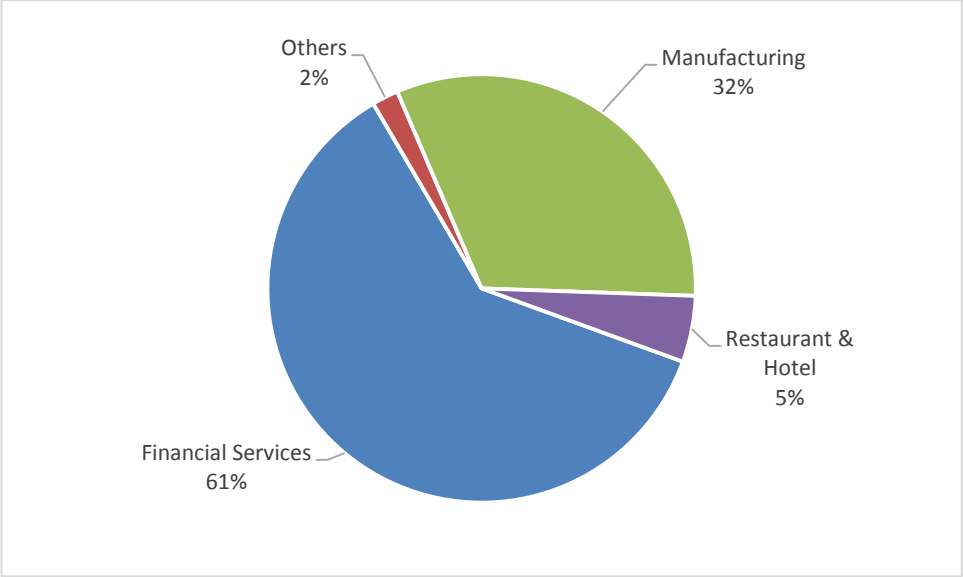
The Bank fulfils its mandate by:

- Supporting investment in both the public and private sectors so as to galvanise growth, productivity, employment and wealth creation, and to facilitate broad-based economic empowerment for Zambian citizens;
- Supporting infrastructure financing by catalysing economic activities and improving service delivery;
- Proactively providing technical support in the form of policy advocacy and advice to government and other stakeholders.

3.1.2 Portfolio Analysis of DBZ

DBZ has only disbursed a total of 83.4 million Zambian Kwacha towards development loans in the period under review. Figure 31 shows that that 61% of the developmental loans went to financial services, followed by 32% to manufacturing, 5% to restaurants and hotels and the balance to other sectors.

Figure 31: Resources Distribution by Sector – DBZ



Source: DBZ 2012 Annual Report

An analysis of the mandate of the Bank and its portfolio distribution shows that the mandate of DBZ is broad. This problem is compounded by the Bank investing the bulk of its resources in risk-free government security instruments, a decision which appears to be contradictory in an institution which is supposed to be providing development finance to Zambians.

3.1.3 Corporate Governance and Risk Management for DBZ

3.1.3.1 The Governing Legal Environment

The Act establishing the Development Bank of Zambia, as amended in 2001, establishes the bank's governing structure, including a board of directors and a chief executive officer.

3.1.3.2 The Board

The board of directors is the principle policy organ of the Bank, with the authority to generate its lending policies and to appoint the Bank's Chief Executive Officer.

To enable the Board to discharge its functions and operate freely, unencumbered by external control, the authority which the Minister of Finance had over the Bank has been reduced and limited to the appointment of the chairperson of the board and three other directors representing the Class A shareholders. The Class B shareholders appoint six other board members.

Currently the composition of the board is biased towards the board members appointed by the Class B shareholders (private sector). In addition, the directors appointed by the Class A shareholders are drawn from the private sector, with one exception. Currently the board consists of a chairman and nine other members whose term of office is three years and who are eligible for reappointment.

The board of directors has set up three board sub-committees through which the board is able to examine issues in greater detail and thus have a more complete view of the bank's operations, strengths and weaknesses. The three subcommittees are Credit, Finance and Audit, and Staff Management.

3.1.3.3 Risk Management

The board is the focal point of the corporation governance system of the bank. It has overall responsibility for the performance of the Bank, including the risk management process. Specifically, the board's activities include:

- Ensuring that risk management policies and procedures are in place;
- Delegating to management the design, implementation and monitoring of the entire risk management process; and
- Ensuring that management reports regularly by submitting quarterly reports to the board.

All these activities are governed by the risk management framework which the Bank has put in place. This framework operates at three levels:

- Individual departments;
- Asset Liability Management Committee (ALCO); and
- Board of Directors

3.1.4 DBZ's Business Model

The activities of the DBZ are mainly funded through shareholders' equity, government special funds and a small number of loans from institutional partners.[47] The composition of total funding and the total book value of investment over the two years under review are shown in Table 115 below.

[47] i.e. the Development Bank of Southern Africa.

Table 115: Funding and Lending for DBZ

	2012 ZMK Million	Breakdown (%)	2011 ZMK Million	Breakdown (%)
Long-term	20.1	100.0	34.2	100.0
Short-term	---	---	---	
Sub-total	20.1	100.0	34.2	100.0
Equity	346.9		330.4	
Total Funding	367.0		364.6	
Lending & Invest.	354.0	7.9↑	328.1	

Source: DBZ 2012 Annual Report

Table 115 shows that government's share capital has been contributing almost 95% of the total funding for DBZ. In addition, Table 109 also shows that the Bank has exclusively (100% in 2012) long-term sources of external funding. This business model is sustainable, since the Bank's investment is likely to be long-term given the nature of the sectors supported by the Bank. Nevertheless, it must be noted that the business model for DBZ, though superficially appealing, is flawed because of low levels of funding liabilities.

The situation is made worse by the fact that almost 72.3% of the bank's investment is placed in money market instruments. Furthermore, the Bank's portfolio of creditors is so concentrated that if one creditor had to pull out, the Bank's operations would be negatively affected. This shows that the Bank has serious funding problems, which might impact negatively on the Bank's operations.

3.1.5 Financial Performance of DBZ

The financial performance of the Bank over the period under review is shown in Table 116 below. The most noticeable feature is the deterioration that has occurred to the financial base of the Bank. Although the bank is currently making some profit, losses which the Bank had previously experienced have contributed to the weakening of the capital base as well as to the loss of credit lines.

Table 116: Statement of Financial position DBZ

	2012 ZMK Million	**% change**	**2011** ZMK Million
Assets			
Total Assets	387,742.0	3.0	375,496.0
Liabilities and Equity			
Equity	346,899.0	5.0	330,443.0
Liabilities			
Total liabilities	40,883.0	-9.0	45,053.0
Total Equity and Liabilities	387,782.0		375,496.0
Statement of Comprehensive Income			
Net Interest Income	18,137	314.0	4,380.0
Profit after tax	11,398	-3.0	11,708.0
Operating expenses	12,598	53.0	8,213.0
Impairments	5,914	24.0	4,787.0
Key ratios	**%**		**%**
Return on Assets	2.9		3.1
Return on Equity	3.3		3.5
Net Profit margin	63.0		267
Operating cost as % of revenue	69.0		188.0
Impairments as % of revenue	33.0		109.0
Operating costs & Impairments as % of revenue	102.0		297.0

Source: DBZ 2012 Annual Report

As indicated in Table 116, DBZ's financial performance has shown improvements on the following key financial indicators:

- Net assets are strong at ZMK 346,899 Million, an improvement of 5% from 2011;
- Liabilities decreased by 9%, mainly on account of loan repayments;
- The net profit margin decreased remarkably owing to a reduction in the net foreign currency translation gain;
- Operating expenses as a percentage of NII decreased from 188% to 69%, which showed a great improvement on cost management. At 69%, operating expenses can be covered by NII; and
- Impairments are currently 33% of NII, also an improvement from 109% in 2011. Again, this shows that impairments can be covered by NII.

Operating costs and impairments together, however, account for 102% of NII. This is an indication that DBZ not sustainable. However, if the downward trend continues, impairments and operating costs could be covered by NII in the future.

4 Co-ordination, Regulation and Supervision of DFIs in Zambia

4.1 Co-ordination

The Development Bank of Zambia's activities are mainly coordinated through the Ministry of Finance Economic and Development.

Table 117: Co-ordination, legal and Regulation of DFIs- Zambia

Institutions	Legal and ownership	Co-ordinator	Regulator
1. Development Bank of Zambia	• Act of Parliament in the early 1970s, Amendment Act No. 11 of 2001 • Majority owned by the Government of Zambia	• Ministry of finance	• Bank of Zambia

Source: Act of Parliament in the early 1970s, Amendment Act (No. 11 of 2001)

4.2 Regulation and Supervision

In Zambia, the Central Bank is responsible for regulating the Development Bank of Zambia as provided for in the Banking and Financial Services Act of 1994 (as amended in 2000 and 2005 (BFSA)). The amendments extended the Central Bank's regulatory and supervisory mandate to non-bank financial institutions, including those which are not licensed by the Central Bank of Zambia. Despite this commendable move, two issues regarding regulatory framework used to supervise the DFIs remain: (a) the limited supervisory powers of the Central Bank over DFI, and (b) the regulations used are inappropriate for the DFI.

5 Conclusion

Zambia's financial sector is still characterised by low financial intermediation, with limited access to financial services for the rural population and low-to-middle income earners, high costs of funds and undeveloped development finance, money and capital markets.

Key findings on the development finance system of Zambia are outlined below:

- Despite the country having a robust financial system, it still lacks a well-developed DFI sector. This has exacerbated the development finance gap;

- DBZ, which is the only DFI currently operating in Zambia, is not well capitalised, with government showing a lack of consistent policy regarding it;;
- There is no uniform statutory way to establish DFIs in Zambia;
- DBZ lacks resources, making it difficult for the Bank to fulfil its policy mandate;
- DBZ does not have a mandate to fund projects outside the country;
- While the business model for DBZ is in line with a development finance model, the Bank has a very low gearing ratio. This is typical when there is a lack of resource mobilisation strategy and a poor balance sheet;
- The Bank is not financially sustainable;
- DBZ's strategic plans are either weak or poorly aligned to national development plans;
- DBZ has weak corporate governance structures;
- There is weak risk management framework in place for DBZ;
- Currently most board members are appointed by the Minister; and
- Despite the DBZ being regulated by the Central Bank of Zambia, there is generally a lack of regulatory framework for DFIs which demonstrates two things: (a) weak regulation of DFIs, (b) an inappropriate regulatory policy framework for DFIs.

COUNTRY STUDY 13: ZIMBABWE

The SADC DFRC Project Team of Dr. Lufeyo Banda and Dr. Herrick Mpuku held discussions in Zambia from 21 to 24 October 2013 for the SADC DFI Scan study. The summary review below is based on discussions with representatives from the Ministry of Finance, the Central Bank, the Industrial Development Corporation (IDCZ), the Infrastructure Development Bank of Zimbabwe (IDBZ), the Agricultural Bank of Zimbabwe (Agribank) and the Small Enterprises Development Corporation (SEDCO) coupled with information collected through questionnaires and annual reports.

1 Background on Zimbabwe

Zimbabwe's economic performance weakened in 2012 following three consecutive years of GDP acceleration. The estimated GDP growth of 4.4% for 2012 represents a significant slowdown when compared to the growth rates of 5.4%, 9.6% and 10.6% experienced in 2009, 2010 and 2011, respectively. Most major sectors of the economy registered lower growth rates in 2012, and this weighed down overall economic performance. Mining and quarrying grew by 10.1% in 2012, compared to 25.1% in 2011 and 60.1% in 2010. The manufacturing sector grew by only 2.3%, compared to 15.0% in 2011. The weaker growth rate experienced in 2012 was caused by a number of factors, including drought, electricity supply challenges, liquidity constraints and a failure by the manufacturing sector to cope with cheap imports. The economy is expected to register a GDP growth rate of 3.4% in 2013 and 3.1% in 2014.

Table 118: Key Figures for Zimbabwe

Capital	Harare
Exchange Rate: 1 US$ =	1.00 US Dollar (US$)
Population ^	13 724 317
Population growth rate (%) ^	2.70
Urban population (% of total) ^	39.11
Urbanisation rate (%) ^	3.96
GDP per capita (US$) ^	787.94
GDP growth rate (%, real) ^	10.6
GNI per capita, Atlas method (current US$) ^	680
Population less than US$2 per day~	---
Population below national poverty line *	34.9
Gini co-efficient ~	---
HDI (Global Ranking)"	172
HDI (Country Index Score) "	0.397
Unemployment rate (%) *	4.16
Bank branches per 100 000 ^	---
Lending Interest Rate ^	---
Deposit Interest Rate ^	---
Credit % of GDP ^	18.55
Inflation	1.87
Ease of Doing Business Ranking (out of 185 countries)	172

Sources: ^ World Bank's World Development Indicators (2012), ~ World Bank PovcalNet: an online poverty analysis tool, various years; = www.coinmill.com on 26 August 2013; "UNDP's International Human Development Indicators (2012); * African Economic Outlook, various years; ! World Bank's Doing Business Survey Data (2013).

Table 118 shows that inflation has subdued and has been moving downward compared to the first six months of 2013. Inflation fell from 2.98% in February to 1.87% in June 2013. The decline in inflation is largely due to the falling value of the South African Rand.

This performance trend suggests that the creation of the Government of National Unity in 2009 and its adoption of a multi-currency regime brought macroeconomic stability and sustained growth for a period of five years. However, this recovery has been fragile because of political uncertainty, the high debt burden of about US$10billion, with arrears amounting to about US$6.5 billion, and the unsustainable current account deficit of about 23% of GDP. Zimbabwe has had limited access to the concessional lines of credit required for infrastructural development and the retooling of the manufacturing sector. Furthermore, most of the facilities used carry a significant risk premium and have largely been short-term in tenure.

2 Access to finance - Zimbabwe

Zimbabwe's financial sector is relatively well-developed, although it has recently been experiencing some problems. Presently, the financial sector consists of the Reserve Bank of Zimbabwe (RBZ) at the apex, discount houses, commercial banks, merchant banks, finance houses, building societies, the People's Own Savings Bank (POSB), insurance companies, pension funds, venture capital companies, asset management companies, development finance institutions, the Zimbabwe Stock Exchange, microfinance institutions and money transfer agencies that act as intermediaries for remittances. Despite all this, what is clear is that the instruments of financial inclusion, such as development finance institutions, have suffered from the macroeconomic instability.

Table 119: Access to Finance - Zimbabwe

#	Indicator		SSA Region
1	% of firms using banks to finance investment	13.1	18.0
2	Proportion of investment financed internally (%)	84.7	78.4
3	Proportion of investment financed by banks (%)	8.6	9.9
4	Proportion of investment financed by suppliers of credit (%)	6.0	3.8
5	Proportion of investment finance by equity or stock sale (%)	0.4	3.7
6	Availability of financial services	51.4	100(int)
7	% of firms identifying access to finance as a major constraint	63.7	41.9

Sources: Enterprise Surveys (http://www.enterprisesurveys.org), The World Bank,
The Global Competitiveness Report 2011-2012 © 2011 World Economic Forum

Total credit provided by the financial sector to the private sector in 2012 was 18.55% of GDP, which was much less than the 36.45% growth experienced in the preceding year. Factors affecting the deceleration in lending included a declining growth in deposits and the uncertainties that arise in an election year. Commercial banks dominated lending at US$3-063.68 million or 85.2% of total. Lending continues to be largely for the short-term requirements of working capital (at 77.10%) and consumer durables (at 15.17%).

An analysis of Zimbabwean investment in terms of access to finance by entrepreneurs shows that most investment was internally financed and of the external resources, 8.6% was provided by the banks, 6.0% from trade credit lines, and 0.4% by equity or stock sales. The finding of the World Bank Enterprise Surveys, which revealed that 84.7% of investment was internally financed by business owners, indicates a finance gap which can be reduced by the provision of credit via specialised financial institutions such as DFIs.

3 Analysis of Development Finance Institutions of Zimbabwe

The Government of Zimbabwe, prior to 1990, set up various development finance institutions to provide term funding to various sectors of the economy. The institutions include the Zimbabwe Development Bank (which is now IDBZ), the Small Enterprise Development Corporation (SEDCO), the Industrial Development Corporation and the smallholder finance facility at the Agricultural Finance Corporation (now Agribank). Table 120 below gives an outline of these DFIs together with the sectors they service.

Table 120: Sectoral Analysis in Zimbabwe

Sector	Institution
Agricultural	Agribank
Industry	IDCZ
Infrastructure	IDBZ
Micro financing and SMEs	SEDCO

Source: DBZ 2012 Annual Report

3.1 Agricultural Bank of Zimbabwe (Agribank)

The Agricultural Development Bank of Zimbabwe (AgriBank) is 100% owned by the Government of Zimbabwe and the shareholding structure is 50% Ministry of Agriculture and 50% Ministry of Finance. The bank was established in 1924 as the Land and Agricultural Bank to cater for the needs of commercial farmers. In 1971 the Land and Agricultural Bank and the Agricultural Assistance Board were amalgamated into the Agriculture Finance

Corporation (AFC) by an Act of Parliament. The AFC was mandated to supply credit to large- and small-scale farmers and agro-processing operators.

In 1996, the AFC was incorporated as the Agricultural Bank of Zimbabwe (AgriBank) and was subsequently given a banking licence in June 1999. The Bank began operations on 10 January 2000 and established branches offering treasury and retail banking services. In 2003, the government changed the bank into an agricultural development bank with the aim of aligning it with the resolutions of the Agrarian Land Reform Programme. AgriBank became the main source of formal finance for A1 and A2 farmers, as well as established commercial farmers.

3.1.1 Agribank's Mandate

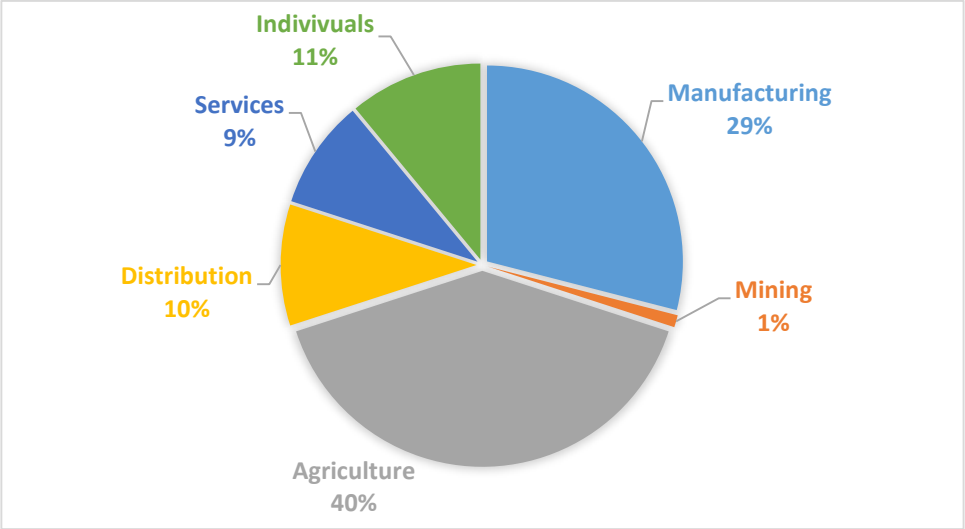
The main purpose of AgriBank is to promote agricultural development and to encourage the inclusion of the marginalized and unbanked, but economically-active, poorer sections of society. It should be emphasised that the bank's strategic focus is basically the same as in colonial times. Previously, it was to assist settler farmers meet the finance needs of their time whereas after Independence the focus shifted to meet the needs of the "new farmers" as they are now called.

In the past AgriBank was the main source of farm purchase and development finance for the agricultural sector with its medium-to-long-term financing facilities. It also acted as the development bank for a variety of donor-funded development projects targeted at the smallholder community and brought banking services to the unbanked rural communities through its services to rural dealerships and retailers.

3.1.2 Portfolio Analysis of Agribank

As indicated in the preceding section, Agribank's core mandate is to support agricultural activities and to facilitate government policy in so far as the agricultural sector is concerned. The fact that the Bank is a fully-fledged commercial Bank means that it can also support other areas of the economy of Zimbabwe. Figure 32 below shows the distribution of the loans advanced to different sectors of the economy.

Figure **32: Resources Distribution by Sector – Agribank Zimbabwe**



Source: Agribank 2012 Annual Report

Figure 32 shows that that of the total book investment of US$83.8 million (2012), which excludes investment in financial instruments, 40% of the developmental loans were advanced to the agricultural sector, followed by 29% to manufacturing, 11% to individual clients, 10% to the distributional sector and the rest to the mining and services sectors.

The above chart illustrates the problem of mandate drifting and mandate shrinking. The problem of mandate drifting is compounded by the limited resources of the Bank.

3.1.3 Corporate Governance and Risk Management for Agribank

3.1.3.1 The Governing Legal Environment

The Act establishing Agribank of Zimbabwe also establishes its operational offices, which include the Board of Governors and the Chief Executive Officer. The shareholder (i.e. the government) has reaffirmed the Bank's role as a DFI with loan-granting and deposit-taking mandates, subject to the supervision of the Reserve Bank of Zimbabwe and operating in terms of the Banking Act.

3.1.3.2 The Board

The board of Agribank is currently composed of ten directors, of which seven are non-executive. The board meetings are held at least quarterly, or more often if needed. The board oversees compliance with corporate governance. Roles and functions of the board are spelt out in the board charter and Agribank is said to be fully compliant with the minimum regulatory requirements. Board committees have also been set up to assist the board in the

effective discharge of its duties. These include the Audit, Human Resources, Loans and Advances, Loan Review, Assets and Liabilities, and Risk committees. All these committees are headed by chairpersons who are independent and non-executive directors.

3.1.3.3 Risk Management

The bank's risk management practices are guided by the regulatory framework, including Central Bank oversight and statutory provisions, and international conventions (e.g. Basel II) on best practice. It is also guided by market practice, both domestic and international, and the requirements of both the common and business law.

The board of the Bank has an overall responsibility for determining the type and level of business risk that the Bank assumes, and that is essential to achieve the corporate rather than developmental objectives of the Bank. The Board has also delegated part of its risk management to its various sub-committees particularly the Audit, Risk, Loan Review, Assets and Liabilities, and Human Resources committees.

The bank, to a large extent, observes enterprise-wide risk management [EWRM], but the risk-management framework is highly centralized, and as a result, the Bank has been experiencing a high rate non-performing loans [NPLs], although this improved during the period under review.

3.1.4 Agribank's Business Model

The Bank finances its activities through shareholders' equity, deposits and resources raised from institutional investors like the IDC of South Africa. Table 121 below shows the total funding and investment over the two years under review.

Table 121 Funding and Lending for Agribank

	2012 US$ Million	Breakdown (%)	2011 US$ Million	Breakdown (%)
Long-term	30.8	43.0	30.1	32.5
Short-term	40.9	57.0	62.5	67.5
Sub-total	71.7	100.0	92.6	100.0
Equity	26.7		21.3	
Total Funding	98.4		113.9	
Lending & Invest.	89.1	22↑	73.0	

Source: Agribank 2012 Annual Report

Table 121 shows that Agribank, at 57% short-term funding to total external funding (2012), has largely short-term external funding. This business model is not sustainable since the

Bank's investment or lending is likely to be long-term given the nature of the agricultural sector. The problems of the business model are further complicated by the fact that the Bank in 2012 had $71.7 million of debt and $26.7 million of shareholders' equity, giving a very high gearing ratio of 268.5%. This high gearing ratio is likely to lead to low levels of resource mobilization from the market, which will in turn lead to a higher cost for the financial products offered by the Bank.

Currently the Bank needs at least US$50 million to be recapitalised, but the Bank has only received US$4 million, which is an amount too small to make any meaningful impact on the balance sheet of the Bank. The shareholders should therefore seriously consider re-capitalising the Bank. The government faces financial constraints and limited fiscal space, but is nevertheless working to ensure that the Bank is adequately capitalized, so that Agribank can play the fundamental role in agricultural recovery envisaged in ZIM ASSET, the government's economic blue print.

3.1.5 Financial Performance of Agribank

In the past, AgriBank was the main conduit for finance to the agricultural sector. Together with other banks, it disbursed ASPEF funds and managed the government's Public Sector Investment Programme (PSIP) funding. PSIP funds were only available to small-scale farmers. They were guaranteed by government without any requirement for collateral. However, about 50% of those who accessed the funding did not repay the loans that they received, resulting in massive bad debts.

AgriBank has been struggling to source funds for its capitalization largely because of its ownership structure, which is unattractive to external investors, and but also because of the high rate of farmer default. The situation was exacerbated by a lack of contract enforcement and government's inability or unwillingness to allocate resources to the bank. For example, in the 2007/08 season AgriBank received less than a third of the funding it had requested from government.

In 2009/2010 AgriBank had a net loss of close to US$1.5 million, and its under-capitalization resulted in a cessation of its loans and input guarantees. In December 2010, AgriBank and ZB Bank Ltd went to the market offering 360-day bonds to raise US$ 10 million and US$ 30 million respectively in order to finance tobacco production for the 2010/11 season. The money raised by these two banks was to be channelled towards

mobilising financial support for tobacco farmers for growing and curing tobacco, and transporting the crop to the auction floors at harvest time.

Table 122: Statement of Financial position Agribank

	US$ Million 2012	% change	US$ Million 2011
ASSETS			
Total Assets	128	24	103
Liabilities and Equity			
Equity	27		21
Liabilities			
Short term liability	64		51
Long term liability	37		31
Total liabilities	101		82
Total Equity and Liabilities	128		103
Statement of Comprehensive Income			
Net Interest Income	5.3	4	5.1
loss for the year	(5.5)	1733	(0.3)
Impairments	3.8		0.5
Operating expenses	22.3		19.3
Key ratios			
Return on Assets	-4.3		-0.3
Return on Equity	-20.4		-1.4
Net Profit margin	-104		-6
Operating expenses as % of NII	421		378
Impairments as % of NII	72		9
Operating costs and impairments as % of NII	492		387

Source: Agribank 2011 Annual Report

The bank's total assets grew by 24%, mainly on account of an increase in loans and advances to customers. As expected, net interest income also increased by 4%, following the increase in loans and advances. Despite the increase in net interest income, yearly loss increased in 2012, by 1733%. This was mainly on because of the increase in impairments and operating costs.

Impairments as a percentage of net interest income were 72%. They can be covered by net interest income, but are still high. Operating costs, on the other hand, are 421% of net interest income, and cannot be covered by it. The institution is clearly not sustainable as it is unable to cover its costs and impairments from net interest income.

It is evident from the above that the bank needs a strategic partner if it is to be sustainable. At this stage, when AgriBank has re-established its client base and has the largest network

of banks in Zimbabwe, with sixty branches, additional funding is particularly important. With more funding, the bank would be once again able to serve the needs of the agricultural sector and play a key role in rural development.

3.2 The Industrial Development Corporation of Zimbabwe (IDCZ)

The Industrial Development Corporation of Zimbabwe Limited (IDCZ) is a self-financing, national development finance institution (DFI). It was established in 1963 by an Act of Parliament. It is wholly owned by the Government of Zimbabwe. The IDCZ is, however, unique among state enterprises in that it was commercialized from its inception as it is also registered as a limited liability company under the Companies Act (Section 3) of Zimbabwe. The corporation is controlled by a board of directors with the board reporting to the Minister of Industry and Commerce.

3.2.1 IDCZ's Mandate

The IDCZ's role in the economy is to add value through industrial processes and capital formation (foreign direct investment) in order to create wealth, employment and industrial development in Zimbabwe. The IDCZ Act allows the Corporation to promote investment and economic co-operation across borders. The Act stipulates that all undertakings of the Corporation be considered strictly on their economic merits. Accordingly, the Corporation is specifically prohibited from serving a purely social or benevolent function. The Corporation is therefore required to operate on a financially self-sustaining basis, irrespective of other considerations.

The objectives of the Corporation according to the Act are: 'to facilitate, promote, guide and assist in the financing of new industries and industrial undertakings… and for the expansion, better organisation and modernisation of existing industries."

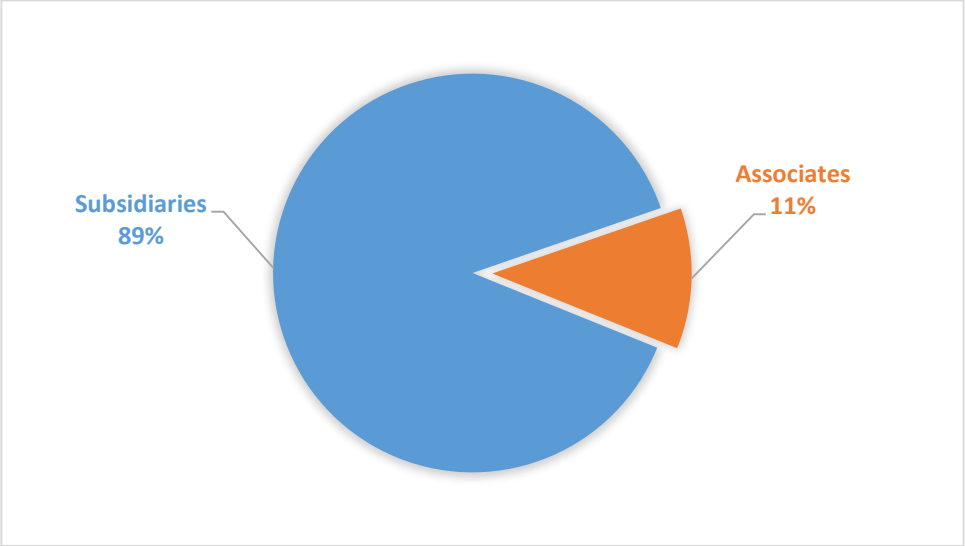
3.2.2 Portfolio Analysis of IDCZ

The IDCZ focuses on facilitating the development of industry and manufacturing, and these will be its target sectors in the event it starts lending in the near future.

IDCZ currently has shares in 29 companies, which include Chemplex Corporation, Olivine Industries, Willowvale Mazda Motor Industries, and Surface Investments. Figure 33 below shows the portfolio allocation of investment at the end of financial year 2012.

Of the total portfolio investment of US$140.7 million (2012), which excludes financial assets for sale and loan receivable, 89% was in subsidiaries and the remaining 11% was in associates. This chart also explains the role of the IDCZ, which is similar to venture capital.

Figure 33: Resources Distribution by Sector - IDCZ



Source: IDCZ 2012 Annual Report

While IDCZ is supposed to identify potential ventures, invest equity, nurture the venture until it is attractive to potential investors, then disinvest after realizing profits and start the cycle again, the real situation is different, as IDCZ has been acting as a holding corporation instead of a DFI. The same situation is happening with IDC South Africa, which does not let go of its stake in its ventures.

3.2.3 Corporate Governance and Risk Management for IDCZ

3.2.3.1 The Governing Legal Environment

The IDCZ is a registered limited liability company, subject to the provisions of the following legislations: the IDC Act (Chapter 14:10) of 1963 (as amended), the Public Finance Management Act (Chapter 22:19) of 2009 and any sections of the Companies Act (Chapter 24:03) which may be applied to it in terms of Section 22 of the IDC Act. Because of its mandate to drive industrialisation, the IDCZ is classified as a development finance institution (DFI).

IDCZ has no regulatory power or authority, and is exempt from the provisions of the Audit and Exchequer Act (Chapter 22:03). Any losses suffered by it are not a charge to the fiscus of the government, as in the case with parastatal organizations.

3.2.3.2 The Board

The board of directors is appointed by the Minister of Industry and Commerce. The IDC Act determines the constitution, rights, powers and obligations of the board. Of the nine directors, led by a non-executive chairman, six are from the private sector, while the two from the public sector are non-executive, with the general manager being the only executive director. It meets at least quarterly.

The Board subscribes to the need to conduct business in line with generally accepted corporate practices prescribed by the codes of best practice (Cadbury Report, King III and Zimbabwe Corporate Governance Code for State Enterprises & Parastatals), generally accepted accounting principles (GAAP), all relevant legislation, regulations, relevant international financial reporting standards, and its own corporate values.

To assist the board to carry out its duties, four committees, which include business development, finance and audit, remuneration and personnel, and risk management, have been established. Each of these committees is headed by a board member.

3.2.3.3 Risk Management

The Risk Management committee identifies risks faced by the Corporation and its investments and proactively seeks measures to manage the risks, which are recommended to both the Corporation and its investors.

3.2.4 IDCZ's Business Model

Most of the activities of IDCZ are funded through shareholder'' equity, as is partly illustrated by the Corporation's low gearing. The composition of the total funding over the two years under review is illustrated in Table 123 below.

Table 123: Funding and Lending for IDCZ

	2012 US$ Million	Breakdown (%)	2011 US$ Million	Breakdown (%)
Long-term	26.6	68.6	32.0	82.3
Short-term	12.2	31.4	6.9	17.7
Sub-total	38.8	100.0	38.9	100.0
Equity	111.1		113.5	
Total Funding	149.9		152.4	

Source: IDCZ 2012 Annual Report

Table 123 shows that despite the low level of external funding, 68.6% of the corporation's external funding was from long-term sources in 2012. This model is sustainable as the loan portfolio of IDCZ is likely to be dominated by long-term infrastructure loans.

The situation above illustrates two things:

a) a lack of long-term funding in the economy; and
b) a failure by the Corporation to use its equity to leverage more funds from the market.

The Corporation needs to diversify its funding portfolio by issuing debt instruments in the market. It needs to make an effort to get positive international credit rating and also needs to request that the shareholders improve the balance sheet by increasing the capital of the Corporation.

3.2.5 Financial Performance of IDCZ

The financial position of the IDCZ showed a deteriorating trend during the period under review, with total assets and net assets decreasing slightly, by 2% and 3% respectively. As a result, the Corporation's return on assets and return on equity have also declined by -1% and -2% respectively.

Table 124: Statement of Financial position IDCZ

	2012 US$ Million	% change	2011 US$ Million
Assets			
Non-current assets	154.0		158.0
Current assets	4.0		3.0
Total Assets	158.0	(2.0)	161.0
Liabilities and Equity			
Equity	111.0	(3.0)	114.0
Current liabilities	14.0		8.0
long term liabilities	33.0		39.0
Total Liabilities	47.0		47.0
Total Equity and Liabilities	158.0		161.0
Statement of Comprehensive Income			
Revenue	1.3	(28.0)	1.8
Profit for period	(2.7)	(69.0)	(1.6)
Operating expenses	3.4	89.0	1.8
Impairment	0.2		0.0
Key ratios			
Return on Assets	(2.0)		(1.0)
Return on Equity	(2.0)		(1.0)
Net Profit margin	(208.0)		(89.0)
Operating expenses as % of revenue	262.0		100.0
Impairment as % of revenue	15.0		0.0
Operating exp. & impairment as % of revenue	277.0		100.0
Current ratio	0.3		0.4
Net working capital	(10.0)		(5.0)

Source: IDCZ 2012 Annual Report

Table 124 can be summarized as follows;

- The losses of the Corporation before tax increased from US$1.6 million in 2011 to US$3.2 million in 2012. After a 2012 tax credit of almost US$0.5 million, the loss from operations increased from US$1.6 million in 2011 to US$2.7 million in 2012;
- Other net comprehensive income of US$28.2 million (2011: US$0.2 million) being a non-cash reserve on revaluation of real estate, turned the loss from operations into a profit of US$7.3 million (2011 loss: US$10.8 million);
- The liquidity position has also deteriorated with the current ratio decreasing from 0.38 to 0.29. This shows that in the event that short-term liabilities are called in, IDCZ would not be able to meet them.

- Net profit margin has also shown a deteriorating trend from -89% to -209%. This was the result of a reduction in revenue of 28% and an increase in operating costs of 89%.
- Impairments as a percentage of revenue are 15%, up from last year when there were no impairments. This shows that the IDCZ can cover impairments from revenue.
- Operating costs as a percentage of revenue were 262%, up from 100% in 2011. Operating costs cannot be covered by revenue alone.

The profit-generating capacity of the Corporation, which is on a downward trend, is simply not sufficient to cover the cost of money. Equity and/or concessional medium-to-long-term borrowing would be the ideal solution once the country risk and national debt arrears settlement problems are resolved.

3.3 The Small & Medium Enterprises Development Corporation -SMEDCO

The Small and Medium Enterprises Development Corporation (SMEDCO) is a development finance institution for the promotion and development of micro, small and medium enterprises and cooperatives in the country. It was formed in 1983 by an Act of Parliament, Chapter 24:12, and is a parastatal which falls under the Ministry of Small and Medium Enterprises and Co-operative Development. The Corporation changed its name from Small Enterprises Development Corporation (SEDCO) to Small and Medium Enterprises Development Corporation (SMEDCO) after the operationalization of the SME Act in February 2014.

SMEDCO is especially designed to lend to micro, small and medium enterprises (MSMEs) in both urban and rural settings. These MSMEs are at the bottom of the economic pyramid and they often face challenges in accessing financial support from mainstream financial institutions, yet their development is vital to employment creation, economic development and poverty alleviation.

The functions of the Corporation are:

a) To encourage and assist in the establishment of MSMEs and co-operatives;
b) To provide assistance, whether in the form of financial assistance, management counselling and training, information, advice or otherwise, to MSMEs and co-operatives;

c) To administer the Micro-, Small and Medium Enterprises Fund established in terms of section 2G of the SME Act;
d) To implement schemes established in terms of Part B of the SME Act; and
e) To do all things which by the SME Act or any other enactment are required or permitted to be done by the Corporation.

3.3.1 SMEDCO's Mandate

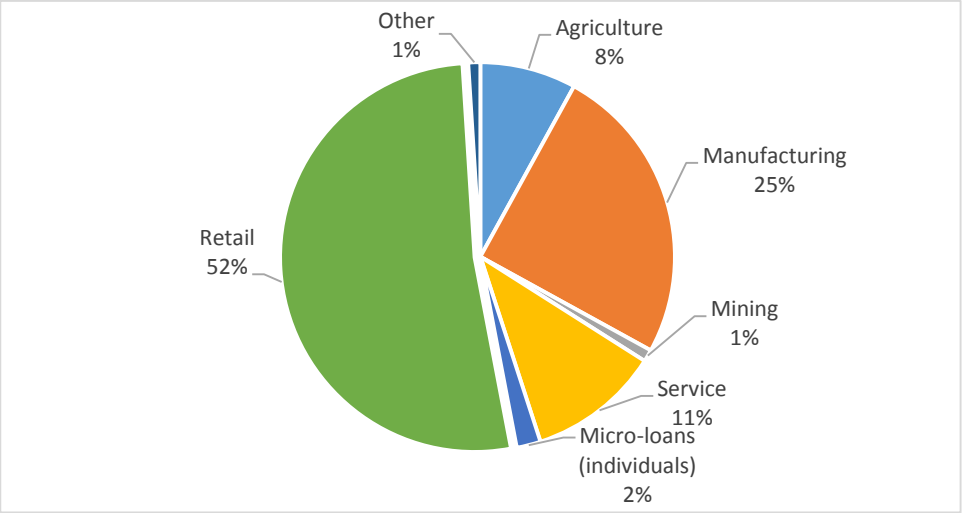
SMEDCO's objective is to develop viable SMEs which will contribute to national economic growth. It provides financial assistance, counselling and related support services, business management training and business infrastructure. Experience in other countries suggests that it would be better if SMEDCO were to focus exclusively on business development services, leaving the provision of financial services to the private sector. The development of microfinance internationally recognizes the fact that government-subsidized and managed programmes almost always fail as subsidized rates make the programmes attractive to the wealthy with connections in high places, instead of the poor who often lack information about the programme.

The intention of the Act was to establish a DFI for small enterprises. It would appear that SMEDCO was envisaged as a catalyst, especially with regard to organising finance for small-scale enterprises through the established commercial financial institutions in Zimbabwe. This concept changed early in the formation of SMEDCO, and by February 1984 it was clearly the intention that the Corporation should function as a lending organisation in competition with the established financial institutions. At the time of its establishment there were only five banks in Zimbabwe, none of which catered for the needs of SMEs, and funding for these was not obtained from commercial banks but from multi-lateral institutions such as the World Bank, the International Bank of Reconstruction and Development and PTA Bank. These funds were medium-term to long-term finance for asset acquisition. Development partners such as SIDA, CIDA and others assisted with internal capacity building for MSMEs.

3.3.2 Portfolio Analysis of SMEDCO

As illustrated in Figure 34, the mandate of the Corporation is broad and in its quest to support the SMEs, SMEDCO covers sectors such as agriculture, manufacturing, mining, retail, and services, and also offers loans to individuals.

Figure 34: Resources Distribution by Sector - SMEDCO



Source: SMEDCO 2012 Annual Report

Figure 34 also shows that the loan portfolio of the Corporation has the highest exposure to the retail sector owing to the short-term nature of the loans being disbursed during the period under review. There was minimal activity in the mining sector as this is often capital-intensive and requires medium-to-long-term funding even for small-scale miners. The cap on the amount of the loan was also deterrent to potential clients in the mining sector, leaving the largest exposure to the retail sector. There was also an increase in exposure in the manufacturing sector because of small-scale manufacturers who managed to access working capital loans in 2012.

3.3.3 Corporate Governance and Risk Management for SEDCO

3.3.3.1 The Governing Legal Environment

SEDCO's foundational Act (1983 as amended in 2014_ established SEDCO's operating organs. These consist of the chief executive officer and the ultimate governing authority of a board of directors, appointed by the Minister of Small and Medium Enterprises and Cooperative Development for a period of three years.

3.3.3.2 The Board

The Board of Directors of SMEDCO is has a maximum of nine members. There are seven at present. All board members are appointed by the Minister of Small and Medium Enterprises and Cooperative Development. All the board members, with the exception of a representative from the Ministry of Small and Medium Enterprises and Cooperative Development, are independent and have varying backgrounds and expertise. The

chairperson of the board is a lawyer. The board members are all non-executive and independent. The CEO is the only executive member of the board. The board has four committees, namely Finance and Risk, Audit and Internal Controls, Human Resources and Remuneration and Corporate Strategy.

3.3.3.3 Risk Management

The board of directors has overall responsibility for determining the type and level of business risk that SMEDCO assumes. To this end the Board has adopted a risk management framework, and the Corporation is subject to Public Finance Management Act and a corporate governance framework. At an operational level the corporation's risk management rests with the Risk department. The department is also tasked with implementation of enterprise-wide risk management to ensure that all forms of risk are managed.

3.3.4 SMEDCO's Business Model

SMEDCO is operated by the Ministry of Small and Medium Enterprises and Cooperative Development and is the disbursing arm of the Ministry. Services provided include: credit, training and extension advisory services to the small enterprise sector. SMEDCO relies largely on national budgetary allocations for the funds it lends out to SMEs, including rural SMEs. It also sources funding from the National Social Security Authority (NSSA) as well as loans from POSB and commercial banks, mainly the Central Bank of Zimbabwe. SEDCO provides loans ranging from US$100 to US$20,000 to clients ranging from home-based enterprises and vendors wanting finance to buy stock to retail shops and small or medium manufacturing ventures. Unfortunately, loans have not been well managed and SMEDCO has suffered high default rates. The total funding for the two years under review is shown in Table 125 below.

Table 125: Funding and Lending for SMEDCO

	2012 US$ Million	**Breakdown (%)**	**2011** US$ Million	**Breakdown (%)**
Long-term	3.6	100	3.2	100
Sub-total	**3.6**	**100.0**	**3.2**	**100.0**
Equity	4.5		5.9	
Total Funding	**8.1**		**9.1**	
Lending & Invest.	4.9	11.4↑	4.4	

Source: SMEDCO 2012 Annual Report

Table 125 shows that the Corporation has exclusively (100% in 2012) long-term sources of external funding. Despite a good business model, the table shows that, like other financial

institutions, SMEDCO lost its cash reserves as a result of hyperinflation and was left with no cash when dollarization took place. Given its reliance on the national budget, funding for SMEDCO remains precarious. For example, in the 2011 Budget, SMEDCO partially allocated resources for onward lending to SMEs. The corporation received only US$1,500,000 out of the allocated amount of US$5,500,000, making it difficult for the corporation to fulfil its strategic priorities and recapitalise.

3.3.5 Financial Performance of SMEDCO

The audited accounts for the financial year ended 31 December 2011 show losses worsening in 2011. This can be attributed to operating expenses which grew by 315% because of a non-recurring expense.

Although operating expenses are 96% of revenue, an indication that revenue can at the moment cover operating costs, it should be noted that, should the trend of increasing costs continue, the corporation will not be able to cover its operating costs.

It should be pointed out that the accounts were audited by the Auditor General of Zimbabwe. The Auditor General did not provide an audit opinion on the accounts because there was insufficient appropriate audit evidence on which to base one. For this reason, the figures in the financial statements could not be verified.

Table126: Statement of Financial position for SMEDCO Zimbabwe

	2011 US$ '000	% change	2010 US$ 000
Assets			
Non-current assets	6075.0		5985.0
Current assets	2706.0		3145.0
Total Assets	8781.0	(4.0)	9130.0
Liabilities And Equity			
Equity	4503.0		5881.0
Current liabilities	369.0		99.0
long term liabilities	3908.0		3150.0
Total Liabilities	4277.0		3249.0
Total Equity and Liabilities	8780.0		9130.0
Statement of Comprehensive Income			
Revenue	1811.0	187.0	632.0
Profit for period	(1336.0)	(960.0)	(126.0)
Operating expenses	1742.0	315.0	420.0
Key ratios			
Return on Assets	(15.0)		(1.0)
Return on Equity	(30.0		(2.0)
Net Profit margin	(74.0)		(20.0)
Operating expenses as % of NII	96.0		66.0

Source: SEDCO Zimbabwe 2011 Annual Report

SMEDCO continues to experience operating losses. SMEDCO will not be able to sustain itself unless operating costs are reduced dramatically, or the level of revenue generation is increased, also dramatically.

3.4 The Infrastructure Development Bank of Zimbabwe (IDBZ)

The Infrastructure Development Bank of Zimbabwe (IDBZ), formerly the Zimbabwe Development Bank (ZDB), was re-launched by the Zimbabwean government on 31 August 2005, as a vehicle for the mobilisation of infrastructure development in Zimbabwe, with finance from both domestic and international sources.

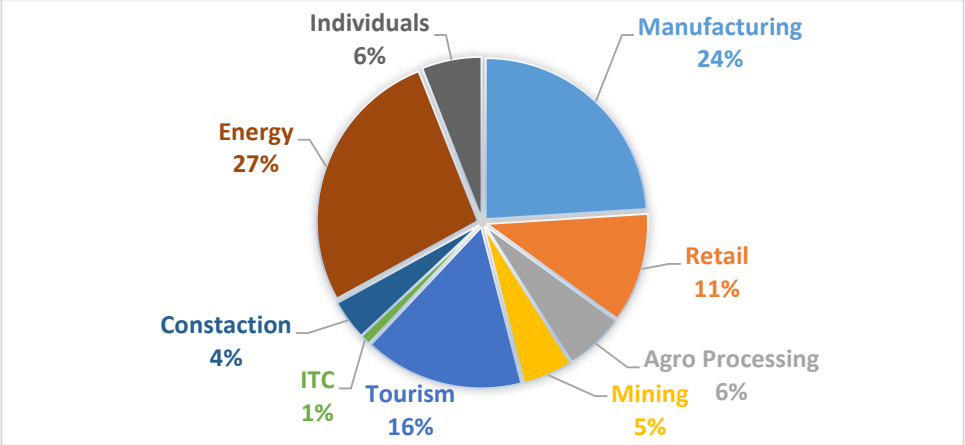
3.4.1 IDBZ's Mandate

IDBZ's mandate is to mobilize financial and technical resources of appropriate duration and cost for public and private institutions involved in infrastructure development, in order to facilitate investment in infrastructure. Its long-term products include equity, bonds and guarantees, long-term loans and project finance. Short-term products offered include trade finance, lease finance, working capital, personal loans and treasury services.

3.4.2 Portfolio Analysis of IDBZ

As indicated in the preceding sections, the main economic sector supported by IDBZ is infrastructure development in areas such as energy, housing, water, agriculture, transport, communication, and any other infrastructure critical to national development. Figure 35 below shows a total investment distribution of loans and advances of US$ 66.4 million between the various economic sectors supported by the Bank. This sectoral analysis excludes investments in equity, property and financial instruments.

Figure 35: Resources Distribution by Sector – IDBZ



Source: IDBZ 2012 Annual Report

Figure 35 shows that of the US$66.4 million development loans and advances, the energy sector accounted for 27%, followed by 24% to manufacturing, 16% to tourism and hospitality, 11% to the retail sector and the balance to the remaining sectors supported by the IDBZ. The above sectoral distribution shows that although the Bank's main focus is on infrastructure, it does cover other areas. This situation leads to mandate overlap with IDC and Agribank.

3.4.3 Corporate Governance and Risk Management for IDBZ

3.4.3.1 The Governing Legal Environment

Despite the fact that IDBZ is not licenced or governed in terms of the Banking Act, the Bank does observe the regulations issued by the Reserve Bank of Zimbabwe. IDBZ is also committed to the observance of all the tenets of good corporate governance as provided for in the King II and King III reports on corporate governance. The IDBZ has put in place governance structures, policies and procedures that are appropriate for its operations. Furthermore, it also complies fully with the corporate governance and performance

monitoring framework introduced in 2010 by government for State Enterprises and Parastatals (SEPs).

3.4.3.2 The Board

The IDBZ board currently consists of eight directors, although its foundational legislation stipulates no fewer than twelve or more than fifteen. All but one of the current directors are non-executive, including the chairman. The need to bring the board up to full strength so as to comply with the Act has been brought to the attention the Minister of Finance. The Minister of Finance has also been made aware of the recommendations of the King II and King III Reports on board composition, with an emphasis on maintaining an appropriate balance between executive and non-executive directors. Despite attempts to raise corporate governance issues, it seems that AADFI standards are not yet being applied. This is a gap which needs to be filled.

The duties and responsibilities of the board are outlined in section 4A of the Infrastructure Development Bank of Zimbabwe Act [Chapter 24:14] and clearly state that the board is responsible for formulating and implementing policies and strategies necessary for the achievement of the Bank's objectives. The board is also charged with the responsibility of supervising the overall activities engaged in by the IDBZ by ensuring that the Bank has adequate control systems to monitor and manage risk, and that there is an efficient and economic use of the Bank's resources. The board is also required to formulate and enforce rules of good corporate governance and ethical practices for observance by the IDBZ directors, management and staff.

The Board has put in place five committees which have clearly defined areas of responsibility and terms of reference. These board committees cover investment, audit, corporate governance, risk management, and human resources.

3.4.3.3 Risk Management

The IDBZ, as a development finance institution, is exposed to various risks which should be managed on an integrated plan. Different business units within the Bank are responsible for the identification, measurement and reporting of various elements of the risk areas, while the aggregation of the Bank’s risk profile is done centrally by the Risk Management Unit at an enterprise-wide level. The Bank has put in place a board-approved bank-wide risk

management framework which guides and informs all bank activities, processes, procedures, systems and policies relating to enterprise risk management.

The Bank also conducts its credit risk management based on an internal rating system. The IDBZ introduced this system from the Central Bank; is based on the Basel II Core Principles. The system consists of 10 credit levels, with non-performing loans classified at levels 8 and 10, which require reserves to cover expected losses (20% for level 8, 50% for level 9 and 100% for level 10). However, these reserves had not been provided for during the period under review.

The ratio of NPLs had increased dramatically to 37% in 2011, as a result of dollarization and this inevitably led to a reduction in lending limits for individual borrowers and changes in its credit policy, with the setting of a collateral minimum for borrowers of 150% of the loan. In addition, the Bank made efforts to strengthen its monitoring of borrowers and collection of credit. As a result, the Bank has seen the ratio of NPLs declining from 37% in 2011 to 19% in 2012.

3.4.4 IDBZ's Business Model

IDBZ, as stipulated in their corporate profile, has adopted a business model that ensures sustainable growth, positive returns on investment and value addition. The IDBZ's enabling legislation requires that it only finance technically sound and commercially viable projects. While the Bank's business is expected to be undertaken on commercial terms, its development mandate necessitates that the IDBZ from time to time consider financing social projects which are critical to national development. To this end, a separate constituted development fund window, financed by government grants and other sources of capital, with a separate balance sheet, is used for such projects.

Apart from the IDBZ's shareholders' equity, the Bank's connection with the pension funds, mutual funds, the government, corporate and banking institutions, non-governmental organizations, international organizations and agencies, and other possible financiers and potential investor institutions, allows the Bank to promote investment in infrastructure. Aside from the main inflows from the Ministry of Finance's development fund, the IDBZ also raises independent resources from private investors using their business networks and issuing bonds, bills, deposits and debentures in capital markets, or private equity markets for specific projects. Table 127 shows the total funding for the two years under review.

Table 127: Funding and Lending for IDBZ

	2012 US$ Million	Breakdown (%)	2011 US$ Million	Breakdown (%)
Long-term	14.3	11.9	1.2	1.3
Short-term	105.6	88.1	93.5	98.7
Sub-total	119.9	100.0	94.7	100.0
Equity	(11.3)		(14.7)	
Total Funding	108.6		80.0	
Lending & Invest.	81.8	104↑	40.1	

Source: IDBZ 2012 Annual Report

Table 127 shows that IDBZ has predominantly (88.1% in 2012) short-term external funding. This business model is not sustainable since the Bank's investment in financing infrastructure projects is likely to be long-term. For this reason, the Bank's business model could lead to both funding and liquidity risk.

The situation is further complicated by the high gearing, mainly attributed to the foreign debt legacy of US$37 million. It is gratifying to note that the bank is working closely with the government to restructure the debt by hiving it, together with matching assets, into a stand-alone special purpose vehicle. It is expected that once the bank is freed from this debt, it will be able to raise much-needed resources from both internal and external sources for infrastructure projects. The Infrastructure Development Bank of Zimbabwe (IDBZ) will need to be re-capacitated to enable it to fulfil its mandate in infrastructural development strategically.

3.4.5 Financial Performance of IDBZ

IDBZ recorded an increase in liabilities from $97 million in 2011 to $122 million in 2012, while total assets rose from $82 million to $111 million. The increase in assets and liabilities was mainly attributed to an increase in infrastructure projects and borrowing using infrastructure bonds which the Bank had issued during the period under review.

Table 128: Statement of Financial position for IDBZ

	2012 US$ Million	% Change	2011 US$ Million
Assets			
Loans and advances	66.0		30.0
Other Assets	45.0		52.0
Total Assets	111.0	35.0	82.0
Liabilities and Equity			
Equity	(11.0)		(15.0)
Liabilities	122.0		97.0
Total Equity and Liability	111.0		82.0
Statement of Comprehensive Income			
Net Interest Income	7,000.0	(30.0)	10.000.0
Profit for period	3,500.0	192.0	1.200.0
Loan impairment	2.0	(67.0)	6.0
Operating expenses	10.0	11.0	9.0
Key ratios	%		%
Return on Assets	3.0		1.0
Return on Equity	(32.0)		(8.0)
Net Profit margin	50.0		12.0
Impairment as % of NII	29.0		60.0
Operating expenses as % of NII	143.0		90.0
Impairment and operating exp. As % of NII	171.0		150.0

Source: IDBZ 2012 Annual Report

Table 128 can be summarized as follows:

- The balance sheet continues to show an excess of debt, largely legacy debt carried forward from the IDB. Most of the legacy debt is a foreign line of credit, on which the Government of Zimbabwe has now reached an agreement to transfer the debt to the special purpose vehicle (SPV) to be established;
- Despite its excess debt, the Bank still paid dividends to shareholders in 2011 and 2012;
- The Bank recorded a significant increase of 192% in profit arising from cost control mechanisms and management of the loan book, as evidenced by the reduction in loan impairment by 67%;
- Impairments and operating expenses, however, account for 171% of net interest income; as NII cannot cover impairments and operating costs, the bank is unsustainable;
- The balance sheet grew by 35% as a result of funds raised through an infrastructure bond and foreign lines of credit; and

- The equity position improved slightly (by US$4 million), although remaining negative. This was on account of the improved profit in 2012. The negative equity position is due to the US$37.5 million foreign debt.

In summary, if the IDBZ is to sustain its operations in the medium to long term, it will require capital injection as well as more cost control. In addition the Bank needs to put in place a risk framework which will ensure that various risks which affect the Bank are properly managed.

4 Co-ordination, Regulation and Supervision of DFIs in Zimbabwe

4.1 Co-ordination

Table 129 shows that the activities of the four development finance institutions currently operating in Zimbabwe are coordinated by four different ministries: the Ministry of Agriculture, the Ministry of Industry and Commerce, the Ministry of Finance and Economic Development, and the Ministry of Small and Medium Enterprises and Cooperative Development. Each DFI has a different reporting line and this illustrates the lack of an overarching coordinating framework for the DFIs in Zimbabwe, a situation which might contribute to mandate overlaps among the DFIs.

Table 129: Co-ordination, legal and Regulation of DFIs- Zimbabwe

Institutions	Legal and ownership	Co-ordinator	Regulator
1. Agricultural Bank of Zimbabwe (Agribank)	• AFC Act and its Amendment No. 14/1999 • Wholly owned by the State	• Ministry of Agriculture	• Central Bank of Zimbabwe
2. The Industrial Development Corporation of Zimbabwe (IDCZ)	• IDCZ ACT (Chapter 14:10) and Companies Act (Chapter 24:03) • Wholly owned by the State	• Minister of Industry and Commerce	• Own Act
3. Infrastructure Development Bank of Zimbabwe (IDBZ)	• IDBZ Act (Chapter 24:14) • Majority owned by the State (86.59%)	• Minister of Finance and Economic Development	• Own Act
4. The Small Business Enterprise Development Company (SEDCO)	• SEDCO Act of Parliament of 1983, (amended to SME Act,2012) • Wholly owned by the State	• Ministry of Small and Medium Enterprises and Cooperative Development	• Own Act

Sources: Survey questionnaires, AFC Act and its Amendment No. 14/1999, IDCZ ACT (Chapter 14:10), IDBZ Act (Chapter 24:14), SEDCO Act of Parliament of 1983

4.2 Regulation and Supervision

Table 129 also shows that only one of the four DFIs reviewed in this study is supervised and regulated by the Central Bank of Zimbabwe. This shows that the regulations governing development finance in Zimbabwe are currently fragmented. For this reason there is need for all DFIs in Zimbabwe to come under a single financial services authority, a regulator that regulates all DFIs so that the country does not have an eclectic piecemeal regulation with each DFI having its own regulator.

5 Conclusion

Zimbabwe has four development finance institutions (DFIs): IDBZ, Agribank, IDCZ and SEDCO. These DFIs face substantial challenges, in that they have low levels of

capitalisation, with the result that these DFIs have failed to provide financing for long-term and capital-intensive projects.

Key findings on the development finance system of Zimbabwe are:

- Zimbabwe, despite having a relatively well developed financial sector, still has a substantial development finance gap. DFIs have a complementary role to play in filling this gap;
- None of the DFIs currently operating in Zimbabwe are well capitalised;
- There is no uniform statutory way of establishing DFIs in Zimbabwe;
- With the exception of SEDCO, DFI mandates are broad and exhibit a high level of mandate creep;
- None of the DFIs of Zimbabwe has a mandate to fund projects outside the country;
- Apart from IDCZ, the DFIs' business models are not in line with the development finance model framework;
- None of the four DFIs currently operating is Zimbabwe is sustainable. This is likely to be related to the poor economic performance of the country;
- There is a lack of strategic plans that are in line with national development plans;
- There are weak corporate governance structures;
- There is a lack of a uniform risk management framework in place for DFIs;
- There is no standard practice with regard to shareholding representation on the boards of DFIs. Most board members are appointed by the Ministers;
- There is no overarching policy framework for coordinating the activities of the DFIs in Zimbabwe. Although the government is the sole shareholder in all of them, they report to different line ministries; and
- Only one DFI is currently regulated by the Central Bank of Zimbabwe, indicating the lack of a regulatory framework for DFIs.

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