# THE INFLUENCE OF THE SOFT STATE ON THE PERFORMANCE OF DEVELOPMENT FINANCE INSTITUTIONS

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From time to time in the text there is critical comment centring on activities and conditions in African countries, in particular of course Kenya and Zimbabwe, since these countries are the principal foci of the study. This is almost inevitable in a research project that aims to identify 'soft state' features in development finance, and is not there in order to highlight faults per se, but, by diagnosis, to lead to the sort of treatment that can ensure a future of more effective capital investment. However, it must be made clear that all opinions expressed in the text are - unless definitely acknowledged - the author's own, and not those of any of the persons or institutions referred to or named above, or indeed of any persons or institutions referred to or named in the text.

STATEMENT OF OBJECTIVES

The main objective of this thesis is to isolate and investigate the importance of the 'soft' state as a causal factor behind the disappointing record of development finance institutions in the furtherance of economic growth in developing countries, particularly those in Anglophone Africa.

Subsidiary objectives were suggested by the progress of the investigation, and are important as supporting the main thrust of the work. They are:-

(i) to determine the relevance of standard ideas on financial intermediation on development - principally devised in relation to European industrialisation - to modern developing countries;

(ii) to relate D.F.I. behaviour to standard theories of the firm;

(iii) to investigate the question as to whether D.F.I.s can be viable in financing contexts that conventional intermediaries avoid;

(iv) to devise a criterion for D.F.I. financial solvency.

Finally, an important last objective is to draw pertinent conclusions from the analysis, and make recommendations for development finance institutions in the future.

ABSTRACT

Development finance institutions put money into capital projects where conventional intermediaries are reluctant to get involved, and/or where there is a political preference for this channel of investment. In the last few decades D.F.I.s have especially proliferated in developing countries. Unfortunately experience has been disappointing. Most D.F.I.s have got into financial difficulties, and have not done much for economic growth. A number of factors can be postulated as responsible for this record. However, the concept of the 'soft' state as a causal factor has not been applied in a structured manner to the problem. The following pages isolate 'soft' state effects on D.F.I. experience via substantial Kenyan and Zimbabwean case studies.

The first part of the thesis is largely theoretical. The concept of the soft state is discussed, and then a consideration of

(i) the place of financial intermediation in development,
(ii) the normative goals that often bias government policy and
(iii) the nature of financial systems in developing countries,

leads to a delineation of a role for development finance institutions.

The second part investigates the major 'general' D.F.I.s in Kenya and Zimbabwe in order to test the deductions made and the hypothesis postulated in Part 1. As necessary background to the D.F.I. analysis the history, the ideological bases, the economics and the financial systems of the countries concerned are discussed. The work on the D.F.I.s themselves leads to some preliminary conclusions as to the effect of the soft state on their operations.

The third part synthesises the material from the previous chapters, and draws some conclusions as to how soft state features have affected the structures and work of D.F.I.s in Kenya and Zimbabwe. A number of recommendations related to the role and behaviour of D.F.I.s in developing countries are made at the end, and some suggestions for further research.

There are three appendices after the final chapter. The first analyses the concept of rent generation by and rent extraction from companies in developing countries and the second formulates a rule as to when D.F.I.s should sell profitable investments. The third looks briefly at some other developing country D.F.I.s.

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# PART 1:

# ISSUES AND IDEAS

# Chapter 1

# THE SCOPE OF THE STUDY

## INTRODUCTION

This thesis is about development finance institutions in developing countries. Though development finance institutions (1) proliferate throughout the world in countries at all levels or stages of economic development, in recent years it is in the poorer nations that enthusiasm for them has been most pronounced. As specialised intermediaries between providers of - generally - long-term funds and those who seek to obtain such money in the form of loans or equity, they ostensibly constitute a convenient and efficient way of channelling money into capital projects in contexts where the furtherance of economic growth is seen as a priority and where private capital markets are limited in scope, and/or unwilling to face the risks they perceive to exist in certain types of lending and equity investment.

Kitchen elaborates on these latter points when he writes, "The raison d'être of a DFC in a market (or mixed) economy is to provide long-term finance (debt or equity) which the capital market cannot (or will not) provide". (Kitchen 1986 p.125). In other words there are lacunae in the capital market - for whatever reasons - which are plugged by the deliberate creation of specialised financing intermediaries. This is an acceptable idea, and one does not have to travel out of the U.K. in order to find successful examples of such organisations, for example 3i (Investors in Industry) or the now defunct Scottish Development Agency. If therefore countries such as the U.K., with highly developed and sophisticated private sector capital markets, have seen the establishment of specialised state-sponsored financial intermediaries, how much more pertinent would such organisations seem to be in developing countries with their more limited financial systems.

And indeed, the following lines indicate the importance that has become attached in real life to the concept of financing economic growth through tailor-made intermediaries. "In the last two decades, with considerable World Bank prompting, development finance institutions were established throughout much of the developing world in the belief that they would be the means for achieving a quantum leap in the rate of economic development". (RBC Dominion Securities 1989 Component 3 Vol.1 p.1) (2).

## THE NATURE OF DEVELOPMENT FINANCE INSTITUTIONS

As noted above, a development finance institution is a financial intermediary principally concerned with directing capital funds on a long or medium term basis - though occasionally they lend working capital - into the hands of those who aim to embark on real investment projects. The recipients may be private sector companies, cooperatives, small businessmen, farmers, nationalised industries, government departments, concerns owned wholly by the D.F.I., or concerns owned on a minority or majority basis by the D.F.I. jointly with other interests.

A D.F.I. may be wholly owned by private sector interests, and in this context Kitchen (1986 p.126), referring to a 1983 World Bank paper by Gordon - quoted later - observes, "Private sector D.F.C.s were found to be generally more vigorous, efficient, and profitable than their government-owned equivalents". Though the empirical work in Part 2 of this study does not show this to be unequivocally true, a simple explanation - that accords with Kitchen's assertion - is that governments in developing countries rarely leave such institutions alone, typically wanting to guide, pressurise and interfere in their business operations even when there are no state holdings in them. (See Ch.5 for further discussion of this issue).

Nevertheless, as a result of considerable government concern with the achievement of economic growth, D.F.I.s in developing countries typically tend to be owned by governments and parastatal organisations, with or without the association of other shareholders such as banks, supranational, regional and foreign national development organisations, and miscellaneous others. D.F.I. grants, borrowing and lines of credit are obtained from governments, banks, the World Bank, the Commonwealth Development Corporation and many other analogous bodies. In theory bonds may be floated on domestic or international capital markets, though in recent years, in the light of the generally poor record of D.F.I.s (see later chapters), it is unlikely there would be any takers without watertight government guarantees.

In addition to actually providing money, D.F.I.s may take on a variety of other functions, such as providing management, extension and training services. Indeed, in relation to a wholly-owned subsidiary, a D.F.I. has little option but to organise management or to provide management itself, and sometimes a D.F.I. may actually initiate new projects. The term 'promotional agency' has been coined to identify institutions go in for this type of work (Levitsky 1986 p.21); however there seems little to be gained by using the term in the text that follows, as promotion differs only in degree but not in kind from less entrepreneurial D.F.I. behaviour.

To classify D.F.I.s in relation to the type of finance they supply is also an unsatisfactory exercise, since a variety of terminology is used in naming them, and traditional nomenclature is often employed according to taste and without precision. Thus 'development corporation', strictly speaking, implies an organisation that provides equity capital but not loans, whereas a 'development bank' should mean the opposite. However in practice 'corporations' will be found that lend and 'banks' that invest. Also D.F.I.s termed 'investment banks', 'investment corporations', 'credit organisations' and so on, are commonplace. It is not sufficient, therefore, just to know what a D.F.I. is called to understand what it does.

## EXPERIENCE

The experience of D.F.I.s in promoting economic growth has been disappointing. Their failure in this respect is mirrored in their own internal viability, and indeed throughout developing countries many have collapsed under mountains of bad debt, while others have limped on supported by open or covert government subsidies, or via taking advantage of the convenient blind eye of creditors.Some, though, have remained - or appear to have remained - viable. A continuation of the above quote makes the position depressingly clear. "Unfortunately... their track record on the whole has not been encouraging: of the literally dozens of development finance institutions that were launched, perhaps a small handful have been able to make substantial progress towards becoming financial institutions which are making a measurable contribution to economic development without substantial and ongoing injections of public funds". (RBC op.cit. p.1).

The RBC suggests a number of reasons for what it describes as the "lacklustre performance of most development finance institutions" (Ibid. p.1), and to mention them at this point is not so much to anticipate more detailed later analysis as to be able to identify the missing ingredients in the listing. Firstly, the report assumes a measure of 'supply-leading' (see Pt.1 Ch.2) by D.F.I.s, since it stresses the contradictions between financial viability and the costs of promoting development. Secondly, and clearly related to the first point, is the labour-intensive - and hence more costly - nature of providing development finance. Thirdly, there is the greater possibility of making mistakes and misjudgements when operating in 'new' territory. Fourthly, the report castigates poor D.F.I. management and indifferent project appraisal,"an unfortunate, but necessary, routine that has to be followed to arrive at the ultimate goal: the dispersion of funds". (Ibid. p.1). Fifthly the poor record of recipients in servicing debt is noted. Sixthly it is apparent that governments may allow factors such as employment creation and regional development to come before the financial viability of projects, and hence of the D.F.I.s that support them.

All of the above are likely and plausible factors behind the indifferent performance of D.F.I.s, and later pages will have more to say about them, both generally and in relation to the two countries on which the study is focussed. However it may be argued that to some extent they - and other factors not mentioned - are linked to, and indeed may be emanations of, phenomena hardly mentioned in the Report, other than indirectly and by implication. Such are, firstly, the political and ideological factors that often guide governments in their policies towards development finance. When such considerations are preeminent, viability can be undermined (3). Ch. 3 of Part 1 will explore this issue in depth. Secondly is the 'soft' state syndrome, whereby structural weaknesses (4) in society damage the ability of an economy to flourish. Properly to investigate the factors referred to in the above paragraph necessitates facing up to these politico/social conditions that affect them. Hence, the assertion, "The current World Bank thrust towards sustainability for development finance institutions involves a major rearrangement of priorities" (Ibid p.2) is rather to understate the problem.

## THE 'SOFT' STATE

The following passage from Gould and Amaro-Reyes in a World Bank publication (1986 p.18) explains the nature of a 'soft' state. "The soft state is characterised by social indiscipline that is manifest by deficiencies or willful neglect of rules and directives by public officials and civil servants, and the collusion of government officials and top civil servants with powerful individuals and groups whose conduct they are supposed to regulate". In the context of Africa, Ergas (1987 p.5) conceptualises this scenario into the idea of the 'patrimonial' state, which is "based on patron-client ties". The overt character of such a state may be - and normally is, since true democracy allows an electorate to overturn a government that presides over a disordered polity - some variety of dictatorship, but the apparent toughness of rule belies a network of weaknesses in political, social and economic structures and practices. Rothschild (in Ergas op.cit. p.118) puts it thus, "The African state appears centralised and bureaucratised...Yet it is not always able to demonstrate an assured capacity to convert its preferences into policies and must, as a matter of political necessity, often negotiate with local strongmen or modernist interest group representatives for its survival".

Gould and Amaro-Reyes go on to delineate specific aspects of this situation, such as "social indiscipline and disobedience to public authority". (op.cit. 1986 p.18). Related to this, (Ergas op.cit. p.5), "(ethnic, clan and extended family type of loyalties prevail)". In the context of D.F.I.s this can mean disregard by borrowers of the need to meet interest payments and capital repayments due to centralised institutions to which they feel no affinity, and of the obligation necessarily to use funds for the purpose for which they were obtained. D.F.I.s themselves may be complacent about their financial obligations to government and other providers of funds, and may expect automatic government help if they get into difficulties due to bad debts.

On the other hand the 'soft' state can mean "overcentralised government, which undermines local initiatives". (Gould and Amaro-Reyes op.cit. p.18). Furthermore, as Ergas (op.cit. p.12) observes, "With a few exceptions...African governments have also a very dismal record as managers of the economy. African governments have often exhibited a perplexing tendency (5) to disregard basic economic principles...". For D.F.I.s this might imply that government interferes too readily in day-to-day business, requiring disbursement of funds not only on grounds congruent with some development plan or social goal, but also requiring finance to be handed out on the basis of political or personal criteria. This is in line with remarks made by Bates (1981 p.102) when he observes, "Privileged access is used by the elites in charge of the programmes for direct personal gain and to create a political following". Lastly, Gould and Amaro-Reyes (op.cit. p.19) refer to the soft state as prone to "endemic corruption that hinders innovation, prevents change and inhibits eradication of corrupt behaviour". And, as Ergas (op.cit. p.5) puts it, "Corruption....is an important dimension of patrimonialism". This can cover a multitude of possibilities in relation to D.F.I.s, such as job creation for relatives, the maximisation of managerial utility irrespective of an institution's capacity to support such behaviour, the diversion of loans and equity capital to 'cronies', inadequate presentation of accounts to hide irregularities, and the filling of influential D.F.I. posts by officials who also hold powerful government positions (6).

It is beyond the scope of the present study to explore the reasons behind the 'soft' state phenomenon, except in so far as such discussion occurs incidentally in the course of the analysis of other issues. A further quote, however, gives the essence of the problem. "The social indiscipline of the soft states has been attributed to political, social, and economic arrangements conditioned by historical circumstances". (Gould and Amaro-Reyes op.cit. p.19). For the above situation to impinge on the conception, establishment, administration and operations of development finance institutions must be (i) to severely damage their ability to remain solvent and (ii) to disable the development projects with which they are associated. Furthermore such lacunae as there are in the private capital market of a country for D.F.I.s to fill may increase in number and size when the state is 'soft', as business confidence in such an environment wastes away and the financial markets increasingly confine themselves to safe business. And of course the not infrequent desire of developing country governments to guide the finance of development in line with ideological goals can only compound the problem.

## HYPOTHESIS

In a low income developing country that wishes to experience sustained economic growth, the soundest and most uncontroversial justification for the establishment of development finance institutions is that they may compensate for certain forms of financial market failure. Without them, in other words, the flow of money capital, and hence of the real resources for which it is a proxy, into economic development may be hindered or dammed. However, it is the purpose of this study to show that, given the circumstances of a 'soft' state environment, D.F.I.s fail in this role.

The second part of the hypothesis follows on from this. That is that D.F.I.s which are bound up with the disorder of a soft state contribute to the economic deficiencies that they are supposed to treat. A passage from the RBC Report (op.cit. p.4) supports this suggestion. "In recent years the D.F.I.s have been criticised, and with a degree of justification, for having failed in their intended mission. In fact, the term 'negative development' was encountered...on a number of occasions to indicate that the effect of some companies' involvement with one or other of the D.F.I.s (in Kenya) had been so detrimental financially and/or competitively that their normal development and expansion had been precluded".

## THE WAY FORWARD

Earlier sections of this chapter constitute an impressionistic survey of the scenario to which the hypothesis relates. Concrete evidence and analysis must be supplied to justify or refute what is hypothesized. This the forthcoming chapters aim to do.

The primary purpose of the remaining chapters in Part 1 is to seek to establish a role for D.F.I.s in developing countries. Firstly, this exercise requires some investigation of the significance of financial institutions in general in the business of economic development, so as to determine what should be the nature of the relationship between D.F.I.s - as constituting one specific grouping amongst intermediaries - and those who use the funds they provide. Introducing the conclusions into the context of the developing country can come up against social and ideological agendas, which can obfuscate and weaken policies that attach to economic and commercial recommendations. Following this, an exploration of the scope of financial systems in developing countries, taking due account of the complications just referred to, reveals the areas in which D.F.I.s may be expected to operate.

Part 2 looks at the experiences of Kenya and Zimbabwe in the light of the analysis in Part 1. Part 3 synthesizes the analysis, draws conclusions and makes some recommendations on the future conduct of D.F.I.s in developing countries.

NOTES PART 1 CHAPTER 1

1. In general this designation will be used in the following pages even though 'companies' or 'corporations' are frequently used as alternatives to 'institutions'.

2. RBC Dominion Securities of Canada was commissioned in the late 1980s to write a report on Kenyan development finance institutions. However despite the locational focus of the project, the completed report has much useful comment on D.F.I.s in general.

3. ...unless of course ideological enthusiasm motivates people towards hard work and efficiency.

4. The words are meant to indicate that though economic and social arrangements in a country may appear well-ordered and logical, the system is prone to inefficiency and disorder.

5. Not so perplexing, perhaps, if one considers only the short term interests of the ruling elites.

6. A useful account of the subordination of commercial criteria to personal motivations in African economies is found in Goran Hyden - 'No Shortcuts to Progress: African Development Management in Perspective' - Heinemann 1983 p.8-29.

# Chapter 2
# FINANCIAL INTERMEDIATION AND GROWTH

## BASIC IDEAS

Economic development in a country cannot proceed very far without the assistance of a structured financial system. As Gurley and Shaw (1955 p.519) observe, "Economic development is retarded if only self-finance and direct finance are available, if financial intermediaries do not exist". In a system devoid of such intermediaries, even the basic matter of trade in goods and services may only take place via barter or the use of commodity money: the cumbersomeness of both these methods inevitably slows up business affairs. When it comes to capital accumulation, in a barter system saving and investment are not easily accomplished unless they be directly related, as when a person devotes time to producing real capital instead of making consumer goods or enjoying leisure. The separation of saving and investment is of course possible once a convenient commodity such as silver has become established as a generally accepted money medium, and such processes have historically given rise to and been associated with financial intermediation. However the growth of economic activity is held back if it rests on the physical moving around in quantity of metallic or other commodity money, and waits on the development by financial intermediaries of the 'token' money concept and, on the basis of this, cheque and allied systems, and depositing, saving, lending, borrowing and investing facilities.

In the context of the modern developing country, what is at issue is not the necessity for a system of financial intermediaries, but how it should be structured, and how the various institutions within it should operate in order to have the optimal (1) impact on economic growth. In the past decades a number of theoretical contributions have been made on the nature of the importance of financial institutions in general on development, and the investigation begins by surveying these ideas. D.F.I.s, as a subset of intermediaries supposedly (2) specifically concerned with growth can very pertinently be associated with these ideas.

'BACKWARDNESS' AND THE PROVISION OF FINANCE

Gerschenkron (1962) takes the importance of finance for development as self-evident, and relates the arrangements for the provision of finance at the outset of industrialisation (3) to the degree of 'backwardness' in an economy. Leaving aside the question as to how the 'degree of backwardness' is to be measured - a problem that is never really resolved - he suggests that the more 'backward' the country, the more it becomes necessary for capital funds and the impetus for development to be supplied, as it were, exogenously. Taking as his main illustrative examples England, Germany and Russia, he explains that in England, purportedly the least backward of the three when industrialisation got under way, budding industrialists mainly supplied their own capital funds, in Germany banks took the initiative, and in Russia, the most 'backward', the state had to organise the provision of capital itself.

Now it is interesting that almost by sleight of hand Gerschenkron smuggles another idea into this scenario. Conveniently for the theory Germany began to industrialise later than England, and Russia later than Germany, and it is supposed that as the years passed, technical progress made ever larger discrete amounts of capital necessary for setting up new industrial projects. Thus, given the state of technical knowledge in the late 18th century, it was feasible for English entrepreneurs to finance new productive methods from their own and their associates' savings, but by the time Russia got going a century later, nothing less than the resources of the state were sufficient to finance the innovations in industry and infrastructure then coming on stream. "The role of the state distinguishes rather clearly the type of Russian industrialisation from its German and Austrian counterparts". (Gerschenkron 1962 p.19). Thus in this model the sources of finance for development are determined, not only by the overall 'degree of backwardness', but also by the state of technical knowledge.

While not denying the important focus the ideas of Gerschenkron gave to the study of industrialisation and finance, there are several weaknesses in the analysis. One has been mentioned at the outset of this discussion, and that is the intractible problem of defining 'degree of backwardness'. Statistics to do with the proportion of the labour force in agriculture, size of G.N.P., G.N.P. per capita and so on might be pressed into service to provide a plausible answer in any particular context. However, historical investigations come up against the problems of sparseness and unreliability of data, and although there might be a rough consensus as to which present day countries are, in a relative sense, backward, it would be impossible to determine how they align with Gerschenkron's 'degree of backwardness' concept.

Secondly, it must be doubted whether the empirical backing for the hypothesis is altogether correct. As Cameron (1972 p.12) points out in relation to England, "..there were numerous instances in which banks made long-term commitments to industrial enterprises.." And again (p.12), far from banks taking the initiative, "...many of the most notable German industrial enterprises antedated the German joint-stock banks by several years or decades". Finally, Russia, according to Cameron, principally experienced a spurt in economic growth after 1880 due to the efforts of private entrepreneurs and private sector banks. (Ibid. p.13-14 passim). Though the importance of the state as a promoter and encourager of development may have been crucial, its direct role is less spectacular. For, despite Gerschenkron's emphasis on the government's financial importance, the late 19th century State Bank, something of a hybrid central and commercial institution, only ever accounted for a minority of the discount and loan operations of the banking system (Crisp in Cameron 1967 p.191-5). Indeed, as is pointed out (Ibid. p.212) "..the State Bank did not develop its operations on the scale envisaged.." There appears, therefore, to have been rather more similarity between the experiences of the three countries in the early days of industrialisation than Gerschenkron's theory suggests. All had a lot of native entrepreneurship, and financial intermediaries became established more as part of the process of growth than - as postulated in the cases of Germany and Russia - as leading sectors.

The third main point of contention is the conceptual weakness of Gerschenkron's coincidental parallel between the 'degree of backwardness' and the current state of technology. For neither need the degree of backwardness - if definable - at the outset of industrialisation be correlated with the state of technological knowledge, nor may the advance in technical knowledge necessarily mean that ever-increasing inputs of capital funds are required for successful implementation of the new techniques. In the first place, for example, the modern nations termed 'newly-industrialised countries' or NICS have advanced economically at roughly the same time but from very differing economic and social starting points. In the second place, though 19th century technological developments might suggest that economic growth was dependent on inexorably rising discrete injections of capital, this is no longer inevitably true. The emphasis on and indeed the success of the small businessman, fragmented supply conditions, diversified markets and the techniques inherent in 'alternative' technology may enable economic growth to proceed on the basis of small injections of capital. As Cameron (1967 p.320) observes, "The most successful historical cases of industrialisation....show the prominence, if not the predominance of smaller scale enterprise in the earliest stages of industrialisation. If small enterprises are successful, it is because they have stood the test of the market, and they will inevitably grow larger".

The verdict on Gerschenkron's ideas must be that though they shed some light on the relationship between financial provisions and early industrialisation, the full reality is less easily conceptualised. If the history of the finance of development in Europe provides any lesson for modern developing countries it must be that nothing substitutes for sound entrepreneurship. Banks are necessary and the state may have a role, but it is unsafe to assume that they can can act as the main engines of growth.

## DEMAND-FOLLOWING AND SUPPLY-LEADING FINANCE

(a) Introduction.

As observed in the last section, Gerschenkron allowed financial intermediaries in 19th century Germany and financial intermediaries with strong state backing in 19th century Russia a much higher 'leading' profile in the process of economic development than banks in 18th century England.

Despite the criticisms that can be directed against the case study conclusions, it is appropriate to look at the broad ideas contained therein in more depth: this exercise provides a framework for the rest of the chapter. To begin with, the analysis is conducted in terms of the Patrick (1976) 'demand following/supply leading' hypothesis. Later, there is more specific discussion on the role of the state in relation to financial intermediation.

(b) Demand-following intermediation.

To consider the demand aspect first, Patrick explains (1976 p.74) "We may term as 'demand-following' the phenomenon in which the creation of modern financial institutions, their financial assets and liabilities, and related financial services is in response to the demand for their services by investors and savers in the real economy". The financial system, therefore, plays a passive role and only reacts to a demand for financial services.

A situation where finance is a 'demand-follower' implies a thrust towards economic development quite separate from any measures a financial system might adopt to promote it. Hence there must be in existence a number of economic and other influences that encourage real investment. The very lack of a suitable clutch of financial arrangements and intermediaries will in some circumstances stimulate their creation, and it would appear that in a number of 19th century European contexts where sustained growth got under way little difficulty arose in diverting some of the enterprise making its presence felt in non-financial developments into finance. Indeed, historical evidence appears to provide many instances of manufacturing entrepreneurs diversifying into finance so as to gather the funds and provide the services they themselves and their fellow-industrialists require. For example, in relation to industrialising England, Cameron (1972 op.cit. p.12) notes, "..banks were often founded by industrialists..".

In modern developing countries the basic commercial fact of life is that, though there may be considerable nominal demand for capital funds, many project proposals are not easily assessed, due to the lack of standing and proven ability of many applicants for funds, so mainstream financial systems do not automatically expand to accommodate these applicants. Even in a situation where a clutch of financial intermediaries, originally established for exploiting business opportunities considered safe, or deliberately brought into being by government pressure or dictat, has funds to spare, it will be reluctant to lend and invest in such high risk contexts. As Porter (1966 p.352) points out, there may not be sufficient bankable projects to absorb the funds available. Indeed, the end result may be detrimental to growth, for "there are large classes of borrowers whose operations are socially desirable and who now pay high - even exhorbitent - rates of interest for non-bank loans, but who may be cut off entirely from credit if an enlarged banking system draws elsewhere their suppliers' funds". (Ibid. p.353-4). It becomes, then, almost incumbent on financial intermediaries (4) to address the problems that give rise to high commercial risk. Bhatia and Khatkhate (1975 p.137-8) observe, "the policy of developing financial intermediaries must be supplemented by a whole range of measures directed towards minimising both the risk of lending to new entrepreneurs and the cost of administering new loans".

Financial intermediaries may undertake a range of functions supporting the provision of finance, such as standard in-house assessment of proposals submitted to them, monitoring, guidance, training and supervision, and so on. Though services of this nature are typically assumed to be especially important in relation to small and medium business financing, clearly they are appropriate in the support of any type of credit or equity capital facility where especial risk attaches.

Such comprehensive support of development financing can be costly (5), and this is reason enough to explain why intermediaries are reluctant to get involved in the business. As a consequence there is a case for government - or some other agency (see Pt. 1 Ch. 3) - assisting in the process by shouldering some of the financial burden of providing support services. This is not a matter of subsidising lending costs, but of improving the environment in which lenders and borrowers operate so that the likelihood of finance being properly used and timeously serviced is greatly increased. A problem arises of course as to where the border comes between the financial obligations of government and intermediary, but given integrity and goodwill the issue is not insoluble.

(c) Supply-leading intermediation.

The alternative scenario means finance taking a leading role. As Patrick (op.cit. p.186) explains, "Before sustained modern industrial growth gets under way, supply-leading may be able to induce real innovation-type investment". The ways in which this can occur are identified as the transfer of resources from agriculture to nascent industrial sectors, and - more significantly from the point of view of the present study - the assumption of a non-financial entrepreneurial role by financial institutions.

(d) Comment.

The neat classification of financial intermediaries into 'demand followers' and 'supply leaders', though useful for analytical purposes, does not fit reality very well. From 'extreme' supply leading to 'extreme' demand following there are a spectrum of possibilities, and quite obviously an institution that provides extension advice - a function considered above in the 'demand' sub-section - is more of a leader than one that is more passive. It is not too clear where Patrick would have drawn the border between the two stances, and whether or not he would have put the intermediary with an active policy of supporting and monitoring the recipients of funds in the supply leading category is uncertain.

However, at the 'supply' extreme lies the financial institution that itself actually initiates and carries through new projects, with or without the collaboration of partners that it persuades or pressurises into joining with it, or which government instructs it to work with. Though Porter remarks, "...there is no clear mandate for making a 'leading' sector of banking" (Ibid p.348), developing country governments in recent decades often appear to have behaved as if this was more or less the case, and to have pushed or encouraged intermediaries into an entrepreneurial role with regard to new projects.

This arrangement, of course, fails to explain exactly how the mechanism works, and in practice the convergence of a number of other factors is necesary if - what will be referred to from now on as - 'pure' supply-leading is to be successful. In particular, a financial intermediary in this role must have within its staff structure people with such a high endowment of entrepreneurial flair and managerial expertise that they would probably do far better for themselves - and understand that they would do better - outside the confines of the organisation. Though Patrick does not avoid referring to the channels connecting financial resources with real development, the discussion remains fairly generalistic.

Finally, it is as well to note the relevance of the words of Nevin, which he wrote as far back as 1961 (p.9) "There can be no escaping the fact that in the majority of underdeveloped territories an overall expansion of credit will not in itself stimulate the rate of economic development".

FINANCIAL INTERMEDIARIES AND THE MOBILISATION OF SAVINGS

The sections above on demand following and supply leading focus on the distribution of capital funds. Not to be ignored, however, is the question as to whether financial intermediaries bring about an increase in savings. Patrick is optimistic. Firstly, by their very existence, financial intermediaries are seen as attracting savings from the public at large, who hitherto had to hold surplus wealth in the forms of precious metals and inventories. Secondly the creation of a range of financial assets makes saving even more attractive, since there is something to suit all tastes. As a result, resources are mobilised and are available to borrowers and investors, and interest rates tend to fall in a system which by definition is more efficient than previously. However Porter, quoting Bloomfield, warns "...against assuming that a mere multiplicity of savings institutions will in itself solve the problem of inadequate saving". (Porter op.cit p.348). Savers may distrust financial intermediaries, they may seek to accumulate only a given quantity of saving, irrespective of the ease of putting money aside at interest, and they may fear the erosion of the value of financial assets by inflation (6). Furthermore, according to Porter, there is little evidence that higher interest rates will call forth more savings.

In the light of these observations, the prospect of D.F.I.s bringing about an increase in the volume of domestic savings is weak, especially as they are not normally geared to collecting savings at the retail level. Certain possibilities, however, are reviewed in Pt. 1 Ch. 5, a chapter which centres specifically on the role and functions of D.F.I.s.

## THE ROLE OF THE STATE AND THE CONCEPT OF FINANCIAL REPRESSION

(a) Introduction.

Previous sections have referred to certain contexts in which the state may play a role in the business of development finance, as in Gerschenkron's 'Russian' model, and in the recommendations about the finance by the state of extension work. This section looks at state involvement more comprehensively, so both including and going beyond these issues.

Broadly speaking, state involvement in the finance of development via financial intermediaries means either direct intervention in intermediation, or the creation of background economic (and other) conditions that influence the process. The sub-sections below follow this categorisation.

(b) State involvement in intermediation.

1. New facilities.

Direct state intervention in modern developing countries in the business of development finance via intermediaries has typically meant the actual setting up and the funding - wholly or in part - of such intermediaries. Patrick (op.cit. p.186), in the context of his supply-leading hypothesis, suggests that "...deliberate creation of the supply of financial services may have favourable allocative and incentive effects; it may well be desirable for the government to establish its own financial institutions or to subsidise private investment institutions". Also, existing intermediaries may be taken over and/or have their remits altered to bias them towards the sort of business the state favours. To quote Patrick again, "the monetary authorities should encourage financial institutions into those kinds of investment activity where the social marginal productivity is relatively high". (Ibid. p.186).

It is possible to support a policy wherby the state aims to fill out the capital market by setting up or encouraging the establishment of development finance intermediation facilities while warning against the inefficiencies that can so easily follow, and which the authors quoted above appear to gloss over. Easy subsidisation can lead to complacency and inefficiency: social marginal productivity is with difficulty computed, and can too readily be pressed into service to justify financial losses. Furthermore, the state may pressurise D.F.I.s to operate in accordance with political or ideological goals: this topic is investigated fully in Chapter 3.

2. Financial repression.

Very frequent has been the biassing of interest rate levels and structures away from market reality, so as to afford cheap loan finance to some. As Galbis (1977 p.59) writes, "...the role played by most governments in less-developed countries needs to be taken into account. In general, this has not been encouraging at all as a proliferation of regulations based on misguided principles has contributed significantly to the malfunctioning of the financial system, and to the inefficient use of real resources. Take, for example, the widespread practice of regulating interest rates". He goes on to explain that allowing interest rates to reach their market levels would enhance economic growth by allocating scarce resources to the investment opportunities with the greatest return. Artificially low rates, however, mean inflation and credit rationing. The result, as McKinnon (1973 p.70) observes is that "It" - the banking system of colonial days - "has been replaced by a very similar neo-colonial banking system, where favoured private and official borrowers still absorb the limited finance available at low rates of interest which are often far below the opportunity cost of scarce capital". This practice, termed by McKinnon 'financial repression' is of course prone to lead to financial losses by lending institutions as beneficiaries of funding, selected for their social worthiness or high political profile rather than business acumen and prominence, get into arrears with interest and repayments, and/or the margin between borrowed and loaned funds is too narrow to cover an intermediary's expenses.

Bhatia and Khatkhate (op.cit. p.135) are not so dismissive of interest rate rigging. They give two reasons for "...modifying the criteria generally preferred by the financial institutions for their lending policies". Markets for labour and capital are imperfect, so "...the prevailing prices do not reflect social productivity". (Ibid. p.135), and also there are serious inbuilt constraints operating against local entrepreneurs. An imaginative approach towards new local entrepreneurs need not lead to losses, and may indeed improve resource allocation: "To the extent that the financial institutions do not recognise these market imperfections in devising their lending practices, the allocative effect of financial intermediation tends to be negative" (Ibid. p.136).

The reference to 'social productivity' comes up against the same general objections as were aired earlier. Furthermore, to cure imperfections in the labour and capital markets by interest rate manipulation is difficult to objectivise. Too easily it can in practice mean, as McKinnon observes (see above) little other than help to favoured groups.

3. Extension assistance.

An earlier section defined a role for the state in the taking on of some of the extension work that supports a successful programme of development financing. Though the problem of delineating appropriate state functions from financial intermediary functions was noted, clearly in the sphere of education there is considerable legitimate scope for state involvement. This can mean both the passing on of technical knowledge related to the types of business pursued by recipients of funds, and also financial instruction.

Such state activity aims to help businessmen achieve viability by increasing their efficiency rather than by subsidising their costs. With the usual caveats about the chance of the patrimonial state biassing its help towards favoured people, this type of work seems a sounder approach towards buttressing development finance than the suggestions in the above sub-section.

(c) General state policy.

Within the context of this section, the other area for state activity is the creation of an environment conducive to the finance of development. Indeed, Cameron (1967 p.320) appears to favour this role before direct intervention: "While there will obviously be exceptional cases, in general the state would do better to devote its own limited resources to creating the conditions in which private enterprise and private capital can flourish". This is a very large issue, and can encompass virtually all facets of government policy: as such, a full theoretical treatment is beyond the scope of this study. However, it is clear that the state, often motivated by ideology, political theory, social aspirations or prejudice (see Ch. 3 for a full analysis), and typically not - as Cameron prescribes - wishing to help private enterprise, has influenced the circumstances of development finance in ways which the harsh economic realities of the 1980s have showed to be short-sighted. The result in many developing world countries appears to have been a blighting of the process of development.

## ASSESSMENT

The establishment of 'demand-following' financial intermediaries is not a matter of controversy: entrepreneurs who have on the drawing board projects that need to be funded beyond their personal resources require organised financing arrangements. The problems centre on the judgement of the worth of project proposals and the type of support and assistance that financial intermediaries can give to business. On the other hand pure 'supply-leading' intermediary does not have, by definition, a ready-made market for its services, though it may be that the mere fact of the establishment of a financing institution reveals a latent and viable demand for funds, that had not had any reason before to make its presence felt.

However, aside from this, pure supply-leading intermediaries will be under something of an obligation to justify their existence. As noted, this is fraught with problems, as various devices are employed to try and force development funds into new projects, and as the frequent involvement of the state tends to bring non-commercial criteria into financing decisions.

The evidence for purely supply-leading intermediaries in history - though not non-existent - is weak. To refer again to the research conducted by Cameron and his associates on banking and industrialisation in 19th century Europe and elsewhere, what is apparent is the considerable amount of enterprise - not directly associated with financial business - that was ready to go in for industrial projects and the willingness of governments to preside over circumstances conducive to growth without the prejudices and interventionist predilections that have been typical of developing world regimes in recent times.

For example, Crisp (in Cameron et al. 1967 p.233) observes about 19th century Russia, "...it must be stressed that the development of the Russian banking system was itself part of the industrialisation process", though admittedly, "in many spheres of economic activity in Russia the banker was the initiator and not simply the servant". With regard to government behaviour (Ibid. p.238), "On the whole, during the period under consideration, and especially after the 1880s, both the State Bank and the Imperial Government acted with wisdom and restraint".

And, with regard to Japan, Patrick (Ibid. p.288) states "Given the generally favourable economic environment, financial and general economic development in Meiji Japan should be attributed primarily to the private individual response to profit (and status) incentives to increase output", and "The government provided a setting conducive to the growth of the economy..."

From the research programme referred to, many similar comments could be quoted in relation to banking and industrialisation in countries not mentioned above. The conclusion is that pure supply-leading by financial intermediaries, whether or not affected by state guidance or pressure, does not represent an uncontroversial policy option that may be adopted as a sure method of bringing about economic development. The main features that emerge from the historical analysis are the existence of considerable entrepreneurial thrust that, while it might sometimes work through the financial system, did not depend on it as the prime initiator of growth, and governments which, while far from ignoring economic development and the finance of it, were more concerned with removing constraints and providing supporting infrastructure than forcing the process through - almost inevitably - normatively-determined channels.

NOTES PART 1 CHAPTER 2

1. The word 'optimal' is of course subject to many interpretations. Here the maximum real rate of sustainable economic growth in percentage terms is implied, though admittedly this ignores the distribution of income question, and also the social cost/benefit viewpoint.

2. This qualification is put in in the light of empirical evidence in Part 2.

3. 'Economic development' and 'industrialisation' are not of course synonymous, but the semantic difference does not have much operational significance in the case of the modern developing country. Almost inevitably such countries aim to build up manufacturing and commerce, but even if efforts are concentrated on mining and agriculture, ancillary industries, infrastructure, sophisticated commercial services, and new methods in primary production qualify in a broad sense as 'industrialisation'.

4. At this stage in the study the discussion is not meant to apply only to specialised D.F.I.s. Other intermediaries may well have occasion to diversify into this type of business.

5. The exception is of course when a partner in a project takes on the support functions itself.

6. (a) Ghosh (1986) gives an interesting example from India of a reluctance to save in monetary form. He points out that subsistence farmers, at times when it would be possible to save, that is when crops are abundant, prefer to save in kind, so as to avoid being dependent on money-lenders at some future time when the crops might fail. He does not explain why farmers should not sell the surplus in good years, save the receipts, and so have funds available when needed, but inflation and

the differential prices caused by different crop outcomes may be postulated as preventing these tactics.

(b) It is possible that higher interest rates might shift savings from goods, e.g. cattle, to banks, or from banks abroad to local banks.

# Chapter 3
# POLITICAL ECONOMY ASPECTS

## INTRODUCTION

The previous chapter investigated the nature of the place for financial intermediation in the business of the finance of economic development. The present chapter considers the political, ideological and sociological factors that have during recent decades often influenced governments in developing countries in their approaches to the process. Clearly any investigation of development finance institutions must take account of this issue in order to properly isolate features that fall into the 'soft state' category.

## SOCIALISM

For the classical Marxist theorist, 'socialism' associates rather incongruously with low income developing countries, where the bulk of the people are ill-educated peasant farmers. To achieve a socialist society, supposedly a necessary pre-condition was a large industrial proletariat who, impoverished by falling wages and increasing unemployment - the result of a falling rate of profit - would eventually put an end to capitalism and set up a dictatorship of the proletariat. The subsequent 'withering away' of the dictatatorship and how it would be replaced by a 'communist' system was never fully worked out.

In practice, of course, this scenario was never of much relevance in even those relatively industrialised countries - mainly in Eastern Europe - that supposedly opted for a Marxist programme, and, given the nature of the systems that came to operate there many left theorists eventually began to label them 'state capitalist' rather than 'socialist' or 'communist'. However, until the sudden and remarkable demise of this politico/economic panorama in the late 1980s, development academics of a Marxist turn of mind generally tended to refer to this group of nations - and a number of other ideologically empathetic territories - as the socialist bloc. For example, in 1982 Amiya Bagchi in 'The Political Economy of Underdevelopment' wrote (p.3) "We have witnessed, since 1917, the emergence of a world-wide socialist socialist bloc covering a quarter of the world surface and population, the latest additions to the bloc being South Vietnam and Cambodia". However, in the late 1980s, economic failure in Eastern Europe and the concomitant collapse of supposedly 'socialist' regimes there, together with the analogous inability of developing country 'socialist' systems to 'deliver the goods', led to considerable heart-searching and debate within developing countries, and must weaken the attractiveness in the future of 'socialist style' development policies. Furthermore critical comment on this issue in the developing world no longer just comes from afar. J.N. Moyo, in the 'Southern Africa Political and Economic Quarterly' (1989 p.10) observes, "The quest for a Marxist-Leninist egalitarian society has long derailed, if it ever was on a track": and later - in relation to Zimbabwe - "1988 showed that socialist propoganda serves no useful purpose in a country with a leadership under the spell of materialism". Dr Byron Hove observed in 1990, (p.4) "I hope that in this decade Zimbabwe does not have to go through the nightmare of a one-party state, as the Romanians did, before they jettisoned it".

There are several reasons why developing country leaders were attracted by supposedly socialist policies.

Firstly it appeared for a time as though state ownership and rigorous central economic planning in the Soviet Union were bringing about rapid growth without inflation and unemployment, and this, coupled with the conception of pre-revolutionary Russia as an undeveloped country, made them want to follow suit. In this context Killick writing about Ghana, reports President Nkrumah as having resolved to "generate a socialist transformation of the economy through rapid development of the state and cooperative sectors" (Killick 1978 p.39).

Secondly state ownership of industry meant that profits did not go out to private sector shareholders, many of whom were abroad, but were available for domestic investment and other forms of government expenditure. Indeed Killick refers to Nkrumah in Ghana as having equated industrial involvement by foreigners as akin to 'neo-colonialism' (Ibid. p.38) (1).

Thirdly, there were supposedly African forms of traditional socialism, on to which newer ideas, compatible with a modern industrial society, could be grafted. It has, however, never been made apparent that African societies in pre-colonial days did behave in ways that could unequivocally be described as 'socialist'. However, Tanzania is a well- publicised example of a country that tried to embrace a supposedly historical socialism. As Blömstrom and Hettne (1984 p.145) explain, "From this moment on" i.e. the Arusha Declaration of 1967, "capitalism was seen as the main enemy. The alternative was to revitalise the 'traditional' African socialism, an original approach which attracted much international attention at the time. The new development strategy gave priority to the development of the rural areas...It was primarily a question of increasing the agricultural production. How was this possible in a country in which the population was widely dispersed with only small lots at their disposal? The so-called Ujamaa villages were thought of as the solution: more efficient production should be achieved by the peasants moving together in villages, which also facilitated the provision of social services".

A rather different conception of 'African' socialism in Kenya will be considered in later pages.

Fourthly there was the attractiveness of an ideology where free democratic elections were not required. There were supposedly economic advantages in this, since long term economic plans could be seen through by continuing governments, and hence the emasculation of proper democratic processes by developing country governments was accorded a spurious legitimacy. To refer again to Tanzania, which in its post-independence salad days was one of the most admired examples of developing world socialist endeavour, "In our democratic one-party system, the act of electing a Parliament does not imply a choice between different policies....In our country there is only one dominant policy, namely the policy of socialism and self-reliance already adopted by TANU and ASP" i.e. Tanganyika African National Union and Afro-Shirazi Party. "Therefore in our circumstances, the act of electing a Parliament merely implies the choosing of suitable persons who are distinctly capable and committed and who can be relied upon to be in the forefront in implementing the accepted policy of our parties, TANU and Afro-Shirazi". (Tanzania Investment Bank 1975 p.29). The practical application of socialism in the developing world varied considerably from place to place, but usually there was - perhaps grudging - acceptance of more or less private enterprise (2). However countries labelling themselves 'socialist' all tended to favour nationalisation, extensive planning, the diversion of profits to the state, and strong curbs on what remained of the private sector. As such the pre-1989 Eastern European countries were powerful role models, though, as noted, some leaders tried to espouse supposedly related philosophies such as 'African socialism'.

The implications for the financial sector in general, and development finance in particular, reflect these approaches. The more ideologically-dedicated the whole 'socialist' strategy, the more likely it was that financial institutions would be nationalised: indeed this happened in Tanzania. Furthermore in a strict 'socialist' context new D.F.I.s would only be established at government instigation, and even if government chose - in the interests of gathering in capital from elsewhere - to hold less than 100% of the equity, strong government presences on D.F.I. boards and pervasive government influence on remits and business were virtually inevitable. Other 'socialist' features of D.F.I. business included the buying out of private - especially foreign - concerns, the favouring with finance of government and parastatals, and a penchant for lending to cooperatives and other collective groupings.

However, it is instructive to note, as will be apparent in forthcoming sections, that policies such as the above may be pursued without recourse to 'socialist' justifications.

## NATIONALISM

Few of the countries that in the middle decades of the 20th century achieved independence from European colonial rule were discrete 'national' entities in terms of ethnic, cultural or linguistic uniformity. However, to avoid conflict, there was little option but to regard old colonial boundaries as inviolate, and to identity the peoples in the newly-independent territories as 'nations'. As Sami Zubaida (1978 p.60) points out, "When, for a variety of reasons, colonial powers were preparing for the eventuality of independence, the nation state was the only one that was available for post-independence statehood". In colonial days indigenous leaders had sought to manufacture and marshall nationalist feeling as an aid to winning independence, and later many were ready to tap the nationalist sentiment they had been instrumental in creating in pursuit of the type of economic growth they wanted. As Killick (1978 p.26) explains, "If the new nations could capitalise upon the patriotic fervour created by the struggle for for independence, then after an heroic initial effort, the take-off would be achieved, and the benefits enjoyed". Nationalism everywhere tends to have an anti-foreign flavour but in developing countries the xenophobia, though usually more passionate than elsewhere, has in practice often been propogandist rather than operational. However, there is plenty of empirical evidence to support the pursuance of nationalist-based policy, such as the nationalisation of foreign companies, compulsory buying into foreign concerns by the state or by parastatals, indigenisation of employment, locational restrictions on foreign firms, curbs on the repatriation of profits and capital, and regulations on the ability of foreign firms to get credit locally.

Furthermore in developing countries there has been considerable running together of, and operational confusion between, socialism and nationalism, since both come to mean strong state control and intervention in the running of economic affairs. For example Killick, writing about Ghana, observes, "..socialism came, in its economic dimension, to mean a large and growing share of the state in economic activities". (Ibid. p.43). Whereas Harvey (1977 p.213) points out, "The primary motive in the Zambian nationalizations has been to lessen foreign ownership and control rather than to achieve public ownership itself...Where no private sector institutions were able to take over the foreign concerns, the government did so - as in the case of the mines. Similarly, where the government wants new foreign investments to be undertaken in collaboration with local people, the sheer size of the operation usually dictates that the government itself is the only possible partner". Possibly, as the above quote suggests, the nationalist approach tends to mean that indigenous nationals and groupings are favoured at the expense of foreign interests, irrespective of how local people are organised, whereas socialism might be expected to be more concerned with class structure and type of organisational framework. However in practice there has been little consistency, and even where socialist-type policies have been pursued with a degree of dedication - as in Tanzania - they have been buttressed by nationalist sentiments.

As a result, when considering the parameters within which development finance institutions may be required to operate, it is not very illuminating to try to distinguish 'nationalist' aims from 'socialist' - or indeed 'capitalist' - ones, a point already intimated in the section above. Government-owned or controlled D.F.I.s that are motivated by nationalist sentiment will be likely to be agents of nationalisation, buyers of majority or minority holdings in other foreign companies, agents for implementing other aspects of governments industrial policy, and so on. However these things may equally be justified by socialist apologetics. The main exercise, as with socialism, is to consider whether D.F.I. behaviour inspired by nationalism is consistent with the financial viability of such institutions, and with economic growth in general.

If nationalism leads to policies that choke off foreign capital and expertise, provide finance and/or jobs for indigenous people too readily without sufficient concern as to their integrity and business acumen, centralise power and privilege, and leave financial institutions at the mercy of whatever is government's interpretation of the national interest, the effect can be pernicious. Though in theory nationalism might have the opposite effect - as is intended - and that is to mobilise people's aspirations and efforts efficiently in pursuit of economic progress, this does not seem to have happened much.

## NEO-COLONIALISM AND D.F.I.s

It is difficult to arrive at an objective definition for 'neo-colonialism', not least because it is a very value-loaded concept, and attractive more to populist politicians and their supporters than to academics. Broadly it would imply the situation whereby, despite a former colony getting political independence, it is still in reality in thrall - principally via economic links - to the metropolitan power or business interests associated with that power. The All-African People's Conference in Cairo in 1961 defined it as "the survival of the colonial system in spite of the formal recognition of political independence in emerging countries which become the victims of an indirect and subtle form of domination by political, economic, social, military or technical means". (quoted in Leys 1975 p.26). There is often a Marxist flavour to neo-colonialist theory, the assumption being that capital migrated to the undeveloped areas in search of the enhanced profits that were supposed to follow from an abundance of unexploited resources and cheap labour, and that western business was always unwilling to allow political independence to deny it the advantages it previously enjoyed. Bagchi (1982 p.78) writes, "The British may indeed be regarded as the real founders of modern neo-colonialism, for both in Latin America and in India in the late 19th century they depended more on economic power and political influence than direct use of political power at every stage for obtaining the lion's share of the surplus of the dominated economies".

According to Bagchi, foreign economic influence in the first stages of industrialisation in developing countries is wielded through the development of concerns making fairly basic import substitutes. When the market for these goods is saturated, business interests turn to more complex import substitutes, such as consumer durables and capital equipment. Here foreign influence is that much more intense, because of the increased dependency "on advanced capitalist countries for technology, product development and managerial expertise" (Ibid. p.128) (3). As a result of this involvement from abroad, "One of the consequences of the iron grip of the firms in the advanced capitalist countries on the products characteristically taken up in the late stage of import substitution is that the overt payments to the parent firms in the form of royalties, technical and consultancy fees, dividend remittances and undercover payments in the form of inflated transfer prices for components and materials are rather large". (Ibid. p.128).

Though the analysis by Bagchi indentifies the economic channels by which neo-colonialism is supposedly practised, it omits the political dimension. A country in the grip of neo-colonialism must, after all, have in administrative and governmental positions a strata of indigenous people prepared to acquiesce in or involve themselves in foreign-controlled economic activity. This is assumed to occur in fully-fledged neo-colonial situations. Leys (1975 p.26) observes, "Nkrumah wrote of 'neo-colonial States' and their 'rulers' who, he said, derived 'their authority to govern, not from the will of the people, but from the support they obtain from their neo-colonialist masters'". (4)

In Anglophone Africa it is difficult to identify a country which might be pigeon-holed as a 'neo-colony' (5). The stance and assertiveness of the various presidents and prime ministers have never squared with supposed subservience to neo-colonial masters. Furthermore the returns - on average - gained by multinational companies from their African investments have never been so buoyant as to either suggest excessive power and influence in the territories or to encourage increased involvement in the future.

The above paragraphs have dealt with broad generalities. However at the microeconomic level behaviour with something of the flavour of neo-colonialism about it may be postulated. This occurs when a government gives a business - which may be a branch of a multinational concern, but which may equally be a domestically-owned firm - especial privileges and protection to buttress its economic position. Such a policy, however, is rarely a one-way arrangement. If successfully supported, a business, in the manner of monopolies, will generate rent income, which to a greater or lesser extent may be creamed away - either officially or informally - by government or government officials.

There are several ways in which a D.F.I. may feature in this type of activity. Firstly it may be a vehicle for government association via a shareholding with the profits of a protected concern. Secondly it may favour protected concerns before others in granting credit. If a D.F.I. is a source of scarce foreign exchange, this is a particularly powerful operational feature. Thirdly, it is likely to constitute an administrative and information link between businesses and government, and so is able to identify and exploit opportunities for extracting income from successful concerns.

However, despite the plausibility of the above scenario, intimations from interviews (see in Part 2) suggest a much more unstructured, pragmatic reality. Policies aimed at cushioning companies in order to generate profits are typically undermined by prohibitions and regulations that damage their prospects.

(Appendix 1 is an analysis and discussion of the creation and extraction of monopoly rents and the effects of government interference in the process)

## PATRONAGE AND REWARDS

The discussion below, though not wholly concerned with practices typical of the soft state, does subsume many of the effects of this phenomenon, and so adds to the remarks about the soft state made in Chapter 1.

The previous section identified D.F.I.s as potential vehicles for channelling business profits to government. There is no need, of course, to associate the vaguenesses of neo-colonialism with the practice. In general a variety of devices can be and have been used to direct largesse to government or government officials. This can include anything from straightforward corruption, as when an official is bribed to carry out -or not carry out - some duty, to quasi-legal methods, as when, for example, expensive import licences have to be obtained before essential imports can be bought.

As well as income extraction, there exist other questionable practices that cannot but be damaging to economic development. The paragraphs below, which relate to the whole issue of 'patronage and rewards', consider some examples.

Firstly, in Africa, the 'extended family' system, though by no means as uniformly omnipresent throughout the continent as is sometimes assumed, can lead to dubious behaviour. Broadly, the system implies that an economically successful man or woman should be prepared to subsidise even distant relatives. An unfortunate practical result of this is that, if such financial support becomes a severe drain, there may be less scruple about taking bribes and other irregular payments to supplement income. Also, a person in a position of power and influence, may be prepared to 'create' jobs for relatives. Thus the extended family system, though perhaps in a traditional tribal society a useful form of informal social security, in a commercial context is an energy-sapping incubus.

Apart from the obligation to the extended family, there are other bases for extracting largesse from the system. Leys (op.cit. p.209), referring to Franz Fanon, observes, "Fanon focussed his attention primarily on the educated strata who were brought into being under colonialism and who inherited state power at independence. The essence of this 'bourgeoisie of the civil service'...is that it is weak financially and therefore politically. It therefore sets about using the state machinery to make itself rich by inserting itself as a sort of commission agent in the foreign-dominated commercial system". Indeed, as he writes later (p.265), looking to the report of the 1972 I.L.O. mission to Kenya, "...the political aim of taking over the economy became merged almost imperceptably with individual aspirations to take over the jobs, positions and life-styles which the economy made possible".

Secondly it has been commonplace in ex-colonial societies for high salaried and influential posts to be assumed by those in positions of political power or bestowed on a man as a reward for political services. Killick (1978 p.216), writing about the favouring of party activists in Ghana, notes, "State enterprise...was an instrument of political power". And Bates (1981 p.104) observes,"Cohen and Stevenson document the tendency of the political elite in the Ivory Coast and Kenya respectively to hold directorates in private firms and state industries".

Thirdly and closely allied to such practices is the furtherence of political ends by wielding power over economic resources. So, as Bates (Ibid p.7) explains, "...market intervention becomes a basis for the programmes," that is, the development programmes, "for direct personal gain, or to create a political following".

Finally, as was noted above, the extraction of revenue from commercial processes may be quite open, and expressed in the form of payments for bureaucratic impositions. Also trade may have to be conducted through agencies that are owned by government or favoured individuals. Firms, both domestic and - as was observed in the last section - foreign, can be given monopoly status, so accumulating profits that benefit both themselves and - via taxes and other levies - the government.

The above discussion suggests several implications for D.F.I.s, both as partakers in the practices referred to, and as furtherers of them. Posts within a D.F.I. may be filled by members of the ruling elite, and even if such people are well-qualified, holding several jobs at the same time may leave insufficient time for any of them to be done properly. More dubious is the penchant for giving unqualified political associates responsible positions in D.F.I.s: such people may then to be doubled by 'advisors', indicating a waste of resources. Another frequently observed area of D.F.I. waste is the supply of various perquisites to directors and senior managers in addition to money emoluments (6).

As providers of finance, D.F.I.s may disburse money to applicants for political and/or personal reasons, with the result that sound applicants with viable projects may fail to get help (7). This type of policy does not necessarily mean that only indigenous people will be favoured. Discussion in the last section suggested that favoured multinationals may be provided with finance before others.

<u>SOCIAL CRITERIA</u>

(a) General.

The purpose of this section is to review criteria for shaping the remits and/or the operational behaviour of D.F.I.s that are pragmatically 'social' rather than dogmatically 'socialist', though often there must be some overlap between the two concepts.

In some circumstances it is reasonable to take a more benign view towards financing work that has a social aspect than it is towards D.F.I. dealings biassed by crude and urgent nationalist or socialist motivations, and in this respect this section is qualitatively different from the others. If D.F.I.s are to justify themselves (see Part 1 Ch. 5 for full discussion) they must take on work that mainstream intermediaries, because of the higher perceived risk, prefer to avoid. Sometimes if financing and associated operations do not seem capable of being validated by standard financial criteria, criteria containing 'social' elements may be used instead to help support moves to allocate funds to applicants. Not of course that this is meant to give D.F.I.s carte blanche to make financial losses: it is all too easy to justify bankruptcy by an appeal to the pursuit of broader social advantages. The business to be developed must (i) promise long term economic advantages and (ii) involve structured approaches towards coping with and in due course nullifying the integral financial problems. Discussion at appropriate junctures throughout the study focuses on how D.F.I.s may approach ostensibly 'difficult' business and yet remain viable. (The reference in Pt. 1 Ch. 2 to the importance of extension and associated work represents an initial gesture towards this issue.)

The bulk of the discussion in this section centres on the finance of small (see (b) for definition difficulties) business. This type of work seems more readily to accord with the ideas in the last paragraph than other guidelines with social ends in mind that are often laid on D.F.I.s, since it lends itself to positive addressing in terms of (i) and (ii) above, as well as, if successful, satisfying the social aim of bringing ever larger numbers of people into the commercial economy. Financial intermediaries in colonial times largely ignored small business finance, and so could be accused by post-independence leaders of undue conservatism and lack of social conscience. Developing country governments have generally been - ostensibly - keen to try and fill this gap in financing facilities.

(b) Small (and larger) business finance.

1. Apologia.

The present study is predominantly concerned with 'general' D.F.I.s that are concerned with the finance of mainly secondary and tertiary industry at the non-small business level. The specialised nature of small business finance suggests separate treatment, and so to avoid inordinate length and complexity there is no comprehensive investigation of the topic.

However, certain academic problems remain. Firstly is the difficulty that no perfect division between small and larger (or medium) business exists, and it may often happen that a business ineligible for assistance from specific 'small business' financing facilties may have problems and needs similar to smaller concerns that are eligible. Secondly in real world situations some D.F.I.s finance small as well as large business, and this side of their work cannot be ignored if they are to be properly studied. Hence for both these reasons some space is given in the study to the smaller business and its financing. The paragraphs below look at the issue from a theoretical angle, and in Part 2 there is analysis of certain Kenyan and Zimbabwean schemes. (Also see Appendix 3 for limited investigations of certain small business D.F.I.s)

2. Problems of Small (and medium) Business Finance.

Though the exceptional difficulties that attach to financing people in the small business sector exist also in rich nations, they are more acute in developing countries. Firstly, to judge the credit-worthiness of many small-scale borrowers is expensive and, through lack of accurate information, prone to error. Secondly the costs of arranging and managing small-scale loans and investments are not proportionately smaller than those for large loans and investment, whereas the return, if of course paid, is substantially less. Thirdly the beneficiary, no matter how well-meaning, may run into difficulties when his lack of education and/or experience render him unfit to cope with difficulties and emergencies that come his way. As Anderson (1982 p. 40) observes, "Page (1979 p.29) notes that, in Africa, 'surveys of small firms find that the majority of entrepreneurs fail to keep even rudimentary financial records'. The quality and extent of book-keeping efforts appear to improve with size of firm, but even for those firms maintaining some form of accounts system, the records are frequently deficient and not regularly consulted as a management tool". Fourthly the collection of interest and repayments may not only come up against the problems of distance and business failure, but also against the actual disappearance of the borrower, who, in the backwoods, as it were, can 'melt into the bush' to avoid paying what is due.

3. Extension and Related Issues.

Financial intermediaries concerned with small and medium business financing may address these problems by monitoring the use of loaned money, running a special debt collection department, and organising various extension services. In this context Anderson (op.cit. 1982 p.933) lists 'industrial extension and advisory services', 'management training', 'vocational training', 'the provision of specialised trading and technical services', 'infrastructure services', 'the promotion of local subcontracting', and 'the provision of industrial estates'.

Unfortunately all this is very expensive, and can easily erode away such income as a D.F.I. may otherwise accumulate. As Levitsky (1986 p.35) observes, "Considering the limited onlending margin, commercial finance institutions cannot be expected to provide broad based technical assistance". In recognition of this drawback, it is feasible to shift responsibility for some of these activities away from the D.F.I., leaving it to concentrate on the purely financial business. Writing under the auspices of the World Bank, he stresses (p.42) the importance of this organisation adding extension to its small enterprise financing. "Projects to assist SME", that is 'small and medium enterprises',"should include a technical assistance component, despite poor experience so far with such efforts. An effective technical assistance component could raise the degree of success of sub-projects, introduce new technologies and increase the number of first time entrepreneurs".

Such arrangements are not, however, without problems. Firstly there is the synchronisation of technical and financial assistance, a point implied in one of the above quotes. And in addition,"Most of the Bank's technical assistance arrangements took much longer to implement than the credit programmes they were supposed to support". (Ibid. p.36). Secondly is the 'staff' issue. Extension and other support services require numerous trained specialists to implement them. Domestic experts are often too few, whereas foreign experts are usually unfamiliar with local conditions. Thirdly is the matter of delineating between purely 'financial' activity, and extension (8). A D.F.I. will want to shift the expense of support services away from itself as much as possible, and its viability then becomes partly a function of its success in doing this. Fourthly when somebody else is responsible for many of the services that buttress loans and investments, a D.F.I. may relax the rigour that should accompany its willingness to extend capital to beneficiaries. On the other hand a non-financing provider of support services is not directly concerned about the payment of debts, so may in its turn be over-confident about the effectiveness of its operations.

However, despite these worrying aspects of the matter, extension support from sources extraneous to the D.F.I. itself must remain a preferred policy. Other methods for assisting applicants for funds, such as subsidised interest rates (see Ch.2), have much less to commend them.

4. Guaranteeing Credit.

Another established device for reducing the risk that financial institutions face when lending and investing on a smaller scale is to guarantee some of the credit extended. Conventional insurance companies are reluctant to take on this type of risk, so normally the guarantor in a country is the central bank or the government itself.

A number of shortcomings have long become apparent in these credit guarantee schemes. Firstly there is often considerable delay between the application for a loan and the decision whether or not to grant it, as it must be agreed to both by the lender and the guarantor, and suitable working arrangements established between them for administering it. Furthermore excessive conservatism in providing finance will be the result if both are cautious, and friction will develop if one party is cautious and the other adventurous. Secondly it is generally expected that the lender bear some of the risk and not pass 100% to the guarantor. As a result, the lender may not be any more indulgent towards helping small enterprise than he would have been without the guarantee scheme. J. Levitsky and R.N. Prasad (1987 p.3) point out that commercial banks having to continue to bear some of the lending risk still tend to ask for collateral. On the other hand, of course, a 100% guarantee could make the lender less careful than otherwise in the allocation of funds. Thirdly is the question of delays in meeting claims and the reluctance of guarantors to reimburse banks for their losses. Often it can be a matter of opinion when a loan should be written off, and it is in the interests of the guarantor to put off the date as long as possible.

As Levitsky and Prasad (Ibid. p.24) observe, "For an effective guarantee scheme to be developed, governments and relevant public authorities must understand that the introduction of a scheme will result in claims that must be met efficiently and fully. Any attempt to avoid or delay meeting claims will inevitably result in the undermining of confidence in the scheme". Indeed their investigation of a number of developing world schemes throws up some dismal results. In the Cameroons, "FOGAPE," that is 'Fonds d'Aide et de Garantie des Crédits aux Petites et Moyennes Enterprises', "has been criticised by the commercial banks as being too 'risk-averse' and for delays in processing guarantee applications through prolonged examination of each request". (Ibid. p.66). In the Ghana Credit Guarantee Scheme, "Claims paid out over the period 1970-80 were reported to be C1.1m, or 0.5% of the amount of guarantees issued in that period. Such a low payout rate over a 10 year period of great economic difficulty raises questions about the operation of the scheme". (Ibid. p.69). Regarding a Liberian scheme, "Confidence in the scheme was low, and commercial banks were sceptical about receiving payment after they filed claims". (Ibid. p.72).

5. Discussion on lending problems.

Analysis and evidence would suggest, therefore, that there is no surefire way of muting the especial risks that an institution faces when lending to small and medium business. Substantial default is a fact of life, and in this context Anderson (1982 p.50-51) presents some interesting figures indicating how severely a lending institutions's operations are affected by even modest defaults. Assuming a lending institution borrows at 5%, and that administrative costs are 5% of turnover, then with a 20% default rate, an interest rate of 37% would need to be charged for viability. If defaulting was at the rate of 50%, there would have to be an interest rate of 120%!

To the basic problem of lending successfully to the small businessman may be added a not infrequent laxness in the administration of the loans. This may be due to staff inadequacy, whether in quality or quantity, and/or a relaxation of standards born of a determination to help those considered to have been 'deprived', come what may.

In this context Harvey's blunt comments on the Credit Organisation of Zambia, formed to advance money to small farmers, are salutary. "C.O.Z. is to some extent a misnomer, since much of the money distributed by it...has been more in the nature of grants than credit. No down payments are required, there is no arrangement with the marketing boards to arrange for repayment out of crop proceeds, and in some cases there has been little care taken in obtaining postal and physical addresses of applicants. More important, the application forms make little attempt beyond inquiring the crop and acreage to be planted to assess the profitability of the venture which the applicant intends to finance with the loan". (Harvey 1975 p.1).

6. Group lending.

A method of lending which tries to sidestep the problems inherent in trying to appraise individuals who apply for finance is to lend to groups of people. This is a very large subject, and it is not intended to address it in depth in this study. However the few remarks below say something on the issues involved.

A number of advantages are associated with group finance. As the World Bank (1989 p.116) observes, "The idea is that by joining together, small borrowers can reduce the costs of borrowing and improve their access to credit. The outside lender's costs are reduced because lending to a group lowers the risk of dealing with small businesses and circumvents the problems involved in selecting borrowers". And even when the loans are made directly to individual members of a group, "... the group provides a guarantee; it is answerable to the lender for the repayment of loans". Unfortunately, though from time to time apparently viable group lending schemes have survived for a while - the World Bank refers to certain of them (Ibid. p.117) - groups are prone to suffer from management inefficiencies, lack of book-keeping knowledge and internal squabbling. In Appendix 3, there are some discouraging observations on attempts to lend to cooperatives - which have 'group' features - in Zimbabwe. The necessity for extension support, therefore, is not removed by the establishment of group financing schemes.

A further feature that is often associated with groups is a mildly ideological ambience, since groups imply some degree of collective rather than individualistic behaviour. Clearly if the formation of groups is encouraged for this reason, commercial integrity takes second place.

(c) Miscellaneous.

Other more generalised 'social' aims that appear almost as a matter of course in the prospectuses of D.F.I.s are such goals as the increase in wage employment, the promotion of indigenous people to managerial positions - referred to earlier but then in the context of nationalism - and the transfer in of technology by firms associating with D.F.I.s in new ventures. Though these objectives will not necessarily conflict with the achievement of D.F.I. financial viability, on the other hand they may do so. A justification of them in terms of the parameters of social cost/benefit analysis technically removes the necessity for overt D.F.I. solvency, but, as was noted in Part 1 Ch. 2, given the notorious difficulties inherent in using this approach in the context of developing countries, it is dangerous to subordinate commercial success to other criteria. And unlike the policy of allocating funds to small businessmen and groups, the aims referred to in this paragraph are much less suited to the sort of management that has a chance of overcoming the likely inherent financial drawbacks.

It cannot be recommended, therefore, that D.F.I.s be burdened with many of the 'social' aims that governments are prone to lay upon them.

## CONCLUSIONS

(a) General Observations.

D.F.I. prospectuses and annual reports almost inevitably state that the organisations shall conduct their business so as to be financially solvent. If, however, they are obliged to follow criteria in line with socialist, nationalist or other normative criteria, financial viability may be in question, as ideological considerations are to be put before hard commercial ones.

Secondly, though the term 'neo-colonial' is rather nebulous as a description of a developing world country in its totality, elements consistent with the idea of neo-colonialism may be identified in particular micro-commercial contexts, such as mutually advantageous links between multinational businessmen and domestic politicians. If D.F.I.s become the middlemen in such arrangements, then their viability or otherwise is influenced by overall industrial and foreign policy, and by the nature and dealings of the personalities involved.

(b) The 'soft' state.

In addition to the inevitable burdens that fall upon development finance institutions if obliged to operate on the basis of ideological or social criteria is a typical lack of conviction and consistency with which government requires adherence to these criteria. Hence practice is distinguished by confusion and hesitancy, with erratic application of ideological principles that are themselves prone, like chameleons, to change colour with changing fashion and changing officials. As Killick, quoting Genoud, records about Ghana, "Day after day, year after year, what was often called nationalism is being renamed socialism". (Killick op.cit. p.39). And Leys notes an example where a quasi-ideological approach to general economic strategy is used to buttress the prosperity of a limited strata of people. "(African socialism in Kenya) focussed on redressing social grievances in order to ensure the continued existence of bourgeois society". (Leys op.cit. p.221). Secondly, and connected with the sentiments in the paragraph above, are the implications of patronage, and the associated dubious activities discussed earlier, for both ideologically-motivated development financing - though this gives more scope for such practices - and financing that is supposedly associated with more objective criteria.

There is plenty of evidence to suggest that D.F.I. experience has been fashioned or influenced by one or more of the phenomena discussed in this chapter, and Part 2 will review the evidence in the context of two African economies. Under the circumstances it is not surprising that during recent decades few congratulatory bouquets have been tossed at developing country D.F.I.s.

PART 1 CHAPTER 3 NOTES

1. Or, in the rather tasteless adaptation by Kwame Nkrumah of a ringing biblical exhortation, "Seek ye first the political kingdom, and all the rest will be added unto you", quoted by Killick (op.cit.)

2.....though Killick (op.cit.) quotes Nkrumah as saying about Ghana (p.37),"we would be hampering our advance to socialism if we were to encourage the growth of Ghanaian private capitalism in our midst".

3. Helleiner develops the issue of technology dependence in 'International Technology Issues: Southern Needs and Northern Responses', explaining that foreign firms prefer to use that technology with which they are familiar, and this tends to mean capital-intensive methods. He puts forward a rather utopian vision (p. 308): "If developed...country governments were to finance...research and development on technological problems of particular concern to the L.D.C.s and make the resulting knowledge freely available to them, the gains would be considerable".

4. This idea has been developed as the 'comprador' argument. See Leys (op.cit.) Ch. 1.

5. However, elsewhere in Africa, fully-fledged neo-colonialism may seem to be more in evidence. Killick (op.cit. p.328) writes, "Observers have contrasted the 'neo-colonial' but booming economy of the Ivory Coast with the more 'independent' but stagnant economy of Ghana". N.B. The Ivory Coast no longer 'boomed' in the 1980s.

6. This clearly relates to Oliver Williamson's 'managerial discretion' model of the firm, where potential profits are sacrificed to more managerial utility.

7. It is reasonable to postulate that a bestower of funds will be more easy-going over interest and repayments if the beneficiaries are his friends and relatives.

8. Mr Osunga, of the Industrial and Commercial Finance Corporation in Kenya, put this point to me.

# Chapter 4

# FINANCIAL MARKETS IN DEVELOPING COUNTRIES

## INTRODUCTION

Chapter 2 discussed the nature of the place of financial intermediation in the finance of economic development. This chapter considers the scope of the work carried out by the mainstream financial systems in African developing countries (1) so as to define what scope remains for dedicated development finance intermediaries. At appropriate points in the chapter it is necessary to bring in some of the arguments from Ch. 3 in order fully to understand the ways in which the operations of intermediaries may be (and indeed have been) influenced by normative considerations.

## BANKS

(a) Background.

Banking services were in place soon after the establishment of European colonial rule in the 19th century. Administrators, merchants and settlers needed to receive remittances and make payments, and so required the sort of facilities with which they were familiar in their home countries. Naturally enough the new banking offices soon began to grant credit, but - understandably - they kept to the lending principles that had been forged in Europe.

Though in parts of continental Europe banks had been prepared to go in for term lending and even for equity finance this had not been true of the U.K., and this attitude was transferred to U.K. colonial territories. (See quote below)

(b) Lending practice after political independence.

Although it is dangerous to be dogmatic about financial conditions in post-colonial Anglophone African countries, in general most banks have preferred to keep to established business methods. With exceptions, this includes banks governments have created and into which governments have bought. As Kitchen (1986 p.121) states, "Traditionally British-type commercial banks specialize in the provision of short-term business credit, especially trade credit and working capital, and personal credit. They provide little in the way of long-term loans relative to their total assets, and seldom take equity stake in business".

The standard British banking-type antipathy to long term financing - even in the U.K. - was based on an unwillingness to balance predominantly short term deposits with long term credit and investment, and also on caution against assuming that the prospects for a potential borrower's proposed venture could be assessed with sufficient certainty. Bridging loans, on the other hand, could be expected to span a predictable gap between payments and receipts.

The difficulty of prognosticating the success or failure of a beneficiary of long term finance in the poorer developing countries is that much more acute than it is in advanced nations, due to lack of information about many deficit units, and also to different customs and traditions, which can produce unexpected and inconvenient attitudes towards bank finance and its servicing. Furthermore many would-be borrowers in developing countries cannot give adequate security, so have to be assessed on the basis of less tangible criteria. Conventional bankers tend to mistrust such criteria, despite much official support for this type of approach. For example, an official Kenyan publication of 1986 observes (p.39), "Commercial banks and Non-Bank Financial Institutions tend to extend credit primarily on the basis of formal security (collateral) while ignoring the assessment of the credit-seeking firm's economic potential. Security and collateral procedures and criteria should be reviewed by the banks. Bank staff will have to be trained to assess the financial viability and the economic growth potential of firms - especially small, newly-established firms - seeking bank loans".

Bank caution and conservatism in former colonial territories was perhaps reinforced by the achievement of political independence, for there could be considerable uncertainty over likely state policy towards them in subsequent years. Fears of nationalisation, controls over the deployment of lending, curbs on profit repatriation, and more dubious behind-the-scenes pressures on their business served to buttress the desire to keep, as far as possible, to well-tried habits.

(c) Government and banks.

Nevertheless governments in many developing countries have not been backward in wanting to introduce changes to their banking systems. The philosophy behind this has generally been to bring more of a 'development' flavour to the business of finance and to get money into the hands of favoured or hitherto deprived groups. As the publication quoted above urges (p.39), "...the provision of longer term funds from financial institutions would improve this" - that is, the lack of long term credit in firms' capital bases - "situation". As well as trying to change the business activities of existing banking institutions governments may also, both directly and by encouragement, bring about the establishment of new ones, including, of course, D.F.I.s.

Imposing modified remits on existing banks is generally resisted, and often results in practice in only limited changes at the margin. The cautious bank schemes in Kenya and Zimbabwe for helping small business (see Part 2) are examples of this. Even nationalisation of banks or joint ownership by government and - probably - the original owners frequently results, as noted above, in behaviour, either by design or default, much the same as before the ownership change, often despite intentions to the contrary.

For example, Shetty (1978 p.1487) discusses how the nationalisation of major banks in India in 1968 failed to achieve the intended aims. He suggests that the major aims were "(i) wider territorial and regional spread of branch networks; (ii) faster mobilisation of financial savings through bank deposits; (iii) re-orientation of credit deployment in favour of small and disadvantaged classes all along the production spectrum". He dismisses what he describes as 'pompous' aims such as to "serve better the needs of development of the economy in conformity with national policy..." However, some years after nationalisation, "..it can be said that the performance of the public sector banks in regard to their socio-economic obligations, particularly the 'priority sector' advances, has been too meagre, too inequitous as between states and regions and too disparate as between banks". (p.1434). He notes that the share of bank credit going to medium and large firms actually fell, and that the share of short-term loans in bank portfolios rose (p.1434-1435).

Another variety of government intervention in the banking system of a developing country is to relax rules for incorporation, so as to encourage more indigenous people to get into the industry. However, unless the supervision of banks is comprehensive, efficient and impartial, there is scope for corruption, as when the new proto-bankers choose to lend money to themselves and their friends, and slovenliness, when, having little or no knowledge of sound banking practices, they invest funds in impossibly risky ventures. C.V. Brown's excellent book (1964) on Nigerian banking gives an illuminating picture of this sort of thing in that country, and Part 2 in this study describes similar experiences in Kenya. However, there have been successes. For example, Harvey (1990 p.232) writes, "There were a number of ...financial institutions created after independence... The Botswana Co-operative Bank's customers were co-operative societies and unions. It remained small. It ran into some problems in the 1980s, reflecting in part the problems of its clients, and in part the weakness of its management. However, the government took the necessary action, and it remained solvent".

(d) Private sector banking developments.

In Europe and America banking and finance have not stood still, and likewise the mainstream private sector financial sectors in some African sub-Saharan countries have been expanded by the establishment - though not on a systematic basis - of new institutions and practices. Such are merchant banks which can arrange loan packages, discount houses - in certain territories - and various commercial banking subsidiaries dispensing specialised - including long-term - finance. However in general the results in terms of the provision of finance with a 'development' ambience appear to have been disappointing. Unless pressurised to expand into areas of business they consider risky, institutions have preferred to remain faithful to established criteria, and to accommodate only established customers. And indeed, in some contexts financial systems appear to have retreated rather than to have gone forward into new types of work (see Part 2).

STOCK MARKETS

(a) Background.

Gerschenkron, Cameron and the other writers considered earlier primarily focussed on the role of banks as engines of development. The establishment of sophisticated domestic capital markets linked to stock exchanges was a later development in the mainly European countries with which they were concerned, and, as they were primarily interested in the initiation, rather than the later stages, of rapid economic - equated to 'industrial' - growth, detailed analysis in relation to stock markets was inappropriate.

Though throughout the colonial period in colonial territories there was substantial - and largely unrecorded - investment of savings at local level in a multitude of small-scale ventures, the bulk of capital funds to finance western-style industrial and commercial ventures was brought in by foreign companies, who did not, therefore, see colonial territories as important sources of long term money. With time, the necessity for territorial governments to raise loans, and the establishment of development finance institutions witnessed to the stirrings of embryonic capital markets. Local incorporation, and 'over the counter' securities trading then led, in certain instances, including the countries of concern in this investigation, to the formation of stock exchanges. Zimbabwe with its very early stock exchange is unusual. (See Part 2).

(b) Supply-leading or Demand-following.

1. Demand-following.

Basically, a capital market based on one or more securities exchanges is a 'demand follower'. A stock exchange is there to facilitate the transfer of securities, and does not of itself initiate industrial and commercial ventures. When a company issues shares to the public, whether to dilute the ownership of existing assets, or to raise new funds, commercial profit and loss considerations are the main motivating factors, and these centre on the market place where the goods or services in question are being traded.

2. Supply-leading.

However, in a more indirect sense, a developed capital market with stock market facilities may be said to possess some 'supply-leading' characteristics.

Firstly its existence may cause savings to be channelled into business, so increasing the resources available to industry and commerce, and keeping down the price of the funds. The latter favourably affects firms' costs, and so will in some cases constitute the difference between viability and unviability.

With regard to a stock market, by its existence, actually increasing - as opposed to redistributing - the flow of savings into an economy, this clearly will happen if foreign money is attracted in. However, in practice, the issue is not very significant because (i) for years foreigners have had little inclination to go in for portfolio investment in developing countries, and (ii) governments would baulk at the increase in foreign ownership of domestic assets that it would entail.

In a purely domestic context writers are not agreed as to whether more investible funds are generated by the existence of a stock market. However, Drake (1983 p.75) observes, on the basis of evidence in previous writings by himself and Arowolo, (Drake 1969, Arowolo 1971) "It is, at the very least arguable that a portion of the funds which have been subscribed to corporate shares and debentures in the developing countries would not otherwise have been saved and invested locally".

Secondly, a stock market enables enterprises to expand by providing a method for raising new capital funds. Even if banking institutions exist that lend on the long term, equity capital is, in an emergency, less risky, since, given a downturn in a firm's fortunes, dividends can be reduced: interest on loans, however, normally has to be paid.

Thirdly, if security prices move freely according to market forces, capital funds are deemed to flow into the most profitable ventures. As Samuels and Yacout (1981 p.219) observe,"Funds coming to the exchange are allocated to where they can most effectively be used... Over time there is pressure on firms to employ their resources effectively". On the other hand, of course, capital market imperfections are less likely to be ironed out in small markets where there are not many stocks and only limited trading. Hence stock prices may not properly reflect the marginal efficiency of capital, so damaging allocational efficiency.

Fourthly, a stock exchange can be a channel for the implementation of monetary policy. Though this fact may not be directly relevant to business centring on equities, nevertheless open market operations, as an instrument of monetary policy, may be less distortive of general resource allocation than other more specific monetary measures. As Drake (1985 p.77) notes, "A flourishing securities market is invaluable for the implementation of general official financial policy, which is less damaging to resource allocation than are selective controls".

(c) The insufficiency of a stock market in a developing country.

The paragraphs that follow address the question as to whether or to what extent a stock market in a developing country can satisfy an economy's capital funds requirements without any need for development finance institutions. Though the usefulness of a stock market from the theory-focussed discussion in sub-section (b) above was established, in reality there are a number of features in the context of developing countries that may prevent stock markets reaching their full potential.

To begin with, the demand for industrial securities - debentures and equities - will be considered. By definition demand comes from (i) individuals and (ii) institutions. In a developing country demand from individuals is, relative to both population size and to the demand of institutions, weaker than in a developed country. There are several reasons for this. Firstly there are, proportionally, far fewer people with the sort of incomes that allow for involvement in the business of stock market trading. Drake quotes Maniatis as saying, "... there is not a sufficiently large class of well-to-do to sustain a corporate securities market in an underdeveloped country". (Drake 1977 p.79) (3). Furthermore the minority of affluent people that do exist may - if exchange control rules are liberal- typically prefer to invest surplus funds abroad.

Even where exchange control regulations are fairly tight - and normally curbs are accepted as understandable in relation to personal monies even in liberalised financial systems - the influential may still find ways to export their savings. Secondly, information on the subject of financial investment is, in general, not widely diffused, so many people, particularly those away from towns where financial knowledge is more readily available, remain more or less ignorant of this channel for saving. Associated with this may be a paucity, as part of a general shortage of skills, of investment advice and operators in the business of broking and market-making. Thirdly, attempts to persuade people to put their surplus cash into the financial markets rather than keeping it with them are more readily served by the diffusion of banking offices and various forms of saving apparatus than by sophisticated stock exchange business. Banks and analogous bodies promise secure interest, whereas direct investment in industry carries with it more risk.

In consequence, therefore, surpluses emanating from the personal sector are less likely than in economically developed countries to find their way directly into stock market paper.

Demand from institutions is differentiated depending on the institutions in question. Banks within the British tradition tend not to put money into equities and debentures, though they do invest in government stock. Insurance companies and pension funds, however, go for a range of assets. Multi-national companies tend to prefer to repatriate profits, if exchange control rules allow it. Though they may be prepared to put money into shares of sound companies, governments, suspicious of further foreign control of their economies, frequently disallow this, and usually require retained profits to go into designated government stock. Apart from purchases - for monetary reasons - of their own stock, developing country governments have little reason to be direct players in their nations' stock markets. Development finance institutions constitute the principal channel through which funds directly from or indirectly via the state go in this direction. As a preliminary to later discussion, it can be intimated at this point that D.F.I.s may have a role in stock market development.

Referring to work he had done on south-east Asian countries, Drake, (1985 p.8) mainly due to institutional demand, downgraded the importance of demand as a factor preventing the development of stock markets: "There is evidence of widespread and generally strong demand for securities in many countries, for example Korea, Taiwan, Hong Kong, Singapore, Malaysia". However, these are prime examples of the group of rapidly growing countries, where an expected accompaniment to the build-up of secondary industry has been substantial development in all aspects of financial business: sub-Saharan African countries have some way to go to reach the level of sophistication of the above group.

To turn now to the supply of stock market securities circulating in many developing countries, an initial division can be made between government stock and industrial paper. The supply of government stock is largely a function of high government spending, and since high government spending is a typical feature of such countries, a lot of stock is issued. This mops up savings, and distorts markets, when governments, by pressure, regulations on the investment of profits and reserve requirements, oblige various institutions to hold more than otherwise they might have wished. In recent years the economic problems of many developing countries, together with the requirements of structural adjustment, have led to programmes of retrenchment, with governments aiming to reduce their call on national resources. However success often seems elusive, for established patterns of government expenditure are not easily curbed. As a result, the market for equities is seen by business to be reduced in that governments commandeer a large proportion of the funds available, and certain groupings of those with spare funds are not allowed to purchase equities.

A number of other reasons exist for the generally small number of industrial securities, both new and existing issues, in African developing countries.

Firstly, in so far as new long-term capital funds are to be raised by multi-nationals for use in such territories - and not much of this has been happening in recent years - capital markets abroad and the resources of head office establishments are a more convenient and smoother source of funds than the more politically and economically uncertain contexts of the hosts. On the other hand there is some advantage to a firm in diversifying a share issue locally amongst a wide variety of holders, since it then becomes cumbersome for government - or agent of government - to take over the concern by buying up equities.

Secondly, it is one thing for a company to issue shares locally, but often quite another to get permission to switch the money raised into foreign exchange to cover the imports that real investment usually necessitates.

Thirdly, the large number of small businesses and small family companies in a developing country do not, traditionally, make use of the stock market (4). Partly, as with the demand for securities, it is due to a lack of information and understanding. However, for the small businessman, the stock market is an inappropriate way of raising capital as the amounts of money needed are too small to justify the trouble and expense, and there would in any case be no demand for the stock of unknown concerns. Family savings, and financial intermediaries, where ancillary services may accompany finance, are more appropriate sources of capital.

Fourthly, larger domestic firms, which might more realistically use the stock market, may prefer, even if registered as companies, not to go public and obtain a listing, partly out of conservatism, but also to avoid diluting ownership with outside shareholders. As Drake (1985 p.9) observes, "Such firms have been noticeably unwilling to adopt corporate form, issue equity and admit outsiders even as minority shareholders".

However, before being too keen to go on to a dismissal of the value of a stock market, it is as well to quote Drake's (1977 p.79) riposte, "It is therefore sometimes argued that the whole machinery of public companies, issuing shares and bonds which are traded on the stock exchange, is inappropriate to underdeveloped countries where there is likely to be, for some time, a preponderance of firms which are too small to approach the public capital market and depend on institutional finance for expansion.

In these circumstances, a case can perhaps be made for long-term bank financing, in the traditional way of the continental banks which provide equity capital, often substantial, to firms... (But) in the absence of a securities market the investments (equity and debenture type) made by banks and other institutions will lack liquidity - with a consequent diminution of the flexibility and an increase in the costs of bank operation; second, total reliance on institutional finance would close off the important entrepreneurial avenue of direct appeal to the public; finally...it cannot be presumed that institutional lending will be conducted at lower real cost than fund raising via the securities market". In line with Drake's point of view, a role for D.F.I.s in this type of business is discussed in Chapter 5.

(d) Government Intervention.

The shortcomings of stock market operation discussed above did not look into government intervention in the stock market, excepting for issues that could not be avoided without weakening the analysis, such as the raising of funds via the sale of stock. As far as possible, however, the politico-economic dimension was avoided.

Governments parading hard socialist credentials are likely to be opposed to the very existence of stock markets, though interestingly enough no African stock exchange in existence before independence has been closed. More general is intervention in capital market processes, sometimes justified on the basis of socialist, or nationalist, aspirations, sometimes related to Africanization, sometimes more to do with raising government revenue, nepotism, patronage or greed.

Firstly taxation may be so arranged as to discriminate against share income. As Drake (1985 p.11) observes, "...it is usual that interest paid by companies on loan funds is treated as a tax-deductible operating expense, whereas dividends are paid out of profits upon which tax has usually been levied already". And, "Moreover, dividends accruing to individuals are truly taxed twice - as part of company's profits and again as income in the hands of shareholders". (Ibid p.12).

Secondly, the financing of excess government spending may introduce distortions into the capital market. For example, if government sells stock by offering exceptionally high interest rates, funds will flow into government stock and desert industrial securities. Furthermore - and this refers to the tax issue as well - "...the tax-free status (in some countries) of time deposits and government and public enterprise bonds lessens the appeal of corporate debt instruments". (World Development Report 1989 p.110). As a result, share prices would fall, and new issues not be feasible.

If government issues stock at low rates of interest they can only sell it by leaning on financial institutions - either informally or by reserve requirements - to buy it. This precludes investible funds flowing into viable industrial opportunities.

Thirdly, government body(ies) that oversee the working of the stock market in a country may be costly to run, implying substantial fees from those wishing to issue securities, slow and cumbersome in coming to decisions, and may adopt dictatorial or partial stances in determining the terms surrounding new issues. All or part of an issue may have to be placed with parastatals and/or chosen individuals, and the initial price put unrealistically low, so that these favoured holders can make immediate capital gains.

Fourthly, various financial disabilities may be put on foreign firms, such as exceptionally severe restrictions on the transfer of dividends to foreign shareholders or on the repatriation of capital abroad. (See Appendix 1 for an investigation of these policies). Other distorting effects on stock markets noted by Drake (1977 p.76) have already been considered in Pt. 1 Ch. 3. They comprise the effects of monopoly power wielded by firms - an arrangement frequently bestowed on companies by government (See Appendix 1), and general market imperfections. Inevitably all the activity discussed above weakens a stock market as an accurate indicator of the value of real assets, misallocates resources, and reduces the willingness of institutions and individuals to use the system. Such a stock market fails to develop, and as a corollary the ancillary services that would otherwise surround it, for example the business of issuing shares, remain undeveloped.

FINANCIAL LIBERALISATION

The types of government intervention surveyed have been prevalent features of developing country economies in the last few decades. Belief that they have been contributory causes of the economic doldrums of the 1980s has led in many countries to programmes (or intended programmes) of financial liberalisation.

Liberalisation with regard to banks covers a variety of possible moves, including relaxation of various controls on lending, deposit-gathering, interest rates and the provision of financial services. There is a difficulty in distinguishing between politico-administrative restrictions and monetary measures, and it will always be possible for some curbs on banking business to be justified by monetary reasoning.

Turning to stock markets, liberalisation can mean the relaxation of regulations on the business of new issues, taxation that does not discriminate against income from shares, no preferential treatment for government stock issues, and withdrawal from attempts to rig stock market prices and yields. Controls on inflows and outflows of capital funds and outflows of profits are relaxed.

However, as a necessary support to financial market liberalisation, without which results are unlikely to be as positive as desired, associated macroeconomic adjustments are advisable. (This ties in with Cameron's view introduced in Chapter 2, that the most useful role for government in the finance of development is the creation of an environment conducive to the process) Such are the liberalisation of the external trade in goods and services, a realistic exchange rate regime, relaxation of any credit restrictions that may exist, and the fostering of competition in industry.

Indeed, Dooley and Mathieson (1987 p.32), having firmly excoriated financial repression - "...the costs that such a system, "that is, repression, and in the context of their paper they are defining it more widely than McKinnon does in his interest rate thesis, "imposes on the private sector may be.....substantial", - suggest that the apparent failure of liberalisation in a number of contexts may be due to this. To quote, "The outcomes of these reforms have also varied, with some reforms being sustained over an extended period with relative stability (for example in the Republic of Korea) but others ending in the midst of financial crises (for example, Argentina and Chile).... Such inconsistencies were principally associated with the fact that goods and financial markets adjust at different speeds, and the real exchange rate changes that may be generated by a financial reform make the integration of domestic and foreign goods markets much more difficult". (Ibid.). Furthermore, and in addition to the above macro-economic constraints on the effectiveness of financial market liberalisation measures, liberalisation, though it may undermine some features associated with a soft state, does not automatically put an end to many dubious practices, such as the commandeering of blue chip shares by influential people, or kickbacks for favours.

## SUMMARY

The following paragraphs briefly draw together the conclusions reached in the previous sections of this chapter.

With regard to financial institutions - apart of course from D.F.I.s themselves - commercial banks have been unwilling to go whole-heartedly into long-term lending either directly or via subsidiaries, due to traditional lending practices and caution in an environment less measurable than is the case in Europe. Locally-based banks in the hands of indigenous people and organisations, though in theory better fitted to understand and work within domestic conditions than foreign-based banks, have tended to follow foreign models: others have been driven to bankruptcy by inefficiency and internal corruption. Government may also intervene, forbidding banks to go in for long-term lending, preventing foreign-based companies from getting loans, or crowding out private sector borrowers by forcing banks to channel their resources into government stock, parastatals, or other favoured beneficiaries.

As with banks, to explain the inadequacy of capital markets as sufficient generators of long-term funds in developing countries, the discussion must be aware of both economic factors, which centre on the inevitable deficiencies of embryonic capital-generating arrangements, and political factors, which cover the distortions produced by government intervention in the business of raising long term funds.

Though liberalisation measures do away with some government-imposed restrictions on financial systems, they obviously do not solve all the problems associated with raising capital funds. Ideally they create a climate more conducive than before to financial market development, and as such are important not just in relation to mainstream intermediaries but also to dedicated development finance institutions. Furthermore by releasing conventional banks and stock markets from damaging constraints liberalisation does not automatically render D.F.I.s unnecessary, even though the conditions might have been created whereby with time they may be rendered progressively less vital. For the time being, though, financial market lacunae may still exist, so intimating a role for D.F.I.s. It is the business of the next chapter to explore and delineate that role in depth.

NOTES PART 1 CHAPTER 4

1. To reiterate, the focus is, in the light of the African case studies in Part 2, on Anglophone African countries, though some relevant data from other contexts is introduced into the discussion.

2. To anticipate the discussion in Part 2, Kenya and Zimbabwe would appear, in contrast to most other African countries, to have large business sectors and middle classes.

3. While Drake states that the arguments explaining low demand for securities in underdeveloped countries are "well put" by Maniatis, he goes on to observe (1977 p.80), "No widespread empirical evidence has yet been marshalled in support of these arguments.... While they seem intuitively sensible, there is enough contrary argument and fragmentary evidence to suggest that it would be wrong to regard the characteristics just described as universal constraints on securities demand".

4. This applies also to small businesses in economically advanced countries.

# Chapter 5

# A ROLE FOR DEVELOPMENT FINANCE INSTITUTIONS

## PRIVATE AND GOVERNMENT DEVELOPMENT FINANCE INSTITUTIONS

Before identifying and commenting on the role and functions of D.F.I.s in developing countries, it is intended to explore the definition of the D.F.I. contained in the first chapter by considering how the distinction between the 'public' and the 'private' D.F.I. is to be understood.

All types of financial institution in existence to-day have been pioneered by the private sector. Thus the development finance institution can be traced back at least to the establishment of the Crédit Mobilier by the Péreire brothers in France in 1852 (Kitchen 1986 p.71). Though this particular institution, whose aim was to mobilise small savings and invest in development projects, failed, there were many imitations, and there are to-day numerous financial intermediaries throughout the developed world dedicated to long term finance.

However, herein lies a difficulty of definition, for it is unsatisfactory to label every institution that is concerned with long term lending and investment a D.F.I. Most banking organisations throughout the western industrialised world that make term loans and buy equity are more akin to conventional commercial banks than D.F.I.s, for they see themselves as commercial organisations selling a particular set of financial products in an assessable market place, and are not guided by a philosophy of economic development. In contrast to this, D.F.I.s are identified more with the idea of filling gaps left in the private sector financial markets, in order that economic development projects, with their specialised financial requirements, shall not be starved of capital funds. Also, as discussed in Chapter 2, D.F.I.s may sometimes themselves be active initiators of new projects. Hence the totally - in all senses (1) - private sector D.F.I. is, by definition, uncommon, and probably only appears as a borrower's organisation, as when those running a particular industry, or group of industries, set up a financial intermediary to raise money and direct it to themselves. A rare developing country example of this type of organisation is the dormant - but, despite the sensitivity of the name, still extant - Industrial Promotion Corporation of Rhodesia and Nyasaland, set up in Central African Federation days by industry to channel money into established industry in the absence of a sufficiently extensive capital market.

The European-dominated Central African Federation, though, was an unusual species of developing country, and truly independent D.F.I.s do not exist in the large number of indigenous-governed developing nations of to-day. Gordon (1983 p.8) states, "In the original conception of the World Bank - which was not the inventor of D.F.I.s but has been their leading supporter for more than thirty years - the model D.F.C. was privately owned and controlled but", he significantly goes on to say, "it generally required a special sanction and concessional financing (subordinated low - or no-interest loans) from government". This observation implies strong government involvement, irrespective of ownership. And furthermore, the interests that do own D.F.I.s labelled 'private' are automatically assumed by Gordon to be banks, insurance companies, the I.F.C. and similar bodies, in other words organisations that are or can be made susceptible to government influence, and/or have a philosophy of development promotion.

Some D.F.I.s are overtly 'public' in having 100% or majority state ownership. However, beyond this the distinction between 'public' and 'private' becomes unclear and indeed perhaps - in the present context - irrelevant, because the reasons for the establishment of the various D.F.I.s and the nature of their operations inevitably have been and are affected by the predilections of government. Also, to quote Gordon (p.10) again, "Not only do these various institutions have different purposes, market niches, and clienteles, but they are heavily influenced by different national traditions, cultures, and economic environments. All these factors may override the state-private dichotomy". In later pages, therefore, it is not proposed in the analysis to elevate the importance of the 'private versus public D.F.I.' issue. In general, a country's clutch of D.F.I.s will be treated as a unitary group, rather than as a pair of sub-groups.

## THE ALLOCATION OF CAPITAL FUNDS

(a) General factors.

Before reviewing the specific destinations to which D.F.I. money should be directed, it is useful to note the more general factors that help to define the allocative role.

Firstly is the reluctance of banks, as was discussed earlier, to lend on a long term basis. As Gordon (Ibid. p.3) explains, "..typically, banks have been less responsive to long-term credit needs - especially those of evolving industrial sectors - because of their inadequate resource base, risk aversion, low profitability, and so on. Basically, industrial term lending runs counter to their traditional habits, attitudes, criteria and procedures. 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 themselves constitute reliable collateral". Furthermore some large and - expectedly - worthwhile capital projects may take an exceptionally long time before yielding returns. Government, through D.F.I.s, may be prepared to take the long view, in the full expectation of eventual financial success, while banks prefer to avoid tying up money for very long periods.

In recent years change has come, and banks in the more 'advanced' developing countries (2) have shown a growing willingness to lend long, but inevitably they keep to firms with "established financial record(s)" (Ibid. p.3). Hence there remains a place for the D.F.I. in the business of term lending.

Secondly, D.F.I. loans may be denominated in foreign exchange, when sourced by foreign and international agencies. Given that capital projects usually require imports, and that developing countries are typically short of hard currency, this is a valuable attribute. Though commercial banks may in theory obtain foreign currency from overseas head offices or international financial markets, in recent years the international debt crisis has put an end to most term lending from the foreign private financial sector.

The main disadvantage of D.F.I. foreign currency lending is the question of who bears the exchange risk. A large number of developing country currencies have shown a secular tendency to depreciate, and hence borrowers of foreign exchange, whether the D.F.I.s themselves and/or their own debtors, find themselves having to find increasing quantities of local money to service repayments and interest. True, depreciation caused by domestic inflation can mean proportionately larger local earnings for borrowers, so compensating for higher debt charges: in practice, though, domestic inflation does not affect firms uniformly, and the economic distortions produced by inflation can so affect an economy in general as to damage the viability of debtors. Even where the exchange rate in a country is kept fixed for a substantial period a sudden devaluation will make things difficult for repayers of foreign currency denominated loans, and the chance of this happening may make them unwilling to borrow in the first place. Exchange risk may be addressed by insurance-cum-guarantee schemes, but in the uncertain politico-economic environments of modern developing countries mainstream commercial banks have been reluctant establish them, and hence it has been left to governmnts and/or central banks to make the arrangements. However, this does not automatically smooth away the problem. Apart from the consequent financial burdens that will fall on the authorities, foreign exchange protection can lead to complacency and hence slack operational behaviour on the part of the borrowing institutions.

Thirdly is the necessity that D.F.I.(s) be created to ensure a wider range of types of capital finance, since a properly geared company requires both loan and equity finance in appropriate proportions. Despite the above discussion on the relative unwillingness of banks to lend on a long term basis, it is more straightforward for banks to diversify in this direction, than for a fully-fledged stock market to become established. Therefore even when long term loans are available from commercial banks, a development corporation concerned with equity still has a place.

(b) The direction of funds and gaps in the financial markets.

1. General.

The identification of 'gaps' indicates the unwillingness or inability of the mainstream financial system to meet all - or all desirable or potential - needs. That a D.F.I. has a role in making up for the rest of the system's deficiencies highlights its position as a 'demonstration vehicle'. As RBC Dominion Securities Component 3 Vol. 1 (1989 p.iv) points out, "If D.F.I.s succeed in demonstrating that managing assets involving higher risks and/or non-traditional financing structures can generate attractive returns, they may induce other financial sector intermediaries to pursue these business opportunities". Crucial in the following paragraphs, therefore, is comment on how D.F.I.s, when undertaking work mainstream intermediaries may avoid, can address the factors that are expected to lead to losses.

2. Small business finance.

Firstly D.F.I.s are important as sources of finance to small businessmen, for "Bankers everywhere... are reluctant to lend to small business". (World Development Report 1989 p.100). As noted before, the distinction needs to be made between the very small or totally new one man/family business with no fixed assets worth mentioning and very likely no accounting records, and the established formal sector business (3). Especial difficulties surround attempts to finance the first type - not that this automatically rules out formal financing provisions (4) - but arrangements and specialised intermediaries to help the second group have over the years been widely established.

Though for the larger company appropriate gearing of capital structure is the right approach, there is a case for suggesting that for the small business finance is better extended as debt rather than equity, so as to impose upon small businesses the discipline of having to generate returns. It can be too easy for the inexperienced small businessman to get to see equity capital as 'free' money, since no repayment or compulsory dividend returns are required. On the other hand, where the flexibility that equity funding gives is absent, some potentially viable projects will not be undertaken. As McKendry (1991 p.2) points out, "Institutions which use only loan finance limit their ability to balance risk against return".

Nevertheless, even if equity capital is inappropriate for the very 'small' businessman, there will come a stage in the growth process of a 'small' business when it has the sophistication to consider raising money this way. (The issue is looked at fully in the next sub-section.) When this occurs, a more important constraint is the lack of a securities market for trading in locally-issued paper. For as the 1989 World Development Report (p.101) - in the context of discussion on small business finance - observes "With the development of securities markets, venture capital is more likely to appear as a source of finance for risky new projects".

Sometimes it may be appropriate to lend on a short term as well as long term basis, given the unwillingness of commercial banks even to advance working capital to small concerns. Too heavy an emphasis on such business, however, threatens to turn a D.F.I. into a commercial bank, as safer short lending comes to look a more attractive option.

The recommendations do not seek to ignore the enormous problems connected with small business finance - problems amply elaborated in Chapter 3 - and the difficulties of achieving internal viability. There is no absolutely certain way of avoiding losses, but there are methods for reducing their likelihood.

It was pointed out in Chapter 3 that a major reason for small business D.F.I. unviability is the heavy ancillary costs that will accompany serious and properly thought out schemes, and it was argued that a good proportion of these costs may plausibly be borne by government - and/or external agency - as part of a general approach towards education and expanding the indigenous business community. Though writing about D.F.I.s in general, the following point made by Kitchen (1986 p.125) does subsume the suggestion: "It may be a contentious view, but it seems better to allow DFCs to concentrate on being sound financial institutions rather than social institutions..."(5).

The 'social' aim that allows for subsidised interest rates on lending cannot, however, easily be defended, and there is no need to rehearse again the arguments against this aspect of financial repression. In brief, skills training should make a borrower better able to service debt at the due time, whereas subsidised credit clouds market reality and invites lethargy. There are other bad practices that the development objectives for D.F.I.s in relation to small business finance can be interpreted to justify, for example massaging unpaid interest and repayments into de facto grants, the handing over of funds just to dam the onset of insolvency, capitalising interest and repayments, and of course financing companies for personal and political rather than business reasons: all of this squanders resources, and pushes towards bankruptcy both D.F.I.s and the businesses they support.

3. The finance of medium size domestic companies.

For the purposes of the present discussion it is assumed that domestic medium size firms are those which are sufficiently established to be prepared to issue equity. However, by virtue of being unknown, and/or because of the lack of facilities for trading securities, they would not expect to make much headway if they tried to sell shares to the public in general. Hence there is a role for D.F.I.s taking up and/or underwriting this paper.

Risk can appear to attach to buying the stock of the type of concern identified above, but it is a necessary task if home-grown firms are to make headway. And this is not to imply that losses will automatically result. Firms aiming to capitalise assets or expand are hardly likely to be making losses themselves, and relevant D.F.I.s, committed to the expansion of industry and staffed largely by indigenous people with a more pertinent understanding of local conditions and customs, should have more scope for properly assessing prospects than the general public, who, lacking knowledge, can be expected to be cautious.

The same observations apply when domestic firms that are not yet well known apply for long term loans in support of expansion programmes. The practice of long term lending from the mainstream financial system tends to become established in developing countries much sooner than institutional support for equity finance, but in general banks are only prepared to accommodate the well-established 'blue chip' firm.

D.F.I.s, though, should employ and nurture the expertise that can address the credit needs of obscurer but still successful or potentially successful concerns. As with 'small' business, support services for the financing of 'medium' firms are appropriately financed in part by government and/or other external agencies.

4. Collaboration in new projects.

Linked to both the previous two discussion points is the possibility of a D.F.I. being in with a local partner at the birth of a new venture. The partner may be a private interest or a government body. Again, the reasons for D.F.I. involvement are the difficulties of the associate in raising sufficient equity funds due to the weakness and/or caution of the stock market.

The usual reservations attach to D.F.I. collaboration with a state body. Usually it would be impossible for a D.F.I. not to associate in a venture with a goverment body - and to keep financing it - if sufficient pressure was brought to bear, even when business logic suggested otherwise. And indeed this may also be true of collaboration with private interests, if these interests consist of politically powerful or politically favoured people.

5. Partnership with foreign firms.

In some circumstances, D.F.I.s may collaborate financially with foreign firms at the outset of projects. Indeed governments may insist on this arrangement, so as to avoid total foreign control of new projects. Clearly some foreign firms considering setting up in developing countries may favour association with D.F.I.s. They do not have to provide all the capital needed themselves, and can hope for government protection and favours. And for the country there is an inflow of capital and expertise. However other firms prefer to remain independent, and will not come if collaboration with D.F.I.s is compulsory. As long, therefore, as foreign firms can choose whether or not to have D.F.I.s as partners, it is a useful function.

6. The social cost/benefit issue.

The above discussion has implicitly made financial viability an essential feature of recommended D.F.I. functions. Now it is true that, technically, the purported external benefits that may be expected to follow from a new venture may be used to justify D.F.I. involvement in a financially loss-making concern: this issue was referred to in Chapter 2. However the many difficulties associated with computing external benefits, together with the ease with which financial losses may always in this way conveniently be excused, make this a dangerous practice.

PROMOTION

The unwritten assumption in the section above was that, though they might be active in monitoring, extension and management collaboration, D.F.I.s did not actually initiate projects. However, at the extreme a D.F.I. may actually be a promoter of a new venture, - what was defined in Chapter 2 as 'pure' supply leading - planning and/or financing it wholly itself, or seeking on its own initiative domestic and/or foreign partners. If it chooses to be the sole agent in a new venture it must inevitably get involved with entrepreneurship and management. As a developmental tactic, promotion is ostensibly a legitimate function of a D.F.I. However, as Gordon (1983 p.22) notes, "It is an important process, often glamorous and exciting, but beset with unforseeable difficulties". In Chapter 2, examples from European history fail to provide much unequivocal evidence of successful pure supply-leading behaviour. The dynamism of extra-bank business interests was always far more significant than any direct impetus from the sphere of finance. Though there is no obvious reason why supply-leading financial institutions should be any more effective in modern developing countries than in 19th century Europe, political leaders have been ready to use such institutions to try to achieve the deployment of development that, for whatever reasons, they favoured.

Can any quasi-objective case be made in favour of promotion? (i) It bypasses the caution of private domestic and foreign interests by leading rather than just supporting new developments. (ii) It substitutes for a dearth of local entrepreneurship. (iii) It can be designed to accord with standard approaches to industrial development, such as import substitution or export industry expansion.

However, the above points are matched by serious shortcomings. (i) A promotional D.F.I. has to employ various experts to seek out viable project designs, conduct feasibility studies, locate partners, and so on. This goes way beyond extension and monitoring, is very expensive, and must - if done properly - turn the D.F.I. into something other than a financial intermediary. (ii) To substitute for a dearth of local entrepreneurship implies that the D.F.I. takes on the entrepreneurial function, in other words, that the D.F.I. somehow has good entrepreneurs amongst its employees. This is not very likely, since such people would be more profitably employed running their own businesses. In consequence, there is a strong possibility that government will find itself having to subsidise the mistakes of entrepreneurial incompetence. (iii) In line with observations made above there will always be a temptation to promote schemes for social and political reasons rather than hard business ones. Even less happily, the powerful may pressurise D.F.I.s into underwriting ventures designed for their personal aggrandisement.

Though it would be wrong to rule out D.F.I. promotion of new business in all circumstances, experience has been disappointing. As Gordon observes (1983 p. 22), "A few companies" - that is, development finance companies - "....have created new enterprises, frequently to their subsequent regret".

## THE NORMATIVE AGENDA

(a) Introduction.

In previous sections it has been at times impossible to avoid bringing in some of the normative features that inevitably become associated with the more objective functions that a D.F.I. might be expected to undertake. Here consideration is given explicitly to the more blatant socio-political factors that have often been included in the remits of D.F.I.s in their capacities as allocators of capital funds. As Kitchen (1986 p.123) without either disapproving or approving, observes,"..the development bank assumes a wider role than if it were a purely private sector financial institution. It becomes an instrument of government policy, and is generally expected to act in the long-term interest of a country's economic development, a function which may often clash with its criterion as a profit-making institution". Or, as the World Bank (1989 p.54) observed, "Most (governments) believed that without intervention their financial systems would not be cooperative partners in the development effort". This section, therefore, departs somewhat from the basic aim of the chapter, and does not so much identify as review practices that developing country governments have expected of their countries' D.F.I.s.

To return to Kitchen's discussion, amongst other "broader aims" he mentions the creation of employment, the diversification of industry, the distribution of income, and the encouragement of entrepreneurial activity. (Op.cit. p.123). Following the sub-section immediately below, Kitchen's ideas will be used as the basis for the subsequent discussion.

(b) Money for parastatals.

Numerous instances exist of D.F.I.s financing, usually at government instigation, parastatal industries. The World Bank (1989 p.57) remarks on this - "State-owned enterprises in some countries have clearly benefited from directed credit" - and it is all too obvious that this has been largely the result of these organisations making losses. As the World Bank goes on to say (Ibid. p.57), "Artificially low prices, excessive staffing, or activities that were inherently unviable have resulted in low profits and low retained earnings. Borrowing was necessary not just for investment but to cover losses". Of course directed credit does not have to be just from D.F.I.s, but they are important in this type of business because usually their ownership profile means that they are more readily influenced by governments than are commercial banks.

A further use of D.F.I.s in the context of public ownership of industry has been to make them agents of nationalisation by the directed purchase of 100% or majority holdings of companies' shares. Minority holdings may also be acquired if dividends are good, and if for other reasons majority holdings are to be avoided.

Political considerations constitute a major factor behind D.F.I. involvement with public sector industry, and in the days when philosophies that celebrated the virtues of massive government intervention in industry were uppermost, it would have been thought very proper for D.F.I.s to collaborate with government in this activity. And indeed, ceteris paribus, there would have appeared to be no reason why a parastatal should be any less successful than a private sector firm. However, in practice, as the above quote indicated, parastatals have made losses throughout the developing world, and in consequence, D.F.I.s have been damaged.

Unless (i) business is initiated and carried through on a firm commercial basis, and (ii) a 'developmental' aspect can be identified, D.F.I. financing of parastatals cannot be recommended.

(c) Employment creation.

Unless it replaces, or by its existence results in the liquidation of, one or more other undertakings any new venture can be expected to increase employment, but clearly to maximise employment creation from a given input of money capital, it is necessary to go in either for industries that are inevitably labour-intensive, or for labour-intensive methods of production where there is a choice. However, unless a D.F.I. is the sole instigator of a new venture, the scope for deciding what to produce or how to produce it is limited: too much pressure may make the partner or client pull out. And quite obviously, the partner or client will wish to produce in whatever way is thought most likely to be profitable. As the sole promoter of a new venture, a D.F.I. may deliberately decide in favour of labour-intensive production methods, but unless the wage level is sufficiently low to make this the most cost-effective approach the degree of protection and the level of output prices to ensure viability will have to be that much higher. And/or there will have to be more government financial support. A further problem which can arise in the long term - even where labour intensive production methods are apparently justified by low wage levels - is the matter of spare parts. High wage developed countries favour capital-intensive production methods, so capital equipment producers in such countries may be unable to service 'simpler' equipment which is regarded locally as obsolete. Furthermore, goods for exports have to meet international quality standards, and this may mean using the latest machinery.

A further, considerably more dubious, practice in relation to employment levels exists when D.F.I.s are expected to increase manning in their subsidiaries and associates, so as to absorb some of those seeking work, and so help to show a statistical rise in wage employment. Gillis and Peprah (1981 p.36) identify - "A .. common socio-economic justification for establishing state-owned enterprises is that of employment creation, or reduction in unemployment" - and D.F.I.s, as an intermediate layer between government and industry, may be in a position to pressurise not only majority-owned subsidiaries but also firms in which they have only minority interests to take on more staff. And not to be ignored is the tendency for D.F.I.s to multiply their own workforces.

(d) Industrial diversification.

Typically the internal market for a substantial range of industrial products is, in a large number of developing countries, small by European standards, due to a combination of small populations - though usually, of course, growing fast - and low modal incomes. Given scale economies, then in the case of many product lines there is no room for multiple firm industries if just the domestic market has to be served (6). Hence D.F.I.s concerned with secondary industry tend to have diversified portfolios consisting of stakes in firms that are not in competition with one another, and which typically are heavily protected against competition.

This recipe for 'single firm' industries meets with considerable criticism from Harvey (1991 p.10): "The argument for monopoly on grounds of economies of scale has been overworked, and is almost always damaging. If an economy really is so small that only one steel manufacturer or motor assembler can operate on a sufficient scale, the country is probably better off importing the commodity in question, since without competition the producer's costs will always be excessive". Some industries, such as textiles, can operate successfully with many firms even in a small market, but this is partly because textiles by definition comprise diversified ranges of products. However, in the case of a single firm industry, if it is faced with import competition, something which present-day liberalisation measures aim to bring about, it can no longer behave as a monopoly. Obviously some types of business would not survive import competition, but the approach towards industrialisation in developing countries must be to spot those types of production, which, due to cheap local materials or some other indigenous factor, can hold their own. Also there is room for several firms in an otherwise single firm industry if it develops a flourishing export business. Perhaps such a development should be supported by the establishment of export processing zones, as has been true, with considerable subsequent success, for certain countries, such as, for example, Mauritius (Fowdar 1986 passim).

(e) The redistribution of income.

Because of its specialised and limited role in an economy, a standard D.F.I. cannot have a very substantial role in the matter of macro-economic income redistribution. All it can really do is to create the conditions whereby some people in business may enhance their economic status, by providing them with investment funds and ancillary support. In so far as the policy is successful, then the beneficiaries are relatively better off.

Another way in which a D.F.I. may contribute to the goal of income redistribution is to improve the economic circumstances of a number of indigenous people by giving them managerial and other senior positions in the D.F.I. itself or in firms over which a D.F.I. has influence. This policy is quite legitimate if such people have appropriate qualifications and experience: otherwise inefficiency results or salary costs rise as qualified expatriates have to double the locals. Furthermore foreign partners may be reluctant to establish new ventures or expand existing ones if obliged to employ staff they consider unsuitable. Even more ill-thought-out approaches to redistribution involve favouring particular tribes, classes, political classes and families. As Hailey (1991 p.14) observes, "For a variety of social and political reasons some governments actively discriminate in favour of certain groups within the population to encourage their involvement in the small business sector".

In general income redistribution is more appropriately achieved by the government fiscal and general macroeconomic policy than by the activity of D.F.I.s.

(f) The nurturing of entrepreneurs.

The encouragement of entrepreneurs is most obviously important in relation to small business support. Earlier chapter material explored this and associated issues, and suggested that government should be principally responsible for the finance of extension assistance - including entrepreneurial training - to businessmen, even though some aspects of the package are appropriately operated through D.F.I.s.

Discussion on other aspects of entrepreneurial activity by D.F.I.s has been to some extent implicitly covered in the sub-section on promotion, since the initiation of new ventures must imply entrepreneurial behaviour. Comment in that section was not enthusiastic about D.F.I.s taking on this role, despite Cameron's observation (1969 p.4) that, ".. to maximise the output of the economy as a whole the few really capable entrepreneurs should be placed in positions where they can exercise the greatest leverage. Surely the banking system would be one such strategic area.". Though Cameron was writing about banks in general, what he says is quite relevant to D.F.I.s. Unfortunately, the staff of developing country D.F.I.s have tended to be made up not of people with entrepreneurial flair but of those qualified in administrative and financial disciplines - plus of course political appointees - who look to protection rather than business astuteness to see their ventures pay off. However there are exceptions. The Botswana Development Corporation, for example, has always been staffed by managers with business/private sector backgrounds (7).

(g) Conclusion.

For D.F.I.s to pursue social and political objectives creates obvious problems of viability, since they are likely to conflict with hard commercial criteria. To a very large extent, such aims are best treated in the context of general government policy rather than assigned to be carried out by D.F.I.s.

## CAPITAL FUNDS FROM ABROAD

Within the above text on the allocation of funds are - inevitably- observations on the inflow of capital from abroad, and the paragraphs here elaborate on that material.

International agencies and foreign national financial institutions - whether specialised organisations or commercial banks - that channel money into developing country development often use D.F.I.s as conduits for capital funds. Or, as Gordon (1983 p.16) puts it,"...they are usually the favoured channels for loans from public international or bilateral sources".(8) There are good reasons for this. Firstly it means the delegation of allocation decisions to personnel supposedly skilled in this function. Secondly - though of course very much linked with the first reason - it is a sensible way of disintegrating 'wholesale' sums of money into many 'retail' allocations. Thirdly, if money contributions are in the form of capital rather than loans, the expatriate agencies are owners of the D.F.I.s in question, and so in theory can influence decisions. (And indeed, there is a tendency for donor agencies not to want to be involved with D.F.I.s where there is a strong government presence, in the belief that governments are prone to bulldose allocation policy into business where social and political rather than sound commercial considerations are paramount.) However, too much should not be made of this. As pointed out, the whole point of D.F.I.s as middlemen is that - administratively - they substitute for the donors, and in practice staff of donor agencies are often too stretched to exert more than broad long-term influence. Also, governments may still try and use their weight to pressurise D.F.I.s in receipt of external funds to allocate money in ways they favour (9). Fifthly, donors - with exceptions - prefer, for ideological reasons, not to finance private sector industry directly. Sixthly donors can more readily insist on governments guaranteeing funds provided via D.F.I.s rather than through less structured channels.

The other main way - already referred to - in which D.F.I.s may be the catalyst for foreign funds coming into developing countries is when they become partners with foreign firms in providing equity finance for new ventures. If there is a favourable context for foreign inward investment, then - given that existing large scale business and finance in developing countries is usually rare and/or foreign - D.F.I.s constitute a convenient method of associating foreign capital and expertise with domestic finance and domestic aspirations. Unfortunately, as noted earlier (and see Appendix 1) too often governments show the vacillation and contradictory behaviour typical of the soft state, heaping disabilities on firms with foreign components in them, while at the same time affording them monopolistic advantages.

Finally, as already noted in Ch. 1, it is theoretically possible for D.F.I.s to float bonds on the international capital markets. However in practice such institutions in developing countries would be unlikely to command much interest for the paper they issued.

## D.F.I.s AND INTERNAL SAVINGS

(a) Introduction.

There are two issues to discuss below. They are the questions as to whether D.F.I.s can (i) increase total domestic savings, (ii) influence the deployment of savings.

(b) The increase of domestic savings.

Drake - echoing Porter (see Chapter 2) - observes (1977 p.74), "The mere provision of financial institutions and of opportunities for acquiring financial assets will not per se raise the rate of saving in an economy". This assertion seems particularly applicable to D.F.I.s, which have always typically taken money in wholesale amounts from agencies that did not require the existence of financial intermediaries as a spur to accumulating funds. Furthermore, since D.F.I.s channel money to beneficiaries at market or concessionary rates, they are not in a position to generate more savings by offering high returns.

However, it is plausible that small businessmen, aware that D.F.I. financial and technical help can make it possible for them to get ahead, may consider it worthwhile to save capital funds themselves for future business investment, whereas before they might have spent their spare money. If D.F.I. funding is made conditional on some accumulation of own funds, a willingness to save is reinforced.

Finally, a prosperous, well-run D.F.I. can become a repository for industrial surpluses that might otherwise - given exchange control permission - have gone abroad. This may not increase the total savings generated internally, but it prevents some of them being lost. Needless to say, this type of scenario assumes that D.F.I.s are so financially structured as to be able to accept random industrial surpluses, and also are more attractive to those with money to place than other financial intermediaries. In practice, these supporting conditions have never been much in evidence.

(c) The deployment of savings.

Gordon (1983 p.16) - as noted earlier - postulates a function for D.F.I.s as mobilisers of foreign savings, since they act as channels for the inflow of foreign funds, but apart from that his comments mainly apply to internal allocation. He notes that "..the record of D.F.C.s in mobilising domestic resources is mixed, but poor on the whole for both private and state-owned D.F.C.s, particularly the latter. Government institutions, by and large, are not concerned with the availability of domestic resources because they draw on the national budget or the central bank for whatever sums their approved lending targets require, often at concessional rates" and later (p. 17), "..state-owned D.F.C.s have been less active and innovative than their private counterparts in mobilizing domestic resources, especially in the market. State-owned D.F.C.s have little incentive to woo private funds so long as they can count on public money to meet contingencies". The above comments are borne out by experience. Research shows (see Part 2 Chapters 5-8 and Appendix 3) that D.F.I. money comes principally in loan and equity capital form from governments, parastatals, domestic, foreign and supranational development agencies, and - rarely - major financial intermediaries. There are also grants from governments, de facto if not de jure. There is virtually no use of private sector funds, except, as noted, for occasional bank or insurance company money. Mobilisation of private sector surpluses may be desirable as increasing pool of funds available to D.F.I.s, but, as was intimated in the last sub-section, requires a superior record of business dealings to create the necessary confidence.

A related issue concerns the possibility of a D.F.I. diverting to itself more of a nation's total savings by accepting deposits. It would be impractical and inconvenient for a D.F.I. to attract in small deposits from low-waged people. This is better done by commercial banks and other many-branched intermediaries geared to this type of work. However, the idea of accepting deposits in wholesale amounts from institutions and companies is financially feasible. The World Bank (1989 p.120) sees it as improving resource allocation, and providing better opportunities - at one stage removed - for small savers.

Furthermore deposits are regarded (Ibid. p.120) as an important disciplinary feature in a financial system: "..financial institutions require the independence and discipline that only voluntary deposits can give". In the light of the generally unsatisfactory experiences of developing country D.F.I.s., deposits might indeed act as a valuable 'disciplinary' factor. On the other hand, most deposits would have to be long term, or an institution's 'development' status, implying the provision of long term funds, would be compromised: hence many potential depositors, not wanting to tie up money for long periods, would be put off. A solution would be to issue certificates of deposit, but a requirement for this is a sophisticated financial system, where such paper can be traded.

Clearly, though, the above suggestions are of little relevance unless financial systems and the D.F.I.s within them are perceived as operating in circumstances of efficiency and integrity. Without this, and in the light of the experiences of the last few decades, D.F.I.s in Africa will have little option in the foreseeable future but to obtain money from the well used sources.

## OTHER D.F.I. FUNCTIONS

The above sections have considered to what extent D.F.I.s have a role with regard to the key functions of financial institutions in general, that is gathering funds from surplus units and channelling them to deficit units. Here certain relevant ancillary functions and issues are reviewed.

The term 'development' in the generic title implies a mode of behaviour not automatically true of other financial institutions. Essentially a D.F.I. is concerned with financing the growth of industry and commerce (or designated sectors of industry and commerce) in the absence of 'mainstream' financial facilities. In so far as it holds equity capital, in due course it should sell off its shares, so recouping funds for new operations. If it ties up funds in shares for long - perhaps indefinite - periods, then it mutates into little more than a holding company or investment trust.

With regard to lending, loans should be dignified by the firm expectation of repayment on time, so that in the same way money is constantly generated for new borrowers.

Drake (1985 p.9) writes,".. (in less-developed countries' securities markets) the most general, continuing and severe problem has been an insufficient supply of securities", and clearly if a D.F.I. is active in the business of revolving capital, and sells off shares in established ventures, it helps the growth of the private capital market. Indeed Kitchen (1986 p.123) states that the development of the capital market is one of the "broader aims which governments expect development banks to subscribe to". To elaborate on this point, apart from increasing the supply of securities on the market when they sell, D.F.I.s, by associating with domestic and/or foreign interests in the finance of new projects - as discussed earlier - help to increase the total supply of securities existing inside countries, and via the formation of investment trust subsidiaries can attract more people into the stock market by spreading perceived risk. Furthermore they can require recipients of loans to go public, and can, via the influence they wield when financing firms, bring about an upgrading of accounting and financial reporting practices, and so promote then into the category of organisation that can plausibly ask for a stock exchange quotation. Also a D.F.I., by fostering an increase in stock market activity, should be a catalyst for more the establishment of more financial services ancillary to the stock market, such as stock-broking and investment advice business. Unfortunately, in practice, as Gordon (1983 p.24) - with D.F.I.s in mind - observes, "The results ... have been disappointing. Although the development of capital markets is often included amongst government policy objectives, it is seldom given high priority..."

At the margin, for a D.F.I. to dispose of shares amounts to 'privatisation'. This is obviously the case when a wholly-owned subsidiary is disposed of, but even when a D.F.I. is only a partial proprietor in a company it could amount to the same thing if previously the D.F.I. had been in control. Now 'privatisation' has a political flavour, and would previously not have been thought to be a term applicable to a D.F.I. that as a matter of course revolved capital by disposing of shares in established companies. On the other hand D.F.I.s have often been used by governments as agents of nationalisation and the creation of new state enterprise: in the neo-liberal era, with widespread state ownership of industry and commerce being no longer fashionable, to the sale to the public of assets, held by D.F.I.s for long periods as a matter of state policy, the term 'privatisation' is quite apt.

A commercial - as opposed to ideological - complication of privatisation (or indeed the sale of minority shareholdings) relates to the matter of profits and losses. As Bere and Shirley (1987 p.vi) point out,"One obstacle to this" that is, 'privatisation'," is the fact that governments in developing countries rarely want to sell profitable state enterprises, and the money losers they do want to sell are unattractive to buyers". Indeed, it may not be, as the quotation suggests, a question of choice, since a D.F.I. may rely on a handful of profitable subsidiaries to cross-subsidise unviable investments, and so keep financially solvent. Now clearly any financial intermediary going in for financing that has a 'venture capital' flavour must expect some failures amongst its financing ventures, and so has to rely on profitable ventures to maintain solvency. However, this is not a recipe for D.F.I.s never selling off performing equity holdings. Investment appraisal should come up with an expected average rate of return on planned projects, and it is suggested that when this rate of return equals or exceeds that on those existing shareholdings that have positive returns, disposal of assets may take place (10).

## SUMMARY

D.F.I.s have been shown to have a role in the provision of long term finance, and, in instances where they are funded by foreign agencies, in the provision of foreign currency loans. Furthermore, even when banks have become more responsive to longer term credit needs, D.F.I.s may be necessary to achieve better company gearing ratios by investing in equity.

More specific directions for finance include loans to small businesses, though with the proviso that government provides and pays for various support services, equity capital (as well as loans) to domestic firms that, due to (i) the caution and/or ignorance of private investors, and/or (ii) stock market underdevelopment. cannot raise equity privately, and collaborative financing with foreign interests. There are reservations with regard to a D.F.I. being a sole promoter of new ventures. Though D.F.I.s should establish extension divisions staffed by various extra-financial specialists for properly assessing applications for funds, identifying worthwhile collaborative ventures and monitoring and guiding the progress of new projects, the initiation and carrying through of projects by D.F.I.s themselves require a level of entrepreneurship and involvement in industry of a quite different order: as noted earlier, most such ventures have been high cost failures.

Even more overtly 'social' aims cannot be recommended for D.F.I.s. Ventures strongly seasoned with this approach tend to end up as loss-making D.F.I. liabilities, and/or take the protectionist high road to inefficiency.

D.F.I.s certainly influence the deployment of savings, and may, in certain indirect senses possibly bring about an increase in total domestic savings. Also, via collaboration with foreign and international agencies, they can bring in to their countries more of - as it were - other people's savings.

Finally, D.F.I.s have a role in the development of countries' private capital markets. This occurs when they underwrite new issues by local companies which - by virtue of being unknown - need this type of support, and when, as revolving capital organisations, they sell shares in successful ventures.

ENVOI

At the end of Part 1, it is as well to acknowledge the basic dilemma which relates to

D.F.I.s as providers of finance. If they are to fill capital market gaps, and yet provide money profitably on commercial terms, then it may be wondered why they are necessary. Why indeed would mainstream private intermediaries leave any financing gaps in the first place if such business was profitable? On the other hand, if D.F.I.s take on work to which especial difficulties attach, losses are to be expected.

It has been the main purpose of Part 1, and particularly of this chapter, to admit to especial difficulties surrounding the provision of development finance in certain developing country contexts, but to argue also that tailor-made D.F.I.s can be endowed with attributes - not necessarily available to mainstream intermediaries - that can cause them to take on such work and yet remain viable. To state the arguments here would of course be to repeat what has already appeared in earlier sections. However a major weakness in the establishment of D.F.I.s in developing countries has been lack of appreciation of the basic dilemma and hence of the energy to address the task of reconciling opposing objectives. D.F.I.s typically are supposed to pursue 'worthy' social objectives, such as lending to poor risk borrowers at sub-commercial rates of interest, and using their influence to expand employment and indigenisation, but at the same time obtain funds commercially, stand on their own feet and make profits. Add to this 'soft' state features, such as D.F.I. jobs and funds as rewards and bribes for political support, and the indifferent performance of so many developing country D.F.I.s is understandable (11).

These issues are now to be examined in Part 2 in the context of Kenya and Zimbabwe.

NOTES CHAPTER 5 PART 1

1. A D.F.I. that was technically wholly privately owned, but which was subject to considerable official pressure as to how it conducted its business operations, would not be regarded -in the context of this study - as properly independent.

2. ....such as Kenya and Zimbabwe.

3. Increasingly, though, commercial banks in developing countries have been encouraged into establishing small business lending schemes. Usually, though, these schemes are very limited in scope and heavily guaranteed.

4. A well-known example of lending to exceptionally small businesses is the Grameen Bank of Bangladesh. However, this institution is concerned with rural credit, not small industrial or commercial loans. Furthermore, Dr Huq of Glasgow University explained that though successful, it is relatively small, accounting for only about 5% of rural credit. And it relies on an exceptionally able chief executive, and a level of cooperative organisation amongst the Bangladesh peasantry not necessarily found in Africa.

5. In answer to a question at the 1991 Development Studies Association conference, David Wright of the O.D.A. preferred extension assistance to come from agencies separate from the donor organisations.

6. Bottle stalls, repair shops, food markets and the like do, of course, represent areas of production and distribution where a plethora of businesses may exist even in limited market contexts. However the text at this point is mainly concerned with 'western-type' manufactured products.

7. I am indebted to C. Harvey for this information.

8. Obviously direct loans and grants to governments for large scale infrastructure creation do not normally pass through D.F.I. hands.

9. Technically, of course, the consequences of donor influence over D.F.I. financing operations may, for different reasons, justify it being criticised just as firmly as government influence.

10. Other plausible arithmetical prescriptions may be devised. However, the one suggested here is discussed in Appendix 2.

11. In the preparation for this study the writer had a look at the remits of various D.F.I.s in a number of Anglophone African countries, and was able to arrange interviews at some institutions not addressed in the main text. The results of this work appear in Appendix 3.

# PART 2:
# APPLICATIONS AND ANALYSIS

# Chapter 1
# INTRODUCTION TO THE EMPIRICAL INVESTIGATION

## GENERAL

The second part of the study applies the ideas of Part 1 to the establishment and operational behaviour of certain of the development finance institutions in Kenya and Zimbabwe. To this end the politico/ideological bases, the economic experiences, and the nature of the mainstream financial systems of the countries are reviewed as necessary backgrounds to and justifications for the D.F.I.s that are in place. Following this, there are detailed investigations of the main D.F.I.s concerned with - principally - the finance of secondary industry. In Part 3 the material is synthesized and reviewed, in order to isolate features of D.F.I. organisation and behaviour that accord with the 'soft state' concept.

The rest of this chapter is mainly concerned with the historical groundwork for the investigation.

## THE BACKGROUND

(a) Introduction.

Any study that aims to compare some aspect of recent Kenyan history with the parallel Zimbabwean aspect comes up against one very important area in which the two countries have been very similar, and another in which they have been quite different. Indeed it is this fact which makes a comparison especially interesting and informative: if the countries had been alike in all respects, much less of value might have emerged from the study.

The similarity is to do with economic and financial status and structure. Of all the countries of Anglophone Africa - and ignoring South Africa - Kenya and Zimbabwe, during the period when European colonial territories were achieving independence, stood out as by far the most industrially developed. Both had - by African standards - substantial secondary industry, and were increasingly suppliers of manufactures to neighbouring territories. Furthermore, as a corollary of this, their financial systems were more highly developed. From this it may be supposed that the necessity for specialised officially-sponsored D.F.I.s would be that much less, since in general the more sophisticated a mainstream financial system in a country is, the wider the range of credit and equity needs that can be satisfied by it.

The difference centres on the nature of the political history of the two countries, which, although showing some superficial resemblence during the first half of the 20th century, diverged markedly in the middle years. Furthermore, despite some earlier resemblence, factors present earlier are largely responsible for what happened later. Hence it is necessary to take a brief look at the historical background to the two countries, for only in this way can later attitudes to matters such as the provision of development finance be fully understood.

(b) Kenyan history. (1)

Prior to the colonial period the coastal area of Kenya was linked commercially to the Middle East, and - except for a period when Portuguese influence was paramount - the Arabs for several centuries controlled and operated from several ports. Of these, Mombasa was the chief. Far western parts came in the 19th century under the suzereignty of the fairly sophisticated kingdom of Buganda, but the rest of the territory was dominated by the culture of African traditional societies. The interest of the British in East Africa in the 1890s focussed on Uganda, and Kenya became a colony almost by default, since it was the area through which a railway had of necessity to be built if Uganda was to be controlled. The capital, Nairobi, roughly half way between the coast and Lake Victoria, and - crucially - lying on a modest river, originally came into being as a railway centre.

Though on the Equator, the central regions of Southern Kenya are high and so quite temperate. As such they attracted in a number of European settlers, and cash crop production, particularly in tea, coffee and tobacco, was developed. However there has, to date, been little commercially viable mining. Manufacturing flourished in the later colonial years, particularly when Kenya joined with Uganda and (what was then)

Tanganyika in the East African Community, and trade turned these territories into markets for Kenyan goods.

It is unlikely that the European population ever exceeded 70000 persons, so with an indigenous population of several millions rising fast, there was never any possibility that Kenya could become a new 'white' dominion. Though the British quashed a tribalist-cum-guerilla uprising in the 1950s, the changing face of Africa made independence inevitable, and it occurred in 1963.

(c) Zimbabwean history. (2)

Zimbabwe, lying in south-central Africa just north of South Africa, was the location of an organised society during European mediaeval times. The Portuguese then exercised spasmodic influence or suzereignty during much of the 16th and 17th centuries, but in 1692 lost all but a foothold in the Eastern Highlands. More lasting European control came in 1890, when Cecil Rhodes led a band of settlers into the area in order to exploit - what was hoped to be - abundant mineral wealth. The indigenous population at this time - broadly speaking - consisted of the majority Shona people, in thrall to the Ndebele, who, two generations before, had migrated there from Natal.

Consolidation of British power led, over the years, to a substantial - by African standards - European influx, and industry, infrastructure, and towns developed more vigorously than elsewhere in sub-Saharan Africa (3). A further economic boost was given to what was then known as Southern Rhodesia by the creation in 1953 of the Central African Federation. Salisbury, the capital of Southern Rhodesia, became the Federation's capital, and Southern Rhodesia was built up as the centre of the Federation's manufacturing capability, rather to the detriment of Northern Rhodesia and Nyasaland, which were somewhat neglected.

With the dissolution of the Federation in 1963, Northern Rhodesia and Nyasaland went their separate ways as Zambia and Malawi, and in 1965 the prime minister of Southern Rhodesia, Ian Smith, seized independence for that country. The settler government, beleaguered by economic sanctions, presided, during all but the last years of illegal independence, over a high rate of economic growth and extensive industrial diversification (4). However, war and other pressures eventually brought the regime to the conference table, and legal independence under African majority rule was achieved in 1980. At the same time, the name 'Zimbabwe' was resurrected, and applied to the country.

(d) Comment.

Several points that are relevant to future discussion emerge from the above. Firstly, the extent of European penetration and influence, due to numbers, economic power, the historical conception of the place of the European in the country, and erstwhile political power, was, at the time of legal independence, much greater in Zimbabwe than in Kenya. Secondly, the nature of the 1950s uprising in Kenya was rooted in traditional tribalist culture, and this left the country with leaders looking - superficially at least - to a new Kenya linked to old ideas. Zimbabwe, however, went through a much longer period of struggle, and the indigenous leaders of the independence movement looked to East Europe for sympathy and support. Partly as a consequence their philosophy and ideas were influenced from this quarter. Thirdly, and perhaps most significantly, Zimbabwe came to legal independence later than Kenya, and indeed most other African former colonial territories. As a consequence the mistakes of others could be seen, if not necessarily avoided.

## THE DEVELOPMENT FINANCE INSTITUTIONS IN KENYA AND ZIMBABWE

At independence the governments of both Kenya and Zimbabwe put a high priority on economic growth, and, as was the case in other African countries, saw in the concept of the development finance institution a method that would contribute to the achievement of this goal. Though in both countries D.F.I.s already existed, their economic weight was slight. Hence in due course new D.F.I.s were established, and those already existing were given an enhanced profile.

The rest of this section identifies and describes the D.F.I.s operating in Kenya and Zimbabwe in the eighties. In the chapters that come later it is not intended to cover all of them, but for the sake of clarity it is important to appreciate what is omitted from the study as well as to preview what is to be included.

The D.F.I.s to be fully investigated are the Industrial Development Corporation in Zimbabwe and the Industrial and Commercial Development Corporation in Kenya (formerly also called the I.D.C.), the Development Finance Corporation of Kenya and the Industrial Development Bank in Kenya, and lastly the Zimbabwe Development Bank. The first two date back to pre-independence days, and mainly hold equity capital in business, though they are at liberty also to lend money. The I.D.B. and the Z.D.B. were established after full independence from colonial rule, and are predominantly concerned with loans. The D.F.C.K. is strong in both equity and loans. The destination of the funds of these organisations is largely secondary industry and commercial services, though the occasional interest in primary production and tourism appears in their portfolios (5).

Omitted from the later chapters in Part 2 are investigations into the specialised concerns that focus on agriculture, tourism and mining. A number of very specific problems attach to the finance of these areas, particularly, of course, agriculture, and to have included full investigations of them would have impossibly expanded the scope of the study. Also excluded are the specialised organisations to do with small business finance, because once again this area justifies more substantial treatment than would be practicable here. However, some of the omitted organisations are briefly surveyed in Appendix 3, and even in the main text it has not been possible to totally ignore small business finance, because certain of the more 'general' D.F.I.s include such work amongst their other functions. Also left out is consideration of the Industrial Promotion Corporation of Rhodesia and Nyasaland. Set up in Central African Federation days, and technically still extant, in recent years it has been dormant (6).

## FINAL NOTE

Though the following chapters are geared to an analysis of the D.F.I.s in Kenya and Zimbabwe, the deductions and recommendations are intended to have wider application. However, though the experience of D.F.I.s has, in recent years, been unsatisfactory throughout the developing world, the countries of Asia and Latin America do have features and problems different not only from the countries of Africa, but also from each other, so it would be rash to assume that the lessons learned from Kenya and Zimbabwe are automatically relevant in totality to them.

Also, even in Africa, traditions in the Francophone amd Lusophone territories are rather different from those with a British-influenced background. Hence the results of the investigation into Kenyan and Zimbabwean D.F.I.s mainly have relevance to Anglophone Africa.

NOTES PART 2 CHAPTER 1

1. Much of the historical material on Kenya comes from 'Kenya: the Quest for Prosperity' by N.N. Miller (Westview Press 1984). However, there are other standard works.

2. 'Rhodes of Africa' by F. Gross (Cassell 1956) was consulted for some of the remarks about early Rhodesian (Zimbabwean) history.

3. ...always excepting, of course, South Africa.

4. The economics of the earlier part of the Rhodesian U.D.I. period were considered in 'Central Banking in the Economies of Central Africa', 1973 M.Phil. thesis by J.E. Maynard for the University of Reading. This provides the basis for some of the remarks here.

5. Kenyan D.F.I.s in particular often seem to do the same type of business. Barbara Grosh in 'Performance of Development Finance Institutions in Kenya' (Institute for Development Studies: University of Nairobi - Working Paper 1987) notes this when she writes (p.4), "The chronology of the D.F.I.s shows a marked tendency to organizational proliferation and duplication".

6. Investigation of development finance in Central African Federation days (and the U.D.I. period) is a very specialised study in itself, and it has not been the purpose in these pages to tackle it in depth.

# Chapter 2

# THE POLITICO-IDEOLOGICAL BASES OF KENYA AND ZIMBABWE

## IDEOLOGY AND INTENTION IN KENYA

At the time of Kenyan independence considerable obeisance was made to the adoption of 'African socialism'. This approach rejected the ideas of Marx in favour of something more associated with traditional society, pointing out that "Valid as Marx' description was", that is, of mid-19th century factory conditions, "it bears little similarity to Kenya today". (Republic of Kenya 1965 p.7). Furthermore, Marx was also rejected on the grounds that his prophesies for future years had been shown to be wrong. "As predictive models of what would happen to factory system societies, both Marxian socialism and laissez-faire capitalism have been failures". (Ibid. p.7).

'African socialism' was perceived as a much looser philosophy, implying mutual help and responsibility rather than the imposition on society of a rigid political construct. In a nutshell, "There are two African traditions which form the essential basis for African socialism - political democracy and mutual social responsibility". (Ibid. p.5). Not of course that political democracy as applied in modern Kenya was taken to mean free elections and different political parties, any more than such arrangements had been commonplace in traditional Africa. Rather was 'democracy' associated with specified curbs on the power of those in control. "Even where traditional leaders appeared to have greater wealth and hold disproportionate political influence over their tribal or clan community, there were traditional checks and balances including sanctions against any possible abuse of such power". (Ibid. p.3). 'Mutual social responsibility' indicated the duty of everyone to work, as the following makes clear: "...African Socialism expects the members of the modern state to contribute willingly and without stint to the development of the nation" (Ibid. p.5).

The picture, then, is of a corporatist, paternalistic state, where political democracy in a western sense does not exist, but where somehow abuses of power can be prevented (1).

Nevertheless, this scenario results in considerable power flowing into the state's hands. "...the European tradition of absolute ownership has gradually been eroded so that today the right of the State to guide, plan, and even order the uses to which property will be put is universally recognised and unquestioned". (Ibid. p.10). And, "Under African Socialism the power to control resource use rests with the state". (Ibid. p.11). However, such pervasive state involvement is not identified as having to imply wholesale nationalisation. State ownership of firms is a respectable option, but all other forms of ownership are valid, depending on circumstances and current policy. What can be expected are many state controls and regulations, and a lot of explicit economic planning.

These ideas are too generalistic to be capable of tight and consistent application to the circumstances of any country, but suggestions were made as to how they would be used as guidelines in Kenya. Planning would be adopted, and nationalisation used when appropriate. The occasions for nationalisation would occur (i) when the assets in private hands threaten the security or undermine the integrity of the nation; or (ii) when productive resources are being wasted; or (iii) when the operation of an industry by private concerns has a serious detrimental effect on the public interest; and (iv) when other less costly means of control are not available or are not effective". (Ibid. p.27).

Also much emphasis, in the publication liberally quoted here, was put on Africanization. Now it is difficult to see how such an approach squares with any philosophy labelled 'socialism', a term correctly associated with notions of social justice and egalitarianism and not with racial or ethnic favouritism. However, this anomaly was clearly not thought to matter. In the matter of Africanization, the Kenyan D.F.I.s were seen to have an important role. "...the Land Bank, the Agricultural Finance Corporation, the Industrial and Commercial Development Corporation and the Marketing Boards" should make "capital available to Africans with small down payments and at low interest rates". (Ibid. p.29). Furthermore, the Development Finance Corporation of Kenya, the Kenya Tourist Development Corporation and the I.C.D.C. were to ensure government stakes in large-scale investments. Joint ventures were to be favoured, so avoiding total foreign control of new firms, and it was proposed that some types of business be reserved to African participants. Existing foreign enterprises were expected to provide for increasing African involvement in ownership, and "both foreign and domestic firms should be required to provide training facilities for Africans at all levels". (Ibid. p.30).

## IDEOLOGY IN PRACTICE IN KENYA

The ideas discussed above do not provide much of a blueprint for policy. Also, of course, much of what was identified as traditional African socialism in modern dress could equally be pigeonholed under a 'nationalist' label, an equation already considered in an earlier chapter. This is obviously true of pervasive state intervention in pursuit of economic growth, a suspicion of foreign business interests resulting in the imposition of controls on them and the preference for joint ventures, and Africanization in all its aspects. Furthermore pragmatism and the whims of politicians played their full parts in Kenyan history after independence.

Perhaps the only rigid application of a principle derived from the Kenyan conception of African socialism was the institution of a one-party state, but with the leader seemingly not in practice being subject to the 'checks and balances' that constrained the autocracy of tribal leaders in traditional society. Indeed, even to describe independent Kenya as a one-party state falls short of the truth, for under Jomo Kenyatta it was increasingly subject to economic and political domination by the Kenyatta family, sometimes cynically known as the 'royal' family (Miller 1984 p.59). Presidential influence was used to gain advantages for this group, and - often in cooperation with multinational corporations - it developed business activities in many disparate fields, such as ranching, gemstones, insurance, and casinos (Ibid. p.59). As the Economist Intelligence Unit (1986 p. 25) observes, "President Kenyatta's Kenya, in spite of protestations about 'African Socialism' was a country where the allocation of resources was guided by market forces, heavily influenced by political muscle and family connections". Inevitably civil servants and indigenous businessmen sought to emulate the prosperity of the ruling clique, so extending the network of nepotism and patronage. Miller (op. cit. p.37) explains, "Taking their cue from the top leadership, civil servants engaged increasingly in outside business interests. Simultaneously, independent black businessmen grew in numbers and took their place in the middle class. The two groups fused and formed an economic patron-client system that derived power and resources from the government and garnered support from clients in exchange for a share of the resources".

The assumption of power by Moi after Kenyatta's death in 1978 did not appreciably change the politico-economic arrangements. To quote again from Miller (op. cit. p.99), "The Moi regime kept the same government structure, the same policies, and even the same informal process that saw much of the day-to-day policies carried out by special-interest groups". However, whereas Kenyatta was a "political monarch", Moi was an "astute political survivor".(Ibid. p.99). (U.S.) A.I.D. (1990 p.I-3), while not even considering it relevant to pronounce on 'socialist' aspirations, commented on the decline in democratic arrangements that followed from the rise of the personal-cum-oligarchic rule, noted above. "While the situation is far better in Kenya that in many other African nations, there has been a steady deterioration over the past few years in both the number and the role of democratic institutions". The inevitable corruption that developed from the emergence of a privileged elite is trenchantly observed: "The Kenyan case has long been marked by a tension between market forces, entrepreneurship and technocratic management on the one hand, and paternalism and what has been termed 'crony capitalism' on the other". (Ibid. p.I-4) (2).

Comment, therefore, does not see much evidence of 'socialism' in modern Kenya. Even Africanization, a policy with very dubious 'socialist' credentials has sometimes lost out to ad hoc pragmatism. As the E.I.U. observes, "In spite of populist rhetoric....multinationals in Kenya have no fears about their ability to get work permits for the foreign workers they want". (E.I.U. op. cit. p.40). And, as Leys points out, (1975 p.208), "The foreign middle class had to be treated with great circumspection if new foreign capital was not to be frightened away i.e. it had to be ritually humiliated while practically wooed".

The politico-social situation where hard philosophy has in all meaningful senses given way to the self-seeking predilections of an entrenched ruling elite and their supporters, and where a sort of painful but vacillating accommodation has been made with foreign business interests, is well-fitted to deliver economic inefficiency. (U.S.) A.I.D. (op.cit. pI-1) observes, "Government policies and bureaucratic procedures continue to hinder expansion of private enterprise and make it difficult for farmers and entrepreneurs to take advantage of opportunities", and "...the problem of entrenched bureaucratic interests, a result of continuity, is an explanation for slow implementation of policy reforms". (Ibid. p.I-2). It may at this stage be intimated that the prospects for Kenyan D.F.I.s, in the light of the above discussion, would not appear to be encouraging.

Clearly, the above scenario, if fair, coincides with the idea, discussed in the opening chapter, of a 'soft' state. There, such phenomena as "overcentralised government, which undermines local initiatives" (p.6), "the collusion of government officials and top civil servants with powerful individuals and groups whose conduct they are supposed to regulate" (p.5) were referred to. These things appear to have existed (and still to exist) in Kenya.

## POLITICS AND IDEOLOGY IN ZIMBABWE

In Zimbabwe at the time of independence propoganda was very firm in its espousal of 'socialist' principles. However, these principles had little to do with the vaguenesses of 'African' socialism, with which Kenya flirted: they were rooted much more in the beliefs of Marxist-Leninist thinkers. This position owed much to the ideas of the new prime minister, Robert Mugabe, an avowed Marxist, who gained support from wanting the wealth of the settler- and foreign-dominated economy redistributed in favour of the impoverished African people. An official Z.A.N.U. (i.e. Zimbabwe African National Union) statement, referred to in a Zimbabwe country study, was uncompromising in its advocacy of this philosophy: "In ideology ZANU is guided by the Marxist-Leninist Principle. ZANU aims to achieve a socialist revolution. All the means of production and distribution will be publicly owned by the people of Zimbabwe. Economic cooperation will be established and strengthened with the socialist world so as to bring capitalist U.S.A., Britain, West Germany etc., to ultimate doom". (Foreign Affairs Study: the American University 1983 p.205).

In other official publications, indication is given of what was to be expected of socialist Zimbabwe. For example, Mukarati, in the UNIDO publication 'Zimbabwe: Towards a New Economic Order' (1980 p.19) explains that the intention in agriculture is towards the creation of state farms, and - ominously for agricultural efficiency - "The task of a 'manager' can early be taken up by a politically advanced cadre with experience in farming". And, with regard to manufacturing, Nyathi-Mdluli (Ibid. 1980 p.91) writes, "The socialist state can only create a socialist mode of production by establishing social ownership of the means of production through nationalisation". The Zimbabwe Banking Corporation, stressing more the likelihood of strong state involvement in the economy, states, ".. a much more interventionist economic policy aimed at rapidly improving economic and social conditions for the majority of the population can therefore be anticipated". (Z.B.C. 1980 p.2). However, despite the concern that independence might bring a quick implementation of these and analogous suggestions,"....assurances (by Mr Mugabe) have been given to the white population and business community that any changes in current policies will be implemented on a gradual basis". (Barclay's Bank 1980 p.1).

The Transitional National Development Plan 1982-3 to 1984-5 is long on rhetoric about socialism, but short on specific policies for implementation. In the 'Foreword' President Mugabe asserts,"Our firm belief is that it is only within the framework of a planned economy that Government is better able to influence and purposefully direct development, create appropriate institutions, and establish the magnitude of investment and its allocation as well as the formation of a pattern of income and wealth distribution in harmony with socialist objectives. The role of Government in the development of our national economy is indispensible if we are to move speedily towards the establishment of the socialist state we envision". Reflecting these aspirations, the main text goes on to say, "Lasting economic and political stability....requires, among other things, a deliberate and sustained process in the direction of social ownership of the means of production, equitable distribution of income, and popular participation in the management of development". (Transitional Plan 1982 p.1) For good measure, obeisance is made to neo-colonialism -"The problem situation in independent Zimbabwe is that created by the inherited system of capitalist exploitation that invariably assumes a neo-colonialist form in Third World countries" (Ibid. p.17) - and nationalism - "This pattern and structure of property relations, "that is, foreign control of technical knowledge and much of the capital stock, "is obviously opposed to the socialist and nationalist principle of vesting the ownership of our country's resources in the people of Zimbabwe through their socialist or State organs".(Ibid. p.3) (3).

Participation by the Zimbabwe government in industry, and controls on foreign firms are best left to the discussion on D.F.I.s. For the rest, socialism in practice came mainly to mean substantial expansion of the social services, especially education, a much more pervasive role for the state in general and the implementation of 'self-help' schemes for the creation of basic amenities, mainly in the rural areas. However, overall there were no radical changes, and the structure of society remained largely unaltered, with the salaried African middle class expanding inexorably as administrators and businessmen multiplied. Furthermore, despite the predilections of the prime minister for a one-party state - "..in line with our Second Congress Resolution we pledge to work towards the attainment of a one-party state" (Mugabe 1985) - clauses in the 1980 Lancaster House agreement prevented it - for the time being - happening.

Fiery rhetoric on socialism became less in evidence as the 80s decade progressed. The 1986-90 National Development Plan more or less restricted itself to economic issues with only limited reference to ideological considerations. For example the assertion that "Government intends to control industries which are deemed strategic to socio-economic development" (First 5-Year National Development Plan 1986 p.30) is a very tentative statement about public ownership. Indeed, elsewhere, the Government resolved, in the mining sector, to "encourage exploration by the private sector and international partners". (Ibid. p.29). And by 1989, pragmatic support for the private sector meant that obeisance to socialist principles in industry was little more than ritualistic. As 'The Promotion of Investment: Policy and Regulations' of April 1989, stated (p.4), "The Government recognises the important developmental contribution that the private sector, both local and foreign, can make by increasing investment in Zimbabwe".

By the end of the decade, Zimbabwe had achieved a socio-political economic system much the same as most other sub-Saharan African countries. A large political and administrative elite lived lives of privilege and affluence far above the lives of the bulk of their countrymen (4). Though there was a substantial loss-making parastatal sector (5), most industrial, commercial and agricultural undertakings remained in private hands. A trenchant comment from a successful Zimbabwean businessman underlined the position: "It's just as well Zimbabwe learned from the mistakes of other newly-independent countries and did not try to interfere and to nationalise industry. The Government has recognised and accepted the private sector, and that was a wise decision". (Zimbabwe: a Field for Investment 1989 p.33). An uneasy and fluctuating relationship was had with foreign economic interests who were, as will be seen in later discussion, at the same time relied on and hampered.

Though a theroretical commitment to a socialist one-party state remained, criticism of the idea was (and is) open. Dr Byron Hove - already quoted in Part 1, Chapter 3 - suggested that one party systems led to sluggishness, inertia, and corruption, and prevented people participating in decision-making processes (Financial Gazette 16-2-90 p.4). Furthermore,"The motivating force behind a one-party state dogma is to install dictatorship by one or more individuals". (Ibid. p.4). And J.N. Moyo, also quoted earlier, commented,"1988 showed that socialist propoganda serves no useful purpose in a country with a leadership under the spell of materialism". (Southern Africa Political and Economic Monthly Feb 89 p.10). To date Zimbabwe continues to be a pluralist democracy, though it must be admitted that at election time the pervasive optimistic exposure given to the main political party, ZANU, gives other parties little chance to make much of an impact. The progressive establishment of economic and social structures based on doctrinaire socialism has in practice been put to one side, and this has been affected by the requirements of structural adjustment, which expects a more open, market-orientated economy.

SUMMARY

To summarise the discussions on the respective ideological styles of Kenya and Zimbabwe, it is apparent that each started from a somewhat different theoretical base, and that the practical outcomes have not been in accord with the implications of these bases.

The uncompromising socialism of Zimbabwean rhetoric has never been realised. Nationalisation has been limited in extent, and large scale industry remains - both in terms of ownership and senior management - in predominently Zimbabwe-European or expatriate hands. Freedom of expression is permitted, and Zimbabwe is still - technically at least - a multi-party state. Possibly one advantage of the country coming late to legal independence was, as was suggested in Chapter 1, that it could observe and learn from the mistakes made by African countries who were free from colonial rule earlier (6).

Kenya started from the much vaguer and imprecise tenets of 'African' socialism, which were deemed to justify a swift transition to a one-party state. Coupled with the fact that freedom of expression has been less than in Zimbabwe, this appears to have resulted in a much greater concentration of power and privilege in a ruling elite. Though there is substantial state ownership, most industry remains in private hands, and the philosophy is capitalist.

It may be concluded that in socio-political terms Zimbabwe and Kenya do not in practice present as very different. How much each suffers from the 'soft state' syndrome is another matter, but in the later core analysis on D.F.I.s, the issue will be explored.

NOTES PART 2 CHAPTER 2

1. There is some evidence for this in Africa. Zaki Ergas, though refering to the Oyo in West Africa, writes in 'The African State in Transition' (1987) p.4. "There were effective 'checks and balances' between the three 'branches' of government, and the King was by no means a ruthless tyrant or despot. He could, in fact, be impeached".

2. Though it has something of a 'slang' ambience, 'crony capitalism' as a term has become established to describe a context where the rewards supposedly bound up with capitalist production are distributed to friends, relatives, political clients, and so on. (See Part 1 Chapter 2 on the 'patrimonial' system). Clearly, such arrangements are prone to deliver economic inefficiency.

3. These quotes well illustrate the sort of confusion that used to exist in developing countries between ideas derived from separate nationalist and socialist dogmas.

4. An interesting observation related to this point comes from the (Zimbabwe) Financial Gazette of 15th Sep. 1989 (p.4), where William Fernham, a specialist in international finance notes that in the parliament of 100 members, 52 were ministers.

5. In 'Parastatals - no end yet to the muddle' (p.11) in Parade June 1988 is the observation, "According to informed sources, the Zimbabwe Goverenment is ulikely to get much needed assistance from the World Bank if it continues to subsidise money-losing enterprises like Air Zimbabwe and the National Railways of Zimbabwe".

6. President Mugabe lived in Mozambique in the late 1970s, and witnessed the dire effects on the economy of that country when most of the skilled Portuguese left. This could hardly have failed to influence his attitude to policy in post-independence Zimbabwe.

# Chapter 3

# THE ECONOMIC PROFILES OF KENYA AND ZIMBABWE

## STATISTICAL SHORTCOMINGS

An inevitable problem in looking into the economic profile of any country is the unreliability and incompleteness of the available statistics. This is especially true of developing countries, where to the problems of collecting data from the monetary sector are added the almost insoluble puzzle of working out the statistical dimensions of the non-monetary sector. Thus, in the data employed later in the text, there are sometimes gaps, and different sets of figures referring to the same economic phenomena do not always exactly agree if derived from different sources.

## THE GENERAL AIM OF THE CHAPTER

The purpose of this chapter is not to investigate the economic structures and recent economic experiences of Kenya and Zimbabwe as an end in itself, but to identify and comment on those features which may have some bearing on (i) the justification and necessity for economic development and, by implication, the finance of it, (ii) the constraints on the finance of development arising from the nature of the economic structures and economic experiences of the two countries, and (iii) the recommended directions of development in the secondary and tertiary sectors.

There is no especial focus on D.F.I.s, for at this point in the progress of the analysis the necessity for them in Kenya and Zimbabwe has not yet been established. However a case in favour of development and the finance of it does validate the possibility of establishing D.F.I.s, so reference to them is not entirely absent from forthcoming sections.

## THE STRUCTURE OF THE CHAPTER

(a) Preliminary remarks.

The next main section looks at the economy of Kenya, the one after that at the economy of Zimbabwe, and finally there is a concluding section.

The investigation of the economic profile of each country will be focussed on the three issues stated in the 'General aim' section, and to this end the topics covered will be 'Population and national income', 'Investment and saving', 'The government sector' and 'Trade and payments'. To avoid repetition, 'introductions' to these topics follow straight on this sub-section, and can be taken as ushering in the 'applied' discussions with the same titles in each of the 'country' sections.

(b) Introduction to 'Population and national income'.

It is a truism to assert that virtually every country, desirous of achieving higher living standards and presenting a more powerful national profile, makes economic growth a major goal. That in itself validates the business of development finance and, in appropriate contexts (see Part 1 Chapter 4 and 5 and Part 2 Chapter 4) the establishment of D.F.I.s. However, a more urgent issue is to look into not only the desirability of development but the necessity for it. In other words, how important is economic development not only to enable a country to forge ahead, but to stop it falling behind? In this context population growth and national income growth are crucial variables on which to focus.

(c) Introduction to 'Investment and saving'.

In the immediate post-second world war decades, too much emphasis in development studies may perhaps have been laid on finance as the engine of economic growth, with a consequent underplaying of other factors (1), and indeed the principal aim of the present piece of work as a whole is to highlight the importance of certain of those other factors. However in the context of an economics-orientated chapter it is appropriate to focus on the principal financial factors that are contributory to the furthering of economic development. This suggests a study of real investment and savings.

(d) Introduction to the 'Government sector'.

Government intervention in economic activity inevitably must have a major impact on the finance of development and, since they are part of the scenario, on specialised development finance institutions. The relevant sections on Kenya and Zimbabwe look at the broad issue of government economic involvement in terms of the taxation/ spending role, government's profile and record as the owner and operator - sometimes fairly indirectly - of parastatals, and government's position as an agent for structural adjustment measures.

(e) Introduction to 'International trade and payments'.

The discussions in the sections on 'International trade and payments' consider the profiles of goods and services traded by Kenya and Zimbabwe. This gives some clues as to the industries that might fruitfully be developed in those countries as producing goods which substitute for imports or goods and services which, by making use of local resources or other advantages, can earn revenue as exports.

KENYA

(a) Data sources and currency.

The figures that appear in this section are derived from various Kenya government publications, and from the U.N.D.P.'s 'African Economic and Financial Data' (1989). Though the standard currency unit in Kenya is the Kenya Shilling, and prices are always expressed in shillings, the government, to cut down cumbersome numerical expressions, likes to present monetary values in Kenya Pounds (K£). Twenty shillings, of course, equal one pound.

The U.N.D.P. expresses values in U.S.$, and when appropriate, as in G.N.P. per capita, uses the World Bank Atlas conversion method to obtain equivalent dollar values, rather than the current exchange rate between the indigenous currency and the U.S. dollar (2).

(b) Population and national income.

For a number of years Kenya appears to have had one of the highest rates of population growth of any country in the world, the annual rate of increase having been slightly over 4%. The following table shows how numbers have as a consequence been rising. (The figure for 1988 and the alternative for 1987 come from the Kenyan Statistical Abstract for 1988, and the differences, the result of expected collection difficulties, are too small to matter.)

**TABLE 1**

Kenyan Population (mil.)

| **1980** | **1981** | **1982** | **1983** | **1984** |
|---|---|---|---|---|
| 16.63 | 17.30 | 18.01 | 18.75 | 19.53 |
| **1985** | **1986** | **1987** | **1988** | |
| 20.35 | 21.21 | 22.10 | | |
| | | 21.80 | 22.70 | |

SOURCE: UNDP - African Economic and Financial Data 1989 Table 1-2.

The clear significance of this rapid growth is the necessity for the economy to expand at a consistently high rate just to keep the average standard of living stable.

The earlier years of Kenyan independence saw rapid economic expansion, as boom conditions in the west led to increased demand for primary goods from the agricultural sector, and Tanzania and Uganda, Kenya's partners in the East African Community, took increasing amounts of manufactures. On the basis of this growth in exports, Kenya built up its import substitution industries. Thus it is believed that from 1964 to 1974 real G.N.P. rose by an average of about 7.5% a year, well ahead of population growth (World Bank 1985 p.10). However some years later, comment on this apparently successful period became critical. A government publication of 1986 (p.17) observes, "During the 1970s, import substitution took place behind high protective barriers and Government encouraged many large-scale investments - including its own - at high cost to the economy. The result is an industrial sector that, although it sometimes earns handsome profits, still produces at costs well above those in world markets...". The problems arising from oil price rises, world recession in the early 1980s, the demise of the East African Community in the 1970s, and the drought of 1984 cut this growth down to an average of 4.5% a year from 1974-84. (Ibid. p.10). It is probable though that the rate of growth was markedly lower after 1980: indeed (U.S.) A.I.D. (1990) believes that average per capita income fell by 0.2% a year from 1981-4.

Furthermore in more recent years G.D.P. growth has barely kept pace with population, as Table 2 shows.

**TABLE 2**

G.D.P. AT FACTOR COST (1982 PRICES)

| | **1981** | **1982** | **1983** | **1984** | **1985** | **1986** | **1987** |
|---|---|---|---|---|---|---|---|
| Total GDP (K£m) | 2860.14 | 2998.24 | 3061.64 | 3091.78 | 3240.13 | 3416.82 | 3580.8 |
| Rate of Growth (%) | | 4.8 | 2.1 | 0.9 | 4.7 | 5.4 | 4.7 |
| GDP Per Cap. (K£m) | 164.94 | 166.25 | 163.57 | 158.7 | 160.08 | 162.54 | 164.06 |

SOURCE: (Kenyan) Annual Abstract of Statistics 1988 Table 38(b).

(The Kenya Economic Survey for 1989 in its Table 2.1 gives marginally higher figures for the smaller span of years it covers, and suggests that in 1988 a G.D.P. of K£3838.45m led to a per capita G.D.P. of K£169.39).

The above figures suggest that in the 1980s Kenyan average real income per head was more or less static. However, according to the U.N.D.P., the situation was rather more dismal. Working with real U.S.$ equivalent, it is reckoned that from a high point of $422 in 1981, per capita income fell to $300 in 1985 before picking up to $330 in 1987 (U.N.D.P. op. cit Table 1-16).

To conclude, the plus side of the above scenario is the substantial average rate of economic growth over the long period. The worrying aspect is the flagging in recent years and hence the increasing difficulty of keeping consistently ahead of the rising population. There is no doubt, therefore, that an ongoing high rate of economic growth is vital just to keep Kenya - in standard of living terms - standing still.

(c) Investment and Saving.

1. Recent Kenyan experience.

In the above sub-section it emerged that economic growth in Kenya was unsatisfactory when considered against population growth. It is important, therefore, to look at the level and financing of investment First of all, investment in relation to G.D.P. is shown in Table 3 below.

**TABLE 3**

INVESTMENT AND SAVING IN KENYA (% OF GDP)

| | **1980** | **1981** | **1982** | **1983** | **1984** | **1985** | **1986** | **1987** |
|---|---|---|---|---|---|---|---|---|
| Gross Domestic Investment (GDI) | 30.0 | 28.4 | 22.1 | 21.2 | 23.5 | 20.1 | 22.6 | 24.6 |
| Gross Domestic Savings (GDS) | 18.7 | 19.5 | 18.3 | 20.1 | 22.1 | 19.0 | 22.6 | 19.6 |
| Gross National Savings (GNS) | 15.8 | 17.8 | 15.6 | 18.0 | 19.8 | 16.6 | 19.8 | 16.7 |
| Resource Balance | -11.4 | -8.9 | -3.8 | -1.0 | -1.4 | -1.1 | -0.1 | -5.1 |

SOURCE: UNDP - African Economic and Financial Data 1989 Tables 1-9 to 1-12.

It is estimated that in 1988 gross investment was equal to about 26% of G.D.P., which would suggest a continuation of the recovery shown in Table 3. Furthermore, these figures were amongst the highest in sub-Saharan African countries. However, although the 1989 Economic Survey makes a point of commenting favourably on this trend, it is only a recovery from a low point in the mid-80s. As seen above, the percentage at the start of the decade was much higher.

In purely arithmetic terms - avoiding for the present foreign exchange considerations - the investment could not be financed from domestic savings, since savings as a % of G.D.P. were always less than investment as a % of G.D.P. The 'resource balance', which is the difference between G.D.I. and G.D.S. (see Table 3) is rather misleading as an indicator of the necessary foreign contribution to investment, as it ignores the fact that some of the savings had to go abroad to service foreign assets in Kenya: this, however, is duly taken into account in the G.N.S. figures. Hence investment funds equal to variable amounts of the G.D.P. - anything from 3% to 15% - have had to be found from foreign sources. It is also worth noting that an unspecified amount of domestic saving is 'forced' saving by foreign business, which is faced by restrictions on profit repatriation (see later) to retain funds in Kenya.

Hence the financing of this investment was as in Table 4.

**TABLE 4**

FINANCING OF INVESTMENT IN KENYA

| | **1984** | **1985** | **1986** | **1987** | **1988 (prov)** |
|---|---|---|---|---|---|
| Grants from Abroad (K£m) | 92.55 | 108.69 | 117.71 | 126.99 | 205.27 |
| Net Borrowing from Abroad (K£m) | 86.30 | 79.90 | 31.06 | 409.47 | 403.01 |
| Domestic Saving (K£m) | 749.83 | 1102.44 | 947.20 | 1088.50 | 1343.77 |
| Foreign Contribution as % of Total | 19.26 | 14.60 | 13.57 | 33.01 | 31.16 |

SOURCE: 1989 Economic Survey Table 2.7.

Towards the end of the decade a substantial share of investment was having to be financed from abroad. As the 1989 Economic Survey observes, "A large share of foreign resources invested in fixed assets was in the form of loans from friendly countries (e.g. mainly U.S.A., Japan and West Germany) and international agencies such as the World Bank and the E.E.C. Grants from friendly governments doubled from K£109m in 1985 to K£205m in 1988". (1989 Economic Survey p.21-22).

However in contrast to this, what is indeed striking is the small inflow of new capital funds from non-official sources abroad. Lack of statistics make it impracticable to treat this issue comprehensively - non-official foreign loans for example are in the available data taken to include local surpluses that are reinvested - but it is clear from balance of payments statistics that net inward foreign direct investment plummeted from 78m U.S. dollar equivalent in 1980 to 3m in 1981 before later recovering somewhat (see Table 5). It is possible that the U.S.$37m for 1987 is an error: the 1989 Kenyan Economic Survey suggests a net K£9.99m (Ibid. Table 7.14) inflow, which has the much smaller official exchange rate dollar value of $12.1m.

**TABLE 5**

NET FOREIGN DIRECT INVESTMENT IN KENYA (CURRENT U.S.$m)

(N.B. Included in the 'foreign borrowing' figures in Table 4)

| 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 |
|---|---|---|---|---|---|---|---|
| 78 | 8 | 3 | 9 | 4 | 13 | 28 | 37 |

SOURCE: UNDP - African Economic and Financial Data Table 2.8.

It is not possible to judge the efficiency of investment in terms of output since figures for net capital formation are not available. Even the 1989-93 Development Plan cryptically observes, "....it has been generally assumed that the sectoral Incremental Capital Output Ratio (ICOR) values will either stabilise at about the average level observed during the last few years or rise slightly over time". (Government of Kenya 1989 p.50-51) but gives no figures! Anecdotal evidence, however, suggests that the overall ICOR has been disappointing.

2. Comment.

As noted earlier, Kenya's population has been rising fast In consequence, for per capita income to increase economic growth has to accelerate. More efficient use of existing resources can go some way towards achieving this. The government publication quoted above identifies the existence of unused plant and equiment (p.17): "High protection often leads to overbuilding of industrial plant and may be responsible for some of the excess capacity observed in Kenya manufacturing today. The demise of the East African Community in the 1970s also created excess capacity". In so far as faster economic growth can be achieved by a higher level of investment, more resources are required. However, unless government decides to commandeer a smaller proportion of the G.N.P. via taxes (see later), it is probably not realistic to prescribe that those resources come from more domestic saving. Amongst low average per capita income sub-Saharan African countries, designated 'IDA-eligible', Kenya's savings/G.D.P. ratio has been one of the highest, and indeed, as Table 3 shows, has over the years been remarkably constant. The answer is to bring in more funds from abroad. Government policy and negotiation has much to do with this, but D.F.I.s may have a role, (noted in Part 1 Chapter 5) as channels for the movement in of money, and as agents in partnership ventures and extension help.

(d) Government sector.

1. Public Finance.

The figures in Tables 6 and 7 and the comments that follow them testify to the substantial increase in the Government's weight in the Kenyan economy as a user of the national product

**TABLE 6**
GOVERNMENT REVENUE AND EXPENDITURE IN KENYA (K£m) (rounded figures)

**TABLE 7**
% INCREASE BETWEEN COLS 1 & 3 IN TABLE 6

| | 1<br>1984/5 | 2<br>1986/7 | 3<br>1988/9 | Table 7 |
|---|---|---|---|---|
| Current Rev. | 1017 | 1387 | 1890 | 86 |
| Current Exp. | 1091 | 1517 | 2140 | 96 |
| Current Surplus | -74 | -130 | -250 | 236 |
| Capital Rev. | 3 | 3 | 8 | 208 |
| Capital Exp. | 218 | 326 | 393 | 81 |
| Net Lending | 37 | 48 | 84 | 127 |
| External Grants | 71 | 63 | 367 | 420 |
| Deficit | 256 | 437 | 352 | 38 |

N.B. A 'minus' surplus, of course, implies a deficit

SOURCE: 1989 Economic Survey Table 6.1.

Current revenue rose from 22.9% of G.D.P. (current market prices) in 1984/5 to 24.8% in 1988/9 but total government expenditure went up from 34.5% to 39.4% (1989 Economic Survey p.63). Despite substantial external grants (see Table 6) a large deficit remained each year, and had to be covered by foreign and domestic borrowing. Indeed domestic borrowing at K£169.4m in 1988/9 rose by over 93% in 5 years (Ibid. p.62).

It is not self-evident that government resource requirements on this scale are a cause for concern, unless clear disadvantages can be identified. Also, to be fair, Kenya in this area has not been out of line with many other African countries. However there are a number of reasons for concluding that government spending has been excessive. and indeed, the conditions of Structural Adjustment (see below) advised that there be cuts.

Firstly, the base for levying income taxes is small, because the great majority of people do not receive money incomes, receive money incomes too meagre to be taxed, or have money incomes that cannot accurately be assessed. As a result, the few in receipt of both substantial and identifiable incomes bear a heavy tax burden. And there has to be heavy reliance on indirect taxes". For the last three years sales tax has displaced income tax as the most dominant source of revenue". (Ibid. p.65) - a policy which discriminates against the less well-off.

Secondly, internal borrowing has had the potential to crowd out private borrowing, since financial regulations (see later for details) 'require' institutions to take up government securities at whatever interest rates government chooses to offer. "Since the central bank works for the Government the Government and its parastatals have first call on banking system credit". ((U.S.) A.I.D. op. cit. Part p.II-18). Perhaps in Kenya 'crowding out' in relation to the actual availability of Kenyan resources has only been part of the issue. A further significant point is that scarce foreign currency has been less available to the private sector and to private investment due to large government requirement (3).

Thirdly is the possible effect of government financing on the money supply and inflation, which reached around 15% per annum in 1989.

Fourthly, continuous borrowing from abroad can soon accumulate a large foreign debt into a sum which, if the money has gone into current spending or poor investments, cannot be serviced. Total Kenyan government foreign debt in 1988 was reckoned at the equivalent of K£2717.41m, which equals nearly half the national income. Furthermore in 1987 Kenya's debt service/export ratio was 41.7% (African Economic and Financial Data Table 3-21) - one of the highest amongst 'I.D.A. recipient' African countries - and the proportion of its total foreign grant and loan receipts on non-concessional terms was, at 34.2%, the highest in this group except for Nigeria (Ibid. Table 3-21).

Fifthly, few developing world governments have given much proof of being able to handle large expenditure programmes with integrity and efficiency. The paragraphs that now follow well illustrate this in relation to Kenya.

2. Parastatals.

At the time when independence was achieved the government of Kenya was not preaching standard Marxist socialism, so large scale nationalisation undertaken as an ideological necessity did not occur. However, the government inherited a number of state-run industries, such as Kenya Railways, and the establishment of new concerns or the take-over of run-down foreign firms, largely through the D.F.I.s - which are themselves mostly parastatals - greatly increased state participation in industry and commerce.

The theory of the parastatal sector was expressed in terms of Kenyanisation. Supposedly African people were short of three central elements in the build-up of new private sector ventures, that is, savings for ploughing into business, management expertise and entrepreneurial flair. Parastatals would therefore in the short term substitute for the inability of Kenyan people to create successful businesses themselves, though in due course they would be sold off to the private sector. The obvious question as to where good managers and entrepreneurs would come from - in a country short of these skills - to run the parastatals was never properly addressed.

In practice very little divestment has taken place. There are several reasons for this.

Firstly, parastatals have in general been financial catastophes. As the World Bank put it, "....the vast majority of the enterprises in which the public sector has a majority interest, and many in which it is only a minority shareholder, are unprofitable and inefficient". (World Bank 1985 p.12). It goes on to castigate them as "undercapitalised". and "neither economically nor financially viable". (Ibid. p.12). The basis of this unviability does not need to be discussed in detail here, as the subject is comprehensively covered later in relation to D.F.I. experience: however, a couple of observations may usefully be made. Poor management is identified by the World Bank as a significant factor. "For all firms", that is, state firms, "it is of utmost importance that qualified management be in place". (Ibid. p.15) Also, (U.S.) A.I.D., in an observation that applied equally to ministries and parastatals, pointed out that employment in government had been going up by 4.6% per annum during the 1980s, to become 50% of total wage employment in 1988, and so commented that the government had become "employer of last resort". ((U.S.) A.I.D. 1990 p.I-8). Consequent on developments such as these, costs have been high and losses have resulted. Indeed, the World Bank reckoned that in 1983 7.2% of the Kenya government budget was devoted to propping up parastatals. Obviously, even if offered them, the private sector would have been unenthusiastic about buying such concerns.

Secondly, to quote the World Bank (1985 p.12), "Because of political and social considerations, the Government has generally been reluctant to liquidate even intrinsically non-viable parastatals". This observation contains a number of inexplicit intimations, but it is not inconsistent with the discussions in Chapter 3 Part 1, where it was suggested that government economic influence may be wielded to reward political supporters and to generate income for officials who have extended families to finance.

Thirdly, it may be argued that government could not sensibly afford to divest itself of those few parastatals that do make money, since the losses on the rest are so much larger. (See later discussion about D.F.I.s).

Fourthly, the very scale of government involvement in some concerns inhibits divestment. In many instances, sufficient local capital funds could not be generated, and selling to foreign interests would be politically unacceptable.

Attempts in the late 80s to address the shortcomings of parastatals failed to get to grips with the underlying malaise. Better reporting systems, attempts to limit financial assistance to parastatals, and the creation of an investment trust to facilitate a modicum of divestment do some good, but a sheltered monopoly position, over-employment - often of unqualified people - and patronage require a tougher approach.

3. Structural adjustment.

The accumulating internal economic shortcomings in Kenya were brought to a head - as they were in many developing countries - by the problems arising from huge oil price rises in 1973/4 and 1979/80 and the associated foreign debt. The end result was the imposition of Structural Adjustment in the early 80s, whereby Kenya received credits from the I.M.F. and the World Bank in exchange for drastic economic restructuring. The aim was freer markets and less government intervention, which implied in Kenya the liberalisation of imports, adjustment of an over-valued exchange rate and a more streamlined private sector capital market. Also, government was advised to cut its spending in relation to G.D.P. By the late 1980s however government spending as a % of G.D.P. was in fact higher than it had been at the beginning of Structural Adjustment. The government's own rather low-key observation on this was, "Demand for more and better public services has led to increased total public expenditure". (Economic Survey 1989 p.62)

4. Comment.

Government involvement with the economy of Kenya seems to have been more a constraint than a promoter of development. The substantial transfer of national resources to government reduces the pool of resources available for development, except, of course, in so far as government uses them for capital projects or transfers them to D.F.I.s. Also the heavy government requirement for foreign exchange thwarts the effectiveness of and hence the enthusiasm for investment by hampering the ability of firms and corporations to buy abroad. Finally the poor state of parastatals will debilitate industry in general by providing unreliable and high cost goods and services. D.F.I.s that have money in them will lose out, and also - since most D.F.I.s themselves are parastatals - will suffer from the same weaknesses as the rest.

(e) International trade and payments.

Table 8 shows the principal categories of exports and their relative importance in the totals.

**TABLE 8**

PRINCIPAL KENYAN EXPORTS

| | **1987** | | **1988 (prov)** | |
|---|---|---|---|---|
| | **Value (K£m)** | **% of Total** | **Value (K£m)** | **% of Total** |
| Coffee | 194.57 | 25.8 | 244.55 | 26.6 |
| Tea | 163.37 | 21.7 | 185.26 | 20.2 |
| Petroleum Prods. | 95.36 | 12.6 | 110.31 | 12.0 |
| Miscellaneous | 187.47 | 24.9 | 244.08 | 26.6 |
| TOTALS | 753.41 | 100.0 | 917.72 | 100.0 |

SOURCE: 1989 Economic Survey Table 7.8 (adjusted).

Clearly, exports rely very heavily on primary crops, and their relative importance has not changed for many years. 'Petroleum products' represent the onward sale of fuels and lubricants to neighbouring countries of imported oil that has been locally refined. 'Miscellaneous' subsumes substantial manufacturing exports, and in this area Kenya is ahead of most African countries.

Nearly half Kenyan exports go to the E.C., with the U.K. being the largest single market. Africa takes about 26% of exports, and Kenya has some advantage in selling to African countries because its manufacturing industries are more developed than those of any country on the eastern side of the continent except Zimbabwe, and it is a member of the Preferential Trading Area, an association of African eastern and south-eastern nations that is in being to promote freer trade. The P.T.A. is still some way from being a totally free trade region, and despite its existence transport logistics result in Kenya's African exports predominantly going to nearby countries, that is Uganda, Tanzania, Rwanda and Burundi. Also, it is a matter of debate whether, given the desire of most African countries to industrialise, Kenya will be permitted indefinitely to exploit its local comparative advantage in manufacturing (4).

Imports in 1987 and 1988(prov) were valued at K£1430.88m and K£1765.14m respectively. (Ibid. p.82). The percentage composition of imports is given below.

**TABLE 9**

COMPOSITION OF KENYAN IMPORTS (% OF TOTALS)

| | **1984** | **1986** | **1988** |
|---|---|---|---|
| Food and Beverages | 11.6 | 8.7 | 5.7 |
| Industrial Supplies | 26.4 | 30.5 | 36.4 |
| Fuel and Lubricants | 30.3 | 17.8 | 13.9 |
| Machinery and other Capital Equipment | 16.9 | 19.0 | 23.5 |
| Transport Equipment | 10.3 | 19.4 | 15.1 |
| Consumer Goods | 4.3 | 4.5 | 5.3 |
| Other | 0.2 | 0.1 | 0.1 |

SOURCE: 1989 Economic Survey Table 7.9.

The points to notice about the above are the substantial rise in the relative proportion of imports made up of capital goods, and the small relative rise in consumer goods imports. Since imports as a percentage of factor cost G.D.P. have remained at around the 30 mark for some years (calculated from Ibid. Table 2.6) the former indicates not only the drive for economic growth, but also the apparently increasing inability of Kenya to produce capital equipment itself: the latter suggests that import substitution production has reached a plateau (5).

Given the nature of most imports, the majority come from the E.C. plus other western industrial countries, with the U.K. the biggest supplier. As implied above, Kenya imports little from elsewhere in Africa, and has a trade surplus in this area.

The substantial balance of trade deficit is modified to a smaller current account deficit by the invisible items. Tourism, bringing in well over K£200m a year, is now one of Kenya's biggest export earners, and there are large export earnings from selling transport services to neighbours. However, there is a substantial outflow of funds to service accumulated foreign debt. The inflow of loans and grants from abroad, identified in the last section as filling the real investment gap, appear in the balance of payments to make up the shortfall in the current account.

The obvious deduction from the above is that Kenya should build on its manufacturing base and its erstwhile manufacturing advantages in order to (i) expand export markets and (ii) meet more of its capital goods requirements. There are other African countries waiting in the wings to supply their own and foreign markets, and without a clear and efficient policy of ploughing development finance into secondary industry, Kenya could fall behind. Tourism, given Kenya's superb natural advantages, could be expanded further, though some might decry the aesthetic price to be paid for this. So far the industry as a whole has done well despite serious shortcomings on the government's side. In this context Appendix 3 throws some light on the creeping miasma besetting the Kenya Tourist Development Corporation, which is the flagship of official state activity in tourism promotion.

## ZIMBABWE

(a) Data sources and currency.

Similar to Kenya, the main sources for Zimbabwean statistics are various Zimbabwean official publications and U.N.D.P.'s 'African Economic and Financial Data'. The Zimbabwe currency is the dollar, conventionally divided into a hundred cents. Originally two dollars equalled the U.K. pound sterling, but there was a substantial devaluation in 1982, and thereafter the dollar has been allowed to creep continually lower against a personal (to Zimbabwe) basket of currencies.

(b) Observations on the Zimbabwe economy.

In important ways Zimbabwe started at official independence in 1980 with more significant economic advantages than many other 'new' African countries.

Firstly, Zimbabwe had a diversified economy. In 1980 primary production constituted only 23.3% of G.D.P., and by 1988 this was down to 20.9%. At the same time manufacturing, at 24.9% in 1980, moved up to 26.5% (from Quarterly Digest of Statistics March 1989 Table 9.2). Indeed an associated U.N.D.P. definition in 'African Economic and Financial Data' Table 1.5, and referring to 'industry' rather than 'manufacturing', puts the percentage in 1987 as high as 38.8. This is well ahead of any non-oil sub-Saharan African country, and even including the oil-exporting territories, only Nigeria is a little ahead. However in contrast Nigeria's agricultural value-added is put at 29.7% of G.D.P., whereas in Zimbabwe, where services have a greater weight, it is only 9.7%. Furthermore, within each category of economic activity in Zimbabwe, there is considerable diversity. Manufacturing ranges over a very wide spectrum of products - this partly due to the enforced diversification during the U.D.I. period (6) - and no raw material or other primary product has ever become of such overwhelming significance as to result in the economy being based on it.

Secondly, the range of Zimbabwean exports is wide. Hence the effects on the balance of trade and the balance of payments of a decline in foreign demand for one export is lessened by continuing sales of other products.

Thirdly, both as a buttress for, and as a consequence of, economic development, the infrastructure is - in an African context - well-developed. Roads and railways have an internal logic, and do not, as in most other African countries, just connect production areas with convenient ports or frontier posts. There is also a large and varied financial system, which is discussed fully later.

Fourthly, as pointed out in Part 2, Chapter 1, the country attracted in more European immigrants than any other sub-Saharan African country except South Africa, the significant point being that nearly all were skilled and qualified (7). Hence the expertise was there to fashion a modern economy quite speedily and to train indigenous people into the possession of similar abilities. Furthermore, the possibility that Southern Rhodesia - as it was formerly - might become a new 'white' dominion, helped for many decades to encourage the inflow of capital funds.

Though the last U.D.I. years saw economic stagnation, at legal independence the strengths surveyed above in the main existed (8) and an optimist in 1980 might have seen in Zimbabwe the makings of the first African N.I.C. So far this has not happened, but in 1990, after a decade of problems, the prospect was still there. As is reported in the 'Banker', referring to bullish sentiments by Dr Chidzero, the Finance Minister, "His enthusiasm is shared by many in the business and financial community, who believe that the country has the potential to emulate the Pacific Rim states, and become Africa's first newly-industrialising country". (Turner Oct 1990 p.87).

(c) Population and National Income.

1. General discussion.

Zimbabwe is described as a 'middle income' African country: it is also a 'middle population' African country. At around 9 million in 1989, it is exceeded by a number of states, including Kenya, but there are plenty of African minnows with far fewer people. The figures below show growth over the eighties: at a rate of increase of on average 2.8% a year, it is typical of Africa in general rather than the very fast expanding Kenyan population. (The alternative lower figure for 1987 and the one for 1988 are the estimates of the March 1989 edition of the Zimbabwe Quarterly Digest of Statistics Table 1).

**TABLE 10**

ZIMBABWEAN POPULATION (Mil.)

| **1980** | **1981** | **1982** | **1983** | **1984** | **1985** | **1986** | **1987** | **1988** |
|---|---|---|---|---|---|---|---|---|
| 7.01 | 7.25 | 7.52 | 7.80 | 8.10 | 8.41 | 8.72 | 9.04 | |
| | | | | | | | 8.64 | 8.88 |

SOURCE: U.N.D.P. - African Economic and Financial Data 1989 - Table 1.2

G.D.P. grew fast in the early 80s largely due to government excess spending financed by borrowing. Later growth flagged, partly due to the 1982 drought, but also because the government retrenched. Later it picked up again. The real G.D.P. figures are given in the table below.

**TABLE 11**

G.D.P. AT FACTOR COST AND CONSTANT (1980) PRICES

| | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 |
|---|---|---|---|---|---|---|---|---|---|
| Total (Z$m) | 3224 | 3537 | 3589 | 3461 | 3540 | 3798 | 3873 | 3847 | 4050 |
| % Increase | | 9.7 | 11.2 | -3.6 | 2.3 | 7.3 | 2.0 | -0.7 | 5.3 |
| Per cap (Z$) | 438.7 | 487.9 | 477.3 | 447.7 | 437.0 | 451.6 | 460.5 | 425.6 | |
| (UNDP Figures) | | | | | | | | 445.3 | 456 |
| % Increase | | 11.2 | -2.2 | -6.2 | -2.4 | 3.3 | 2.0 | -7.6 | 2.4 |

SOURCE: Zimbabwe Quarterly Digest of Statistics March 1989 Table 9.2. and U.N.D.P. African Economic and Financial Data Table 1.2.

Within the data in Table 11 it was the service sector rather than the primary and secondary sectors of the economy that saw the most rapid growth. As the Senior Minister of Finance stated, "Whilst growth in the major productive sectors - mining, manufacturing and agriculture - has been erratic, along with overall gross domestic product, growth in the service sectors has remained positive for most of the period". (Chidzero 1989 p.2). However, this expansion was not so much to do with commercial as with social services, in particular education, for from 1980 a programme of universal education was quickly conceived and implemented. Of course though such a policy might generate useful skills for the creation of wealth in the future, in the meantime it requires substantial income generated from 'productive' areas of the economy to support it Chidzero was all to well aware of this: "....in order for a process of growth to be sustainable growth in the service sectors should be backed by correspondingly high growth in the productive sectors.". (Ibid. p.2). Indeed expanding social expenditure not only relies on productive sector expansion but can inhibit it by taking resources away from investment As Chidzero observed,".... there is a tendency to direct resources away from productive areas". (Ibid. p.2).

Though the progress of the G.D.P. was, as Chidzero pointed out, erratic, it averaged a growth rate of around 3% a year. The per capita income figures in Table 11 are probably much more unreliable than the total G.D.P. figures, but they show no trend upwards, as would be expected from overall growth that hardly exceeded population growth, and which was burdened with heavy overseas debt servicing (see Table 12). However the mass of the people would have felt the benefit of more comprehensive social services, in particular education.

**TABLE 12**

LEAKAGE OF INCOME ABROAD FROM ZIMBABWE

| | **1**<br>**G.D.I. (market prices) ($m)** | **2**<br>**Net Factor Income Paid Abroad ($m)** | **3**<br>**G.N.I. (market prices) ($m)** | **4**<br>**(2) as % of (1)** |
|---|---|---|---|---|
| 1976 | 2166 | 59 | 2107 | 2.7 |
| 1978 | 2359 | 42 | 2317 | 1.8 |
| 1980 | 3441 | 47 | 3394 | 1.4 |
| 1982 | 5197 | 194 | 5003 | 3.7 |
| 1984 | 6404 | 195 | 6209 | 3.0 |
| 1985 | 7019 | 284 | 6735 | 4.0 |

SOURCE: Zimbabwe Quarterly Digest of Statistics Mar 89 Table 9.1

Thus the overall economic health of Zimbabwe during the 1980s was somewhat disappointing. Though extraneous developments played some part in this - and, indeed, indifferent economic progress was widespread in Africa during these years - it is likely that internal events and policies were also to blame.

2. Development finance implications.

As with Kenya, therefore, there can be no compacency about economic growth. It has on average only just been keeping up with population, and moreover has been relying too heavily on more social provision rather than expansion of industrial and commercial productive activities. The business of development finance is thus of vital importance, and within this there is plausibly a role for D.F.I.s.

3. A note on employment.

The rate, consistency and nature of economic growth in Zimbabwe necessarily had an influence on formal sector employment. The table below illustrates the position over a number of years.

**TABLE 13**

EMPLOYEES IN ZIMBABWE (000)

| | TOTAL | TOTAL MINUS AGRICULTURE | MANUFACTURING ONLY |
|---|---|---|---|
| 1970(an.ave) | 853.3 | 555.5 | 114.7 |
| 1975 " | 1050.2 | 686.4 | 156.0 |
| 1980 " | 1009.9 | 682.9 | 159.4 |
| 1981 " | 1037.7 | 743.4 | 173.2 |
| 1982 " | 1045.9 | 711.6 | 180.5 |
| 1983 " | 1033.4 | 769.9 | 173.4 |
| 1984 " | 1036.4 | 765.2 | 166.3 |
| 1985(Sep) | 1061.6 | 787.0 | 171.3 |
| 1986 " | n.a. | 815.5 | 180.4 |
| 1987 " | n.a. | 823.1 | 180.1 |

SOURCE: Zimbabwe Quarterly Digest of Statistics March 1989 Table 7.1

From the above it is clear that during the 1980s the number of employees in manufacturing was not on a rising trend. Though the figures have not been given, the same is true of construction. And in mining and agriculture the movement has been gradually downward. Thus the main areas where the increasing numbers of relatively unskilled people coming on the jobs market would expect to find employment are virtually closed.

Secondly, the areas where growth has been apparent are distribution, public administration and - very especially - education, the latter two of which are financed from the income generated by other sectors. Indeed the accent on education, while socially impeccable, has a dangerous unlooked-for consequence, in that it results in a lot of quite well-educated people whose aspirations are then unlikely to be fulfilled. And this while in certain sectors shortages of skills are apparent As was pointed out in the 1986-90 Development Plan, "All sectors of the economy are greatly short of personnel with scientific and technological know-how...".(p.8) At the same time, Government was, and is, concerned about the general employment issue, though the following is more a ponderous cry of anguish than a policy: "The creation of additional opportunities is intended to provide the majority of able-bodied Zimbabweans with gainful employment. Detailed survey of the economy shows that the issue of unemployment could continue to be one of the main problems during the Plan period". (Ibid. p.11)

(d) Investment and saving.

The rate of growth of the Zimbabwean economy was lower than in Kenya. This would suggest a lower rate of real investment, and the figures below make it clear that this was the case.

**TABLE 14**

CAPITAL FORMATION IN ZIMBABWE (1980 prices)

| | **1980** | **1981** | **1982** | **1983** | **1984** | **1985** | **1986** | **1987** |
|---|---|---|---|---|---|---|---|---|
| G.F.C.F. ($M) | 528 | 722 | 788 | 765 | 618 | 506 | 520 | 496 |
| % change | 19 | 36 | 9 | -3 | -19 | -18 | 3 | -5 |
| G.F.C.F. as % of G.N.P. (constant 1980 prices) | 15.6 | 19.2 | 20.7 | 19.9 | 16.0 | 12.5 | 12.7 | |
| G.C.F. (inc. stock changes) | 646 | 950 | 815 | 600 | 706 | 741 | 742 | |
| (i)% change | 65 | 47 | -14 | -26 | 18 | 5 | <1 | |
| (ii)As % of G.N.P. | 19.0 | 25.3 | 21.4 | 15.6 | 18.3 | 18.3 | 18.1 | |

SOURCE: from Zimbabwe Quarterly Digest of Statistics for March 1989 Tables 9.3 and 9.4

The first - 1986-90 - National Development Plan observed bleakly about investment (p.5), "Shortly after independence, the reconstruction programme as well as the general political and economic climate, led to high levels of investment.....Investment declined significantly during most of the (Transitional National) Plan period. By 1985, the volume of investment in fixed capital was one fifth below its 1982 level". And, with regard to sectoral investment (p.5), "Before Independence, investment in the three productive sectors, agriculture, mining and manufacturing, accounted for 42.0% to 44.0% of total....during the economic recession that followed, the share of these sectors fell below 40%.....These structural imbalances in investment have led to serious implications on the development of the economy and on employment in particular". And, as the Annual Economic Review for 1986 observes, "The decline in real gross fixed capital formation since 1982 has become a major cause for concern at policy-making level". (p.5).

The investment of the early 80s was boosted both by government expenditure on infrastructure, including investment for social services, and private sector investment in industry. Thereafter private sector investment in particular fell away, as drought which sent the economy into recession, low returns on capital, and the multiplication of restrictions discouraged business. As of the end of the 1980s decade it appears that the resources devoted to capital formation were insufficient to maintain intact the existing capital stock and generate a satisfactory rate of growth. Interviews the author had with businessmen in Zimbabwe bear this out, since there were frequent comments about obsolete equipment not - for various reasons - being replaced. The Government, clearly concerned about the stagnation in investment, made a number of oblique intimations of encouragement and support in 'The Promotion of Investment: Policy and Regulations' of 1989. With regard to foreign investment,"...it will endeavour to accord further protection to it by entering into appropriate bilateral and multilateral investment protection or guarantee treaties".(p.7) Referring to constraints that "hamper the development of new entrepreneurial skills....In its promotion of investment by the local private sector, Government will therefore introduce measures to remove these constraints". (p.5) Such sentiments - and others like them - sound laudable but say nothing about concrete policy.

Gross savings, which - domestically - release resources that may be used for investment, overtook investment spending in 1986, but for most years fell short of investment Table 15 gives the details.

**TABLE 15**

SAVINGS AND INVESTMENT IN ZIMBABWE (current prices)

| | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 |
|---|---|---|---|---|---|---|---|---|
| Gross Nat. Savings ($m) | 294 | 492 | 587 | 568 | 549 | 1110 | 1320 | 1706 |
| Gross Cap. Formation($m) inc. stocks) | 358 | 648 | 1026 | 1102 | 1002 | 1212 | 1497 | 1691 |

SOURCE: Zimbabwe Quarterly Digest of Statistics for March 1989 Tables 9.4 and 9.6

Gross domestic savings have not been listed above, but, as in Kenya, were above G.N.S. due to income transfers abroad. For example, 'African Economic and Financial Data' Tables 1.10 and 1.11 reckoned G.N.S. in 1987 to be 18.1% of G.D.P. whereas Gross Domestic Saving was 21.9%. The resource gap in the early 80s between G.N.S. and the value of capital formation was, in the absence of much direct private foreign investment, largely made by official borrowing from abroad. With regard to the reasons behind the substantial rise in savings later on, it has been suggested (1986 Annual Economic Review p.7) that, "An underlying cause might have been a shortage of durable consumption goods generated by foreign exchange shortages". And a salutary point - by no means surprising to a traditional Keynesian: "The development with regard to savings in 1985 is of interest in that it highlights that measures introduced to encourage savings do not necessarily result in increased investment levels". (Ibid. p.8).

In conclusion, real investment in Zimbabwe has been inadequate in relation both to keeping the existing capital stock intact and generating economic growth. Clearly there is a role for D.F.I.s and/or other arrangements in channelling funds to these ends.

(e) The Government Sector.

1. Public Finance.

The table below gives details of Zimbabwe government revenue and expenditure over some recent financial years.

**TABLE 16**

TAXES AND CENTRAL GOVERNMENT BUDGET ACCOUNT EXPENDITURE

| | **1985-6** | **1986-7** | **1987-8** | **1988-9** (est.) |
|---|---|---|---|---|
| REVENUE: | | | | |
| Domestic revenue | 2520 | 2954 | 3661 | 4352 |
| International aid grants | 100 | 103 | 124 | 160 |
| TOTAL REVENUE (from unrounded figures constituent figures) | 2619 | 3056 | 3785 | 4211 |
| TOTAL EXPENDITURE | 3127 | 3822 | 4296 | 5016 |
| SURPLUS(+)or DEFICIT(-) | -508 | -766 | -511 | -805 |

SOURCE: Zimbabwe Quarterly Digest of Statistics for March 1989 Tables 19.3 and 19.4

As it happened, the deficit estimate for 1988-9 proved too sanguine, and the actual figure was $1150m. The Finance Minister observed," In order to release resources for productive purposes so as to achieve an economic growth of 5% per annum as envisaged in the current National Development Plan it will be necessary to progressively reduce the Budget deficit during the next few years to, say, less than 5% of Gross Domestic Product Although in the recent past, we have made all effort to keep down expenditures, the size of the deficit, which is still about 10% of Gross Domestic Product, continues to be far too large". (Chidzero 1989 p.6). And in addition to the above budget deficits, government has incurred more debt liabilities by making investments, lending to parastatals, lending to miscellaneous other bodies, and repaying past loans. The composite figure was expected to be in the region of Z$1000m for 1988-89.

'African Economic and Financial Data' (1989 Table 4-4) estimates Zimbabwean government 'expenditure and lending minus repayments' in recent years as equalling in value anything between 35% and 41% of G.D.P. These figures are more than in most other sub-Saharan African countries. However, Zimbabwe sources put the percentages much higher. The 'Annual Economic Review of Zimbabwe' for 1986 (p.23) put total expenditure (inc. net lending) at 45.3% in 1985-6 and 49.2% in 1986-7. This is up from 38.6% in 1978-9. Even allowing for the inevitable statistical inaccuracies, an examination of the relevant figures in Zimbabwean statistical publications suggest that these latter percentages are nearer the truth.

Chidzero (see above) asserted that the budget deficit was too large to enable the current development plan to be fulfilled. It may also be suggested that the very size relative to the G.D.P. of government appropriations also must have crowded out spending on investment by private and official non-central government agencies. On the other hand, in the 1980s investment in Zimbabwe stagnated (9) at the same time as firms were becoming very liquid. It seems that - similar to, but rather more seriously than in Kenya - the situation was not one of conventional crowding out, but of foreign exchange crowding out Massive government spending bore heavily on the foreign exchange available, so potential spenders on investment projects were held back by not being able to get enough. Zimbabwe dollars lay idly in banks and were available to cover government borrowing requirements. Had it been technically possible for real capital investors to buy what they needed internally, then almost certainly inflation would have been higher than in fact it was.

2. Parastatals.

As with Kenya, many of the Zimbabwean parastatals became during the 1980s a byword for inefficiency and waste. An article in 'African Business' observed drily, "In its five-year National Development Plan (1986-90) the government states that 'it is essential to improve the performance of parastatals in order to reduce their dependence on government subsidies and investment funds', but this elusive improved performance seems to be a dream unlikely to be fulfilled in the remaining three years of the plan period". (Chenje 1988 p.30). A further quote graphically illustrates the position: "Despite years of constant prodding, the government appears to have failed to make the majority of parastatals break even, let alone turn in a respectable profit. And despite attempts to cut subsidies in some of these companies, the government continues to pour millions of dollars annually into these organisations to keep them afloat". (Ibid. p.30). As an example of this sort of thing, the Finance Minister, in his 1989 Budget Statement, stated, "I have allocated $223.9m to the Ministry of Transport. This includes an amount of $115m for subsidies, of which $100m is for the National Railways of Zimbabwe, and $15m for Air Zimbabwe". (Chidzero 1989 p.10). In other words, more than half a Ministry's budget allocation was going to prop up loss-makers.

The Justice Smith Commission was set up in 1985 to look into the workings of parastatals. Chenje (p.31) explains that it laid bare "sordid details of mismanagement, inefficiency, irregular staff appointments and general disregard for laid-down procedures". Even more alarmingly, he writes (p.31) of Air Zimbabwe being "mired in various management scandals".

As a result of these investigations, the government - after a long period of preparation - established in 1988 the Parastatals Commission to monitor the business operations of the various organisations. However it is not too cynical to speculate whether this body will not in its turn become victim to the same maladies as those it seeks to watch. "Quis custodiet ipsos custodes"! (Juvenal) Indeed the issue referred to above in the quote from Dr. Chidzero shows that it did not have much immediate impact.

That reform is necessary is indisputable, especially as the ramifications of parastatal losses go beyond the unacceptable drain of subsidy payments from the Exchequer. For, "According to informed sources, the Zimbabwe Government is unlikely to get much-needed financial assistance from the World Bank if it continues to subsidise money-losing enterprises like Air Zimbabwe and the National Railways of Zimbabwe". (Parade June 1988 p.11).

The implications for development finance in Zimbabwe are the same as in Kenya. Firstly, subsidies to parastatals divert resources away from new real investment Secondly, in so far as parastatals are held wholly or partly by D.F.I.s, the financial positions of those D.F.I.s are jeopardised. Thirdly, parastatal D.F.I.s may be weakened by the same shortcomings that affect the others.

3. The context of structural adjustment.

Though the government of newly independent Zimbabwe in 1980 was not faced with having to service inherited foreign debt - due of course to the fact that sanctions had prevented the U.D.I. regime borrowing abroad - it quickly built up indebtedness as a result of the massive rises in its spending. Difficulties mounted in 1982 with drought, world recession, and the international debt crisis - which involved Zimbabwe - and a Structural Adjustment Programme was urged on the country. The currency was devalued in 1982 by 20%, and certain facilities from the World Bank and the I.M.F., including $70m (U.S.) for an export revolving fund, were extended to Zimbabwe. However, partly due to continued heavy state intervention in the economy - a scenario in line with the ideological predilections of the new government - which meant that, inter alia, the country's external debt rose to 54% of G.D.P. in 1984, most supranational credit arrangements were suspended.

A comment in 'The Banker' on the state of the Zimbabwe economy in 1990 makes for depressing reading. "There is now a desperate crisis in transport, near-crises in almost every other infrastructure, more and more breakdowns in mining, manufacturing and agricultural machinery, lack of spare parts, dilapidated capital equipment, and G.D.P. growth rate dependent on good weather for agriculture. But of greatest concern to President Mugabe's government is unemployment, which now threatens to undermine the country's relative political stability". (Raath May 90 p.71) (10). However despite the above 'end of decade' gloom, and the worrying features discussed in previous sub-sectures, Zimbabwe's overall performance in the 80s had been not without bright spots, as is explained below.

Though the mid-80s were years of drought, a very restrictive set of policies improved the country's fiscal profile, even though draconian curbs on imports helped bring about the run-down atmosphere explained in the quote from Raath. What is decribed as an "impeccable repayments record, even during the peak of debt servicing in 1985-7" (Turner 1990 p.90) led to external debt falling to less than 50% of G.D.P.in 1990. Furthermore, "...with debt servicing due to fall below 20% this year -" that is, of the value of exports, down from 33% in 1987 -" the country is now officially classified as underborrowed". (ibid. p.87). And, unusually,in the light of the impinging of international debt problems on the banks, Standard Chartered and Barclay's in 1987 put together a loan of $70m to the Zimbabwe government.

At the end of the decade there was a greater acceptance of - and move towards - liberalisation measures implicit in the requirements of Structural Adjustment. This includes an Investment Centre (see later for full discussion), the introduction of collective bargaining for wages instead of nationally imposed rates, a relaxation of price controls, easier access to foreign currency by business, and the replacement of import quotas by tariffs. It would be rash, however, to predict how firmly and quickly all this would be allowed to become effective.

The above scenario does not bode well for economic development, nor does it describe a very impressive development performance. It is suggested that only adherence to a strict structural adjustment programme, with the short term hurt that accompanies it, is likely to produce the confidence and gather in the resources - inevitably, it seems, mainly from abroad - to get the economy of Zimbabwe moving ahead faster.

(e) Trade and the payments balance.

As noted earlier, Zimbabwean visible exports cover a broad range of goods. The table below gives the exports in a number of categories for 1981 and 1987. Tobacco, which constitutes almost all of the second category, remains the single largest export, and its percentage contribution to total exports is not dissimilar to coffee in the total of Kenyan exports: manufactures, however, account for a much larger proportion of the total than in Kenya.

**TABLE 17**

ZIMBABWE EXPORTS IN 1981 AND 1987

| Classification | Value (Z$m) (current prices) | % of Total | Value (Z$m) (current prices) | % of Total |
|---|---|---|---|---|
| Foods | 133 | 15.0 | 350 | 18.5 |
| Beverages & tobacco | 225 | 25.3 | 422 | 22.3 |
| Crude materials | 167 | 18.8 | 291 | 15.4 |
| Fuels (inc. electricity) and chemicals | 21 | 0.3 | 39 | 2.1 |
| Manufactures and semi-manufactures | 342 | 38.5 | 789 | 41.7 |
| TOTAL | 888 | 100.0 | 1892 | 100.0 |

SOURCE: Zimbabwe Quarterly Digest of Statistics March 1989 Table 11.5

The customers for Zimbabwe exports are also many, and although the U.K., Germany and South Africa dominate the market, together they still take considerably less than half the total. Other African countries, particularly neighbouring ones, are important markets, and given that the Preferential Trading Area operates as is - supposedly - intended, exports to them should increase further.

For most of the independence years, - 1981 and 1982 were the exceptions - the Zimbabwe dollar value of visible exports has been greater than the value of visible imports. This is not so much due to the influence of industrial growth and market forces as to rigid controls on foreign exchange allocations. The 1986 Annual Economic Review (p.10) explains, "Import allocations have been a burning issue since 1983 when cuts were necessitated by the deteriorating balance of payments position, and allocations continued to decrease up to 1984. The trend was reversed in 1985". Zimbabwe also makes a surplus on its trade in services.

Though in current Zimbabwe dollar terms merchandise exports in the 80s rose on average by something like 15% per annum, whereas current G.D.P. rose by 12%, depreciation greatly reduced their international value. The U.N.D.P. 'current U.S. dollar figures' show no overall rise, as the table below indicates. Import values are also given, and they actually fell.

**TABLE 18**

ZIMBABWE MERCHANDISE TRADE (Mil. current $U.S.)

| | **1980** | **1981** | **1982** | **1983** | **1984** | **1985** | **1986** | **1987** |
|---|---|---|---|---|---|---|---|---|
| Exports | 1445 | 1452 | 1314 | 1155 | 1175 | 1116 | 1317 | 1447 |
| Imports | 1339 | 1535 | 1471 | 1069 | 989 | 917 | 1008 | 1069 |

SOURCE: U.N.D.P. African Economic and Financial Data 1989 Tables 2.1 and 2.2

Regarding the balance of payments on current account as a whole, heavy payments of investment income pushed it well into the red in the mid-80s: at the end of the decade a small surplus was achieved.

Noticeable in the balance of payments capital items in the 1980s is the almost complete cessation into the Zimbabwean economy of direct foreign investment Indeed in most of the years there was net disinvestment. (Chapter 7 explores this issue further). As against this, there was substantial foreign borrowing, mostly by the government and state organisations, and predominantly in the earlier years when structural adjustment loans were operative. In Table 19 below, which gives details, 'other capital flows' includes short term debt, but for the rest acts as a balancing item.

TABLE 19

CAPITAL INFLOWS INTO ZIMBABWE (Mil. current U.S. dollars)

| | 1981 | 1983 | 1985 | 1987 |
|---|---|---|---|---|
| Net foreign dir. inv. | 4 | -2 | 3 | -31 |
| Net long term borrowing | 291 | 443 | 29 | 3 |
| Other capital flows | 334 | -156 | 128 | 106 |

SOURCE: U.N.D.P. 'African Economic and Financial Data' 1989 Tables 2.8, 2.9 and 2.10.

In conclusion, by African standards the composition of Zimbabwean industry and of Zimbabwean exports are extraordinarily diversified. To maintain this lead, and even to aspire to N.I.C. status, development suggests (i) expansion on a broad manufacturing front, and (ii) the aim of getting into sophisticated 'high tech' industries that are not yet usual in African countries - always excepting, of course, South Africa. Development finance institutions might, therefore, be encouraged to set their sights on providing funds for ventures that accord with these proposals. Unfortunately, of course, the run-down of secondary industry in the late 1980s did not bode well for such developments.

ASSESSMENT AND SUMMARY

The purpose of this chapter has been to examine the implications of the economic structures and experiences of Kenya and Zimbabwe for the provision of development finance in terms of three issues, (i) the necessity for economic development and the associated financing of it, (ii) the constraints on the process, and (iii) the development directions into which finance should be channelled. The following lines summarise the deductions.

The necessity for economic growth is self-evident. Zimbabwe has a steadily rising population and Kenya a rapidly rising one. Unless Zimbabwe can grow by at least 3% a year, and Kenya by considerably more, standards of living cannot be maintained, let alone improved.

However there are several financial constraints on growth. By commandeering large shares of the national product, governments in both countries reduce the pool of national resources available for capital investment. Much government spending has gone on large social budgets, and such unfortunate ends as subsidising parastatals, and though social spending, particularly on education, is necessary for development, it may be asked whether there has not been over-emphasis on this area. Many partially educated people, without the parallel availability of jobs that match their aspirations, are a recipe for social discontent. Furthermore, government spending does not only affect the domestic deployment of resource allocation, but - perhaps more importantly - in both countries it uses up scarce foreign exchange, so denying it to those going in for capital investment Lastly, economic and political conditions - coupled with world economic vicissitudes - have cut down the amount of foreign capital funds going into both Kenya and Zimbabwe. Amongst other aims, structural adjustment guides and presses governments into addressing the causes of the financial constraints on development, but by the late 1980s the governments of neither Kenya nor Zimbabwe had been reluctant to embrace some of the the severer provisions of structural adjustment with much enthusiasm.

Important industries on which there is no focus in this study - except for some brief discussion in Appendix 3 - are agriculture and mining. The main areas of production that are relevant to the later D.F.I. analysis are manufacturing and commercial services, and both Kenya and Zimbabwe are, by African standards, strong in these areas. To maintain their comparative advantages in manufacturing vis-a-vis their African neighbours, and to expand export markets, it is essential to introduce more capital funds into secondary industry as well as to make better use of the resources there already. Much the same is true of services. If properly financed and properly run, both countries stand to do well out of them.

NOTES PART 2 CHAPTER 3

1. To some extent, the result of trying to apply something of Keynesian short-term stabilisation policy transferred to the circumstances of developing economies in the post-2nd world war decades was an over-emphasis on purely monetary demand as the engine of economic growth. For example, in I.M.F. Staff Papers of March 1967 (p.80) Hannan Ezekiel writes, "The low rate of saving in less developed countries is one of the most important obstacles to their rapid growth", and he goes on to develop a model showing how monetary expansion can supplement the process.

2. To quote page 1 of the U.N.D.P.'s 'African Economic and Financial Data', "Series in current prices are converted to U.S. dollars at average annual exchange rates. For series in constant prices, G.D.P. and its components are converted to U.S. dollars at the base year official exchange rate.....The G.D.P. implicit deflator for the national currency series is the most broadly based deflator, showing annual price movements for all goods and services produced by an economy". And later, on page 30, "The Atlas conversion factor for any year is the average of the official exchange rate (or alternative conversion factor) for that year and the exchange rate for the two preceding years, after adjusting them for differences in inflation between that country and the United States".

3. Killick and Mwegma (1990) betray some uncertainty on the question of how government use of resources crowds out other business. They assert (p.52), "We have found evidence, econometric and otherwise, that credit to the public sector is crowding out private borrowers". However at an earlier point in the text (p.44) they had observed, "But while some crowding out has undoubtedly occurred we are less sure of its effects on the private sector... It may be that shortages of credit are for the private sector as a whole of secondary importance by comparison with difficulties created, say, by price controls or foreign exchange restrictions".

It remains the opinion of the writer that - certainly for non-small business in the Kenyan private sector - the 'crowding out' effect was more to do with forex shortages than shortage of purchasing power in Kenya. And indeed, Killick and Mwegma tend to support this view when they write (p.54), "Although at the time of writing there are statutory minimum cash and liquidity ratios, we have shown that these have rarely, if ever, been raised to levels at which they begin to affect the lending decisions of at least the major banks..."

Finally, there were of course other reasons as well as forex shortages behind the dearth of non-small private sector business investment.

4. A leading businessman in Nairobi remarked in 1990 during an interview that if the P.T.A. was 'successful' in terms of its remit, then it would not be allowed to continue!

5. This does lend some support to Bagchi's neo-colonialist scenario. See Part 1, Chapter 3.

6. Not all commentators, including, in an interview, a leading merchant banker, have felt that diversification was a - though unlooked for, nevertheless - happy consequence of economic sanctions following the 1965 unilateral declaration of independence. Rather than putting money into a lot of small, high cost, industrial establishments, funds would have been better spent, it is suggested, - given, of course, favourable economic and political conditions - building up production in areas where the country had a particular advantage.

7. At its peak the European population of Zimbabwe was close on a quarter of a million. At the end of the 80s it was probably down to a little over 100000, but since censuses were no longer conducted on an ethnic basis greater accuracy is not possible.

8. A damaging occurrence at the end of the 70s - which of course continued in subsequent years - was an outflow of European skills. This was partly due to a policy of the Ian Smith government in the short Zimbabwe-Rhodesia period, when,

in order to get more Africans quickly into the civil service, many Europeans were, very generously, pensioned off. Seeing little prospect of new jobs in a stagnating economy, they left. However, by the late 80s, the government was urging European young people not to emigrate, but to use their skills in the country.

9. ...except of course that a persistently high public deficit may generate a pessimistic economic outlook such that investment plans are shelved.

10. This last point was put to the author by a senior official in Zimbabwe, who went on to suggest that a police state may be the inevitable outcome, now that the 'people's republic'-type option is no longer available.

# Chapter 4
# THE FINANCIAL SYSTEMS

## INTRODUCTION

Chapter 3 constituted a selective review of the economic structures and experiences of Kenya and Zimbabwe in recent years. The importance of the investigation was partly to sketch in the climate within which economic development occurs, but more importantly to focus on the need for, the constraints on and the destinations of development finance. The necessity for having specialised development finance institutions was not, however, addressed. This chapter, by investigating the nature and scope of the countries' financial systems, delineates a role for such organisations.

## KENYA

(a) Overall structure.

Although in Kenya the financial system - excluding development finance organisations - consists of a large number of separate institutions, more indeed than in Zimbabwe, the variety of institutions is much less, suggesting a less balanced structure. This is congruent with - what was originally - a colonially dependent relationship with the metropolitan power. Colonial Kenya never achieved the degree of apartness from the U.K. that Southern Rhodesia had reached as early as the 1920s, and hence the financial institutions and arrangements were never conceived as needing to constitute a discrete comprehensive system, since any gaps could be filled by the closely linked U.K. system. This legacy at independence has never been substantially changed, though in the 1980s the I.F.C. strongly recommended that the financial markets be developed (I.F.C. 1984 passim, and see later sections).

Nevertheless, as was explained in Chapter 2, Kenya early reached a position of economic importance superior to its neighbours, and the financial sector grew as part of the process: hence in comparison with most of the rest of Africa - Zimbabwe and South Africa being the clear exceptions in ex-British Africa - the I.F.C. is not wrong when it states,"...Kenya is rich in type, number and depth of its financial assets". (Ibid. p.5).

The I.F.C. went on to report that for 1983 Kenya's financial assets equalled in value 64% of G.N.P. This put it ahead of most African countries, including oil-rich Nigeria, which in 1983 was put at 62% (Ibid. p.5). (However in 1985 Zimbabwe was at about 130%). Given the effective collapse in the later 80s of a number of banking institutions, which, however, were not formally liquidated, any later measures relating financial assets to G.N.P. must be suspect, since it is questionable how much of the deposit money in these bankrupt institutions should appear in the statistics.

The central bank is called the Central Bank of Kenya. Then there are over 20 commercial banks, though five of them, Barclays Bank of Kenya, the Standard Bank, the formerly-named Bank of Credit and Commerce, and the public sector Kenya Commercial Bank and National Bank of Kenya accounted in the late 1980s for over two thirds of total bank deposits. There are over 30 non-bank financial institutions, which, owing to a quirk of monetary policy which allowed them to pay more interest than banks, grew in both numbers and size in the eighties. Indeed, a number of them are associated with commercial banks, who in this way could circumvent interest rate regulations. There are no discount houses (1), and only recently have certain commercial banks established merchant banking divisions, such as Barclays Merchant Finance.

For the rest there are between 30 and 40 insurance companies, some building societies, various private pension plans, a Post Office Savings Bank, many hundreds of savings and credit cooperative societies, and a few securities brokerage firms. There is also a stock exchange which, in the 1980s, was not very active.

A flavour of the politico-economic context surrounding Kenyan finance can be intimated by certain I.F.C. comments (Ibid. p.7). (From the standpoint of the early 1990s they appear optimistic, but this is because they were made before the Kenyan bank failures.) Firstly it observes,"Kenya's financial system has not suffered from the severe financial instability and structural weaknesses that have plagued other developing countries in recent years", and goes on to cite moderate inflation and administered interest rates that are more or less positive in real terms. This is broadly true, as the figures below indicate, but a substantial upturn in inflation in the late 80s promised to bring about negative real returns on loaned funds. (see table 1).

**TABLE 1**

INFLATION AND CERTAIN INTEREST RATES IN KENYA

| | 1984 | 1985 | 1986 | 1987 | 1988 |
|---|---|---|---|---|---|
| Inflation rate (%) | 9.1 | 10.7 | 5.7 | 7.1 | 10.7 |
| Discount rate (%) | 12.5 | 12.5 | 12.5 | 12.5 | 12.5 |
| Commercial bank savings deposits (min rate) (%) | 11.0 | 11.0 | 11.0 | 11.0 | 10.0 |

SOURCE: U.N.D.P.: African Economic and Financial Data Tables 1.21 and 1.27 and Kenya Economic Survey 1989 Table 5.7

The I.F.C. goes on to say, "A second area of strength in the system is the separation, in the private sector, of ownership of financial institutions from their clients. Hence credit decisions, at least in the private sector, appear to be made at arm's length, encouraging better credit allocation". This observation was later shown to be wrong, though not, of course, in relation to the major banking institutions (see in next sub-section). Finally, "... there is far less government intervention in credit allocation than one finds in other developing countries". This is very much a relative remark, since the I.F.C. had already pointed out in the text that banks and N.B.F.I.s had, amongst other constraints, to lend to agriculture an amount equal to 17% of deposits. In so far as there are elements of truth in what it says, a gradual move away from the vaguenesses of 'African' socialism, an awareness of the mistakes made by others, an acceptance of unashamed capitalist principles, and a lack of civil service expertise in the field of finance probably account for it.

(b) The banks.

The I.F.C. notes, "The domination of the financial system by commercial banks and deposit-taking non-bank financial institutions and the absence of any significant securities market has led to a bias towards short-term credit in the provision of finance to the private sector" (I.F.C. op.cit. p.i). This was in 1984, and the situation did not appreciably change during the rest of the decade. As in Zimbabwe, a combination of traditional banking practice and caution in an uncertain politico-economic environment caused banks and N.B.F.I.s to be wary of term lending, other than to some sound, established customers. Further discouragement came from the policy of administered interest rates, whereby margins on loans were sqeezed (2). This latter constraint was clearly understood by the government in 1986, and an intention paraded to do something about it, as the following makes clear: "One result of this regulatory framework is that the financial system caters excessively to short-term financial needs. This is partly the result of interest rate regulations, which severely affect the commercial banks. The gradual freeing of interest rates will shift funds to longer term uses". (Republic of Kenya 1986 p.38).

Such term lending as did occur was - as intimated above - to well-established assessable firms, and indeed there was a bias in all lending to this type of borrower. Even the nationalised banks have avoided being too adventurous. As Grosh (1987 p. 18) writes, "The KCB has been chosen to help decentralise resources outside of the cities by bringing banking services to the wananchi", that is, the ordinary rural people. "Such a program is expensive, and if pushed too far could cause insolvency. This has not occurred. Furthermore, it could be interpreted that since KCB must take banking to wananchi that it must extend these loans on less than commercial conditions. This also has not happened. It appears that KCB is operating in a very business-like way with proper controls and procedures".

In the type of phraseology that has been used in many analogous contexts, banks have been exhorted to be more adventurous in their lending policies. "Commercial banks and Non-Bank Financial Institutions tend to extend credit primarily on the basis of formal security (collateral) while ignoring the assessment of the firm's economic potential. Security and collateral procedures and criteria should be reviewed by the banks. Bank staff will have to be trained to assess the financial viability and the economic growth potential of firms - especially small, newly-established firms -

seeking bank loans". (Ibid. p.39). This type of urging lacks specificity, and is vague about any meaningful agenda by which banks may learn to lend successfully in unaccustomed directions.

Nevertheless, as a result of government pressure and the desire to appear socially responsible, banks have made some moves towards helping small business. KCB set up a small business advisory service, but over time it tended to become more concerned with corporate finance. Barclays has been directing USAID short loans to them into small scale rural development at fixed interest rates, with the useful proviso that USAID guarantees the loans the bank makes. Various other schemes, operated by other banks, for lending to small business, exist, but interviews with bankers in Kenya suggest that concern over security, and also a lack of suitably trained personnel in branch offices, have held back their growth.

Finally, a rather distasteful episode in recent Kenyan financial history has tarnished the financial sector and reinforced the determination of the major banks to err on the side of caution. A relaxation of regulations, aimed at getting more indigenous Kenyans into the business of finance, resulted in the formation of a large number of small 'banks', N.B.F.I.s and building societies by people with inadequate expertise and dubious business ethics. Domestic institutions, in particular parastatals, were induced to place deposits with them, and the money accumulated was often loaned by the owners to themselves or their relatives and friends for consumption or investing in unlikely projects. The inevitable financial crash came in 1985-6. A number of institutions collapsed, others were kept in limbo - extant but doing no business - as liquidation would mean the disappearance of large parastatal deposits on their balance sheets. It was observed in early 1990 that government aimed to amalgamate a number of the moribund institutions into the Consolidated Bank of Kenya (Njururi 1990 p.28), but clearly such a project would require a large subsidy to get it under way. The result of the crash was a Banking Act in 1989 which allowed the central bank more supervision over the deposits and loans of financial institutions. Though the purpose of the act was essentially to curb dubious financial behaviour, the effect was also - as noted above - to reinforce the traditional preference for lending based on safe conservative criteria (3).

(c) The money market.

Unlike in Zimbabwe, the money market in Kenya has remained stunted. Though Treasury bills are issued on 91 day, 1 year and 3 year maturity bases, a secondary market has been all but absent. The I.F.C. (1984 p.ii) observed, "The only liquidity mechanism available to investors is discounting with the Central Bank, an option severely discouraged in practice". Furthermore interest rates on Treasury bills have been administered - as they have been on many other financial claims - with reserve ratios and 'behind the scenes' pressure making sure they are absorbed. Commercial bills have generally been held to maturity, given no organised secondary market. Indeed the only fairly virile financial short term market has been the overnight interbank call market.

The I.F.C. (Ibid. p.iii and iv) recommended a number of changes including (i) the issuing of certificates of deposit, (ii) the freeing of interest rates, (iii) the issue of Treasury bills by auction or tender, (iv) free trading of Treasury bills and (v) a development of Central Bank rediscount facilities. To parallel all this was seen the necessity for more brokerage and dealership services. Echoing these sentiments the Kenya Government publication 'Economic Management for Renewed Growth' (1986 p.38) asserted, "A market should be developed in short-term paper," and "..Government will therefore allow banks and NBFI that meet prescribed criteria to issue bearer negotiable certificates of deposit as a first step in introducing private instruments". However, change was slow in coming. In the Dec. 1989 edition of African Business it was noted that the Reserve Bank was "reviewing the possibility of" issuing bearer CDs (Machua 1989), and not till 1990 did they come about. (Foreign exchange CDs, in the event, and perhaps not unexpectedly, proved a failure.) Another development in the process of liberalisation occurred in Aug. 1989, when interest rates were freed.

Money market analysis is somewhat removed from development finance institutions, the focus of the study as a whole. The above discussion, therefore, is mainly important in the implications it has for the capital market and for D.F.I.s. In this context the following points may be made. Firstly, the lack of a flexible secondary market in money market instruments locks banks and other financial institutions into such assets, reducing their liquidity, and so increasing caution in the business of loans and advances. Secondly, (and on the other hand) the introduction of CDs should increase the amount of deposit money that banks can be sure of keeping for definite time periods, so making longer term lending more feasible. Thirdly, non-administered interest rates should enable banks to respond more readily to market trends and market conditions. Though in one sense this enhances the feasibility of making term loans, there is always the danger that rising interest rates will make existing loans uneconomic. Matching assets and liabilities alleviates, but does not solve, the problem. A possible way out is to build interest rate flexibility into the arrangements for granting long term credit.

(d) The capital market.

The capital market with its stock exchange constituent - an association of a few broking firms with no trading floor, and founded in 1954 - has, if anything, been in recent years even quieter in Kenya than the equivalent arrangements in Zimbabwe (see later). Though real investment expressed as a proportion of National Income has been more bullish (see Chapter 3) than in Zimbabwe, the government has been the main spender of capital funds, and such private sector industrial investment as has occurred has largely been sourced from accumulated profits.

New share issues locally have been very rare, as indeed has the inflow of new private capital funds from abroad (4). Though written in 1984, the aforementioned I.F.C. Report (p.27) shows clearly how the onset of Kenyan independence seemed to lead very speedily to a diminution of stock market business. "Analysis of selected characteristics of the 55 companies which have equity securities listed on the Exchange reveals two important features. First, 73% of these 55 companies were incorporated before 1955 and 88% before 1965, confirming that most of the companies that have been established in Kenya in the last 20 years have not raised equity publicly. Second, a significant proportion (33%) of the 55 are foreign controlled. For these, raising additional equity through new local issues may not be a course they desire because they want to maintain control or do not have additional investment plans in Kenya". As a result, there are not many domestic shares to trade, and holders tend to hold on to any securities of the more well-regarded firms that they manage to purchase, even though dividends, whether before or after taxation, have been indifferent.

However, as the I.F.C. (Ibid. p.v) pointed out, "In contrast to the limited and infrequent issue of corporate securities, the Government is a major issuer of long-term loan stocks with maturities ranging from 5-20 years, which is an inevitable consequence of the high government spending in excess of revenue ... These fixed interest securities have typically been offered at yields which are not competitive with alternative private financial assets. Consequently investors consist mainly of a captive group of Government financial institutions, notably the National Social Security Fund and the Central Bank ...".

Several reasons may be put forward for the lack of activity in the Kenya stock market. First is the generally high liquidity of many multinational concerns in Kenya, due to the restrictions put on repatriating profits and capital: hence they have not needed to make local stock issues. Indeed it appears that despite their liquidity firms in recent years have been unwilling to put money into government bonds, due to the poor return. (An exception to this was an issue in 1990 of very high interest Treasury bonds designed to mop up some of this liquidity.) In general rates on various cash deposits have been better. A second reason has been caution by private industry over new investment in Kenya due to general economic and fiscal constraints. As has also been true of Zimbabwe, price controls have squeezed profits and cut dividends. At the same time, dividends have been taxed heavily, and such dividends as are to be remitted abroad have been subject to the availability of foreign exchange. Thirdly and again similar to Zimbabwe, it may not be easy to switch locally raised funds into foreign currency so as to import equipment (5). Fourthly has been the existence of a number of bureaucratic and unsympathetic procedural arrangements cumbering a potential new issue on to the financial markets. The

Capital Issues Committee, set up in 1971, and now replaced by the Capital Markets Development Authority (see below), discouraged issues by setting prices and determining to which favoured people and institutions shares should be allotted. As the World Bank cryptically put it in 1985 (p.51), "..demand becomes a potential problem if undue restrictions are placed on the allotment of shares to discriminate in favour of individual investors". Fifthly has been the dearth of services surrounding a stock market, such as issuing houses, sufficient brokers, investment advice facilities. Indeed the stock exchange itself was criticised by the World Bank for having no specified accounting and auditing standards.

The main move by the government towards addressing the factors that reduced the effectiveness of the stock market was the passing in 1989 of the Capital Markets Authorities Act. The purpose of this act was,"...to establish a Capital Markets Authority for the purpose of promoting and facilitating the development of an orderly, fair and efficient capital market in Kenya and for connected purposes". (Republic of Kenya 1989 p.1275). Broadly, the aim was to remove impediments to the operation of the system, set up self-regulatory arrangements, implement government policies with regard to the capital market and set up an investor compensation fund (Ibid. p.1287). However, considerable scepticism has surrounded the establishment of this body: in certain senior business areas, it is seen as just another layer of bureaucracy in an already inflated process. For though government and Central Bank were expected to retire from their capital market roles in favour of the CMDA, this has not happened.

Clearly substantial other changes are necessary if the stock market is to function more effectively. The abolition of price controls, the relaxation of rules on foreign remittances, tax reform and greater integrity in official circles are necessary for more private sector investment and a parallel growth in capital market arrangements.

(e) A role for D.F.I.s.

It is evident that the mainstream financial system in Kenya has - in certain significant respects - retreated in recent years. New local share issues have become rare, and there is little company share trading on the stock exchange. The banking sector has been tarnished by a scandal and has shown little interest in developing new approaches to lending, especially term lending to borrowers other than soundly established customers. Only when pressurised by government, have banks gone in for new types of business, such as the limited schemes for providing credit to small businessmen. Also, private equity capital and long term loans from abroad have largely dried up. Although a case could be made out for D.F.I.s - as financial gap-fillers - in Kenya at the time of Kenyan independence, their potential role had, by the end of the 80s, become that much greater, due to the atrophy of the mainstream financial system.

Recommended work for D.F.I.s in Kenya equates very well with the theoretical discussion of Part 1 Chapter 5. In the years after independence - which occurred in 1963 - an important area to address was small business lending, which had previously been neglected. Also medium sized domestic business, which, being relatively new or unknown, found it difficult to raise term loans or to float equity capital, stood to benefit from D.F.I. assistance. It must be stressed, of course, that the ability of D.F.I.s to remain financially viable when taking on this type of work rests on factors such as (i) the staff employed by the organisations, who, being both appropriately qualified and (mainly) indigenous, should better be able to judge applications than conventional bankers, (ii) the willingness of government (and other agencies) - in some circumstances - to finance aspects of extension work, (iii) the scope for taking a 'longer' view of projects, consequent on D.F.I. liabilities not generally being in the form of withdrawable deposits.

Post-independence D.F.I.s might also be expected to get involved in the following types of fairly standard work related to the finance of economic development. Firstly, appropriate institutions might partner those incoming foreign companies that wish for such an arrangement in setting up new concerns. Secondly they could act as conduits for the inflow of development money from foreign and international agencies. This function means the acquisition of foreign exchange and - in all likelihood - access to expertise. Thirdly, by selling shares on the stock exchange

D.F.I.s both stimulate the development of the stock market and renew the funds available for investment. Fourthly, although 'pure' supply-leading by D.F.I.s, whereby D.F.I.s, either alone or with a junior partner, actually initiate and carry through new projects, has not been ruled out in earlier theoretical discussion, in Kenya as elsewhere, it remains a possibility, if hedged with reservations (see Part 1, Chapter 5).

From the standpoint of the early 60s, the two paragraphs above would encompass a plausible set of suggestions for D.F.I. operational behaviour. Ceteris paribus, by the late 1980s D.F.I.s, if they had set a good example, might have seen some of their functions wholly or partly taken over by others.

However, in practice, D.F.I.s had, potentially, a bigger role than before. Capital funds for local business - apart from small businessmen who got funds from specific not very successful small business D.F.I.s - were no more easily come by. Local share issues were discouraged by the existence of a not very active stock market, and incoming foreign private capital had all but dried up.

ZIMBABWE

(a) Overall structure.

Zimbabwe, at independence, had the most comprehensive financial system in sub-Saharan Africa, always of course excepting South Africa. A central bank had long been in place, originally, in Federation days, as the Bank of Rhodesia and Nyasaland and later, during the U.D.I. period, as the Reserve Bank of Rhodesia (6). A comprehensive apparatus of monetary control based on interest rate manipulation, last resort lending and reserve ratios, had been developed, and the business of managing foreign payments - mainly via the Swiss franc - in a context of general economic and monetary sanctions had sharpened its acumen in the foreign exchange markets. It is likely that much experienced expertise was lost to the Bank when independence led to quite speedy Africanization.

The commercial banking sector consisted in the late 80s of five organisations. One of these, the Zimbabwe Banking Corporation, or Zimbank, was a parastatal, having formerly been the Netherlands Bank of Rhodesia, in which after independence the government bought a controlling interest. Long established subsidiaries of Barclays and Standard were the largest banks, controlling between them well over half banking deposit liabilities in the country. In general the business operations of all banks were (and are) founded on British principles and practice.

A small but vigorous money market had been established in the 1950s, consisting, institutionally, of two merchant banks and, more unusually, of two discount houses. These made a market in bills, and so - in Federation days - ensured domestic outlets for short term funds that previously had gone abroad, as well as fostering, internally, seasonal crop financing facilities. After the 1965 unilateral declaration of independence, they were more than ever necessary as a destination for short term funds, as residents were no longer able to send such money out of the country. By the late 1980s there were four merchant banks, of which two were commercial bank subsidiaries (7).

Several finance companies existed, again to some extent bound up with commercial banks, well over 70 insurance companies, and a stock exchange. There were also three building societies, a post office savings bank and a clutch of D.F.I.s.

(b) The high profile of the financial sector.

In general, a country with a well-developed financial system has little need, or indeed no need at all, for specialised D.F.I.s, as the range of financial intermediaries and arrangements in existence is able to accommodate most demands for finance. In the U.K., for example, though, institutions with a 'D.F.I.-type' character exist, they are very marginal in terms of volume of lending in relation to the mainstream financial markets.

The discussion in sub-section (a) above intimates that the financial sector in Zimbabwe is, relatively speaking, large, and indeed this is the conclusion of a relevant World Bank publication (1989 p.21), "Compared to many developing countries, Zimbabwe has a highly sophisticated financial intermediary system with a broadly based institutional structure spanning over banks, finance companies, pension funds and insurance companies". It goes on to say, "In terms of the overall degree of intermediation, the country's financial system is comparable with the average performance of middle-income developing countries..". (Ibid. p.21-3). Some interesting statistics bear this out. Total assets of Zimbabwean insurance companies, expressed as a percentage of G.N.P., were at the end of 1985 approximately 22%: this put it in the same league as countries like Australia, Canada and Japan, and way ahead of Nigeria, the Phillipines, Jordan and many other developing countries (Ibid. p.22). Financial assets as a whole as a percentage of G.N.P. were about 120%, which is comparable with nations like Argentina, Mexico and Venezuela (Ibid. p.23).

However, the substantial private financial system (8) has not meant a high level of real investment in the productive sectors of the economy, nor has it addressed the trickier types of capital financing.

With regard to the first point, that is the disappointing level and amount of real investment, the World Bank publication indicates that "..the business community have identified three broad sets of constraints:[1] supply-side factors, related primarily to the shortage of foreign exchange necessary for imports of essential capital goods and industrial inputs; [2] excessive administrative intervention in the areas of investment decision-making, labour relations and price controls; and [3] socio-political factors reflecting the country's history, strategic location and political evolution.....their importance is underlined by the fact that conventional indicators of investment incentives, such as profitability, a supportive tax incentive scheme, and the lack of any apparent financial constraint, have been rather favorable in recent years" (Ibid. p.1). Possibly the latter observations are a little too optimistic. For example the system of price controls has squeezed profits, with the result that rates of return in industry - according to an RAL Merchant Bank source (9) - have rarely been above the rate of inflation.

In general, capital needs in the company sector have been largely self-generated. As the World Bank notes, "A high degree of self-financing is a central feature of corporate finance in Zimbabwe" (Ibid. p.16). This is clear from the following table, where also an upward trend during the 80s in self-financing is evident.

**TABLE 2**

FINANCING SOURCES OF NON-FINANCIAL CORPORATIONS IN ZIMBABWE

(% of total sources of funds)

| | **Average 1980-7** | **1981** | **1983** | **1985** | **1987** |
|---|---|---|---|---|---|
| Gross Internal Funds: | 59.2 | 40.1 | 50.9 | 82.6 | 74.1 |
| Retained earnings | 37.0 | 28.2 | 10.9 | 54.3 | 53.9 |
| Depreciation | 22.2 | 12.0 | 40.1 | 28.3 | 20.2 |
| New stock issues | 8.3 | 10.8 | 9.4 | 0.5 | 14.7 |
| Medium/long term loans | 3.2 | 14.0 | 4.4 | -13.7 | -7.2 |
| Short term loans | 9.6 | 13.4 | 18.7 | 6.6 | 4.7 |
| Trade credits | 17.5 | 17.5 | 12.5 | 19.2 | 13.9 |
| Other sources | 2.1 | 4.1 | 4.1 | 4.8 | -0.2 |

SOURCE: Zimbabwe: Private Investment and Government Policy 1989 Table 3.1.

Of the funds available, well over half have gone on investment in fixed assets. The average percentage of the total use of funds of non-financial corporations over the period 1980-7 was 77.4, and so prompts the World Bank to observe, "This ratio of fixed assets is much larger than in other developing countries and is strikingly close to the pattern observed in industrialised countries, particularly the U.S. and the U.K" (Ibid. p.18). Furthermore, with regard to the self-financing of fixed investment, "internal sources of funds were equivalent to over 100% of fixed investment in the 1980s for both local and foreign-controlled companies" (Ibid. p.17).

Clearly then the private sector financial system has been of very limited significance in raising long term capital funds for industry. This would not necessarily have mattered if the volume of funds devoted to real investment had been large relative to G.D.P. However in practice the volume of funds devoted to real investment has hardly been sufficient even properly to replace obsolete plant and equipment.

"...although investment rose 8.5% at constant prices in 1988 to the highest level in real terms since 1983, at under 16% of G.D.P. (the average since 1980 has been about 17.5%), this was hardly above replacement level". (Stoneman 1990 p.4) It is appropriate, therefore, to investigate the reticence of the financial system towards the provision of capital funds.

The failure of capital to flow more abundantly into the generation of industrial growth is a function of both demand and supply. Major constraints on the demand of existing business for capital funds were identified above in a quote from 'Zimbabwe: Private Investment and Government Policy'. Since these constraints will be frequently referred to in the later discussions that focus specifically on D.F.I.s it is unnecessary to consider them further here. However they are clearly congruent with the nature of the socio/political setting described in Chapter 2. From a supply angle the understandable caution (or lack of enterprise?) of the mainstream financial intermediaries in being prepared to channel long-term funds into economic growth except via very well-established, sound borrowers contributes to the low level of real investment. In general, and ignoring any social and political functions that are expected of them, D.F.I.s in developing countries are supposed to compensate for the inadequacies of the mainstream financial systems, and so provide the capital funds that are not available elsewhere. In Zimbabwe it would appear neither that the most sophisticated financial system in sub-Saharan Africa - always excepting South Africa - could boost the carriage of investment funds into industrial growth, nor that the D.F.I.s could do so instead. The remainder of this section considers further the first point, and the chapters that follow, the second.

(c) The commercial banks.

It is not possible to gauge accurately from published statistics how limited was the extent of commercial bank involvement in long term lending, but a few conclusions may be drawn from the available figures. To begin with, World Bank data already referred to above notes that the percentage of non-financial corporations' financing from medium/long term loans, at 3.2% of the total in 1980, rose to a high point of 32.4% in 1982 and then was down to -7.2% in 1987. (Ibid. p.17). Although medium and long term borrowing is not necessarily from commercial banks, such institutions are plausibly part of the source.

Referring to the combined bank balance sheets, though advances of all time spans are covered in the figures, it is noticeable that after 1981 advances to manufacturing industry steadily declined as a proportion of total advances to corporate and unincorporated enterprises - from 38.2% (1981 average) to 21.9% (1988 September) while advances to mining remained static even in money terms. Advances to finance, insurance and real estate also declined over this period - from 19% to 10.5%. In contrast there were substantial percentage rises in relation to agriculture and - though more erratically - distribution. (Quarterly Digest of Statistics March 1989 Table 20.3). A tentative observation that can be made from this is that the sectors of the economy in which Zimbabwe had outclassed most of the rest of Africa, that is manufacturing and finance, were becoming less significant in bank business operations. Ceteris paribus, long and medium term advances to these sectors, as constituents of the totals, will also have fallen in percentage terms.

Furthermore, as real investment in the economy faltered in the later 80s, the liquidity of the banks gradually increased. A liquidity calculation based on cash, money at call, Reserve Bank balances and bills rose from a low point of 25.2% in 1983 to 34.3% in September 1988. (Ibid. Table 20.1).

As already mentioned, a very obvious reason behind the indifferent lending experience - short as well as long term - of banks in the eighties was the insufficiency of demand for credit by established industry. Indeed the demand for money from foreign companies - defined as firms 25% or more foreign-owned - was subject to a regulation which allowed them to borrow locally only up to an amount equal to 22% of their capital. However it is likely that this as one of many interferences with foreign businesses rather than as a direct curb depressed the desire to borrow.

As referred to above a standard explanation from the supply side of the market in relation to the lack of long term lending was of course the banks' traditional caution in this area of business. This is as true of Zimbank, the government-owned bank, as the foreign-owned ones: in Feb. 1990, for example, the writer was told that nearly all Zimbank loans were in overdraft form, and of less than 5 years to maturity.

Indeed, the banks' reticence about lending long was understandable in view of the fact that loans of all types tended to perform badly. To quote an observation from a university discussion paper about lending in Zimbabwe,"..it is not uncommon for non-performing loans to be some eight times larger than banks own up to in their published accounts". (Roe 1988 p.4). And very graphically, the Head of Corporate Finance in Zimbank, with reference to financing the small industrialist, noted,"At the moment we do lend, and we are taking tremendous knocks. When we send someone out to the growth points, we find there is nothing there". (Lorrimer 1989). It is not surprising that Roe writes (p.5), "Banks which are preoccupied with survival usually make different portfolio decisions from those getting on with normal day-to-day business".

Despite the reluctance of banks to lend on a long term basis other than to very safe firms, government pressure has caused banks to become involved in specialised small business financing arrangements. In the late 80s, the Credit Guarantee Co. was set up, with shares owned by the commercial banks and the central bank. Potential small business borrowers were screened by this organisation, which then recommended bank lending to those who seemed to have viable business plans. The RBZ would reimburse banks for 50% of defaults. This type of scheme is not uncommon in the developing world, and, like many others, it has not - at the time of writing - had much impact. Managing small business lending involves much specialised expertise, and the CGC did not have it. Banks also were short of such skills. Finally, the RBZ tended to show reluctance in covering its share of bad debts.

Reputedly banks began instead to develop their own personal small business credit schemes, where they could match demand for loans to the resources they had available. Part 1 Ch 4 discussed the problems related to small scale lending, and there are no especial grounds for believing that these miscellaneous bank schemes will have more than a marginal effect. The following Reserve Bank statement gives the impression of being little more than a ritual wringing of hands over a situation which had not been changing and was not likely to change. "In the past, the credit policies of banks and financial institutions have tended to channel more credit to established businesses than to small and newly founded businesses. The Reserve Bank is working out modalities with banks and other financial institutions to redress the historical imbalance as far as access and distribution of credit is concerned". (Herald 28th Oct. 1989).

(d) Merchant banks.

The business of merchant banks in Zimbabwe is much the same as that of the U.K. merchant banks , on which of course they are modelled. Accepting bills - hence the generally used alternative designation 'acceptance houses' - is the greatest single source of income, but they have been active in a number of other financial areas. Their role as issuing houses, however, has declined with the drop in new share issues.

A reseach paper from the University of Zimbabwe identified their role in term loans in the early 80s - "...merchant banks specialise in medium term loans which are primarily used to finance capital development projects". (Chirombe et al. 1981 p.3) - and this function has continued. Hence these organisations do constitute a source of capital - outside the government sector (10) - for industry in Zimbabwe, and in that certain of them are subsidiaries of commercial banks it would partially explain why their parents avoid long lending themselves. However, there are important qualifications to note. Firstly the merchant banks are only concerned with lending to established, mainly foreign-owned companies, with proven records. Secondly 'loans and advances' - for whatever length of time - in merchant bank balance sheets are small compared with commercial bank 'advances'. For example, in August 1988 they amounted to $280.2m as compared with the commercial banks' $1400.9m. (Quarterly Digest op.cit. Tables 20.3 and 21.1) and indeed discussions in Zimbabwe revealed that by no means all of this amount constitutes term lending.

Lack of viable demand may once again be intimated as the main factor behind this, a circumstance supported by evidence from another set of intermediaries. For example, the life assurance institutions have been obliged to put 55% of their funds into government and municipal paper - it was 60% until December 1989 (11) - and have considered it wise to put 20% into property, so leaving only a minority of funds for lending to business: demand, however, fell short of what was available (12). The figures quoted earlier on long and medium term borrowing by industry tend to corroborate this.

(e) Interest rates.

During the 1980s, official determination of interest rates prevented the lending institutions responding to the market as economic conditions changed. Bank Rate, for example, until 1981 at 4.5%, was then raised to 9%, and ever after kept at this level. All other important rates, including overdraft minimums, were pegged to this. At the end of the decade there were signs of more flexibility, but it was administered flexibility, reflecting government socio-economic policy, and institutions became no freer to determine rates as they thought fit than before. Thus the Herald (21st Dec. 1989) observes, "The Government has made it easier and cheaper to borrow money - but only if it is used to create jobs, increase productivity and boost exports". Financial repression, therefore, continued.

(f) The capital market.

As with Kenya, by 'capital market' is meant the arrangements pertaining to the issue of company securities and government stock, and the trading of this paper. Given the nature of the current investigation the principal focus in the paragraphs below is on company securities.

As early as 1896 a stock exchange was set up in Southern Rhodesia's - as it was then - second city, Bulawayo, and later, facilities were established in Salisbury (Harare). This remarkably prompt development so soon after the territory became occupied by Europeans must be seen in terms of the rather different circumstances surrounding the occupation of Zambezia as opposed to other parts of Africa that came under British control. Southern Rhodesia was a creation from Cape Province of an influx of settlers determined to create a new white dominion, and they lost no time in fashioning all the sophisticated appurtenances of a western society with which they were familiar: British overall control was a reluctant extra on to a mainly domestically run system. Elsewhere British rule came first, and only much later when the settlers had found their feet under the imperial umbrella did they consider the question of securities markets. And indeed in most colonies formalised securities exchange mechanisms were never forged.

In 1975 all stock exchange business in Rhodesia (Zimbabwe) was concentrated in Salisbury (Harare). After legal independence the new government, armed with socialist credentials, did not favour the perpetuation of a stock exchange, but anecdotal evidence from interviews with financiers suggests that they were persuaded to let it continue. However business at the stock exchange has for some years been slack. After a boom period in the early 80s, when there was a number of new issues and trading in stock was brisk, turnover has been low as a dearth of new issues has starved the market of paper, and holders, flush with liquidity, have tended to hold on to such shares as they can get hold of. Van Agtmael (1984 p.6) as early as 1984 noted that a number of brokers had left the business and merchant banks were orientating their business even more markedly than before to trade finance rather than securities.

A glance at a few pertinent statistics will clarify the quiet profile of the Zimbabwe stock exchange. The number of firms listed - 53 in mid-1988 (IFC 1988 p.70) - is only a fraction of those operating in the country, and has been gradually falling, though the fall of 13 since independence has been due to merger and take-over rather than liquidation. Numbers of new listings have been negligible in the 1980s. The figures for market capitalisation appear to rise quite substantially over the years shown, but in fact the percentage rises are very close to the rises in the local share index. For example, parallel with the rise of 60.5% in Zimbabwe dollar market capitalisation from 2nd quarter 1987 to 2nd quarter 1988 and 48.1% in U.S. dollar terms (I.F.C. Ibid p.70) the index went up 53.5%. And, since figures in Table 3 are at current values, trading value actually fell in real terms.

**TABLE 3**

ZIMBABWE STOCK EXCHANGE STATISTICS (mil.)

| | **1984** | **1985** | **1986** | **1987 2nd quarter** | **1988 2nd quarter** |
|---|---|---|---|---|---|
| Market Capitalisation: | | | | | |
| In Zimbabwe dollars | 264 | 591 | 688 | 817 | 1308 |
| In U.S. dollars | 176 | 360 | 410 | 488 | 723 |
| Trading Value | | | | | |
| In Zimbabwe dollars | 8 | 14 | 20 | 10 | 12 |
| In U.S. dollars | 6 | 9 | 12 | 6 | 7 |

SOURCE: IFC op.cit p.70

Given the paucity of trading, Zimbabwe stock exchange prices over the years showed very little volatility. The twice daily call-over at the Harare stock exchange has led to generally upward adjustments - as indicated above - in line with market forces and analogous movements in stock market prices elsewhere.

In Part 1 it was made clear that a stock exchange - or of course some less formalised method of securities trading - cannot be a 'pure' supply-leader of the economic development process in any direct sense. Rather is it an indirect leader in that its existence may encourage stock issues and hence the real economic results that follow the investment of funds raised. However the stock market in Zimbabwe, despite its age and history of sometimes frenetic activity, has in recent years failed to be other than a marginal, and indeed declining factor in the fostering of economic growth.

Reasons for this retreat are not hard to find. Inevitably, given the theoretically leftist stance of the Zimbabwe government, there has been some anxiety about the continued existence of arrangements that were, as far as orthodox political opinion was concerned, ideologically suspect. (As indicated above, there was a chance that the stock exchange would have been closed down after independence.) Probably, at the beginning of the second decade of independence, this politically-linked worry has subsided. However economic and administrative concerns remain, irrespective of governmental ideological attitudes.

Firstly, there is the foreign exchange situation. For a reputable firm to raise money locally via issuing shares would hardly have been a problem, particularly in the later 80s, when much other business became liquid. However, to translate the funds raised into foreign exchange for the import of new equipment is another matter, given the rigorous foreign exchange conservation policy of the central bank. Indeed, before considering going to the market it has been essential first of all to obtain a foreign exchange allocation (13).

Secondly, general worry about the state of and prospects for the Zimbabwean economy together with the associated indifferent returns on real investment (see Chapter 3) inhibited new investment.

Thirdly, a number of inefficiencies and restrictions bore down on potential industrial expansion. Included were a vigorous local employment policy, which prevented the employment of expatriates except in very specialised circumstances (14), price controls, and considerable administrative procedures before an issue of capital could be made and/or real investment go ahead. The Investment Centre, the official organisation set up to expedite the sanctioning of new investments - whether or not involving a stock issue - was only able to approve investments up to the value of \$5m, and, according to interview evidence, was proving to be cumbersome and slow. All of these factors could be expected to increase firms' costs - or potential costs - and so discourage new real investment.

In the light of the above, the scope for new local share issues was reduced. Hence the increase in stock market trading, which might have followed from the existence of a larger pool of equities in Zimbabwe, did not happen. The lack of D.F.I. participation in the stock market, an issue considered more fully in Chapter 7, may have contributed to the market's stagnation, but was by no means the only factor.

(g) A place for D.F.I.s in Zimbabwe.

There appears to be a role for D.F.I.s in Zimbabwe that, in terms of the recommendations in Pt 1 Chs 4 and 5, is fairly standard. Also, it is much the same as the role discussed for D.F.I.s in Kenya.

The mainstream private sector financial system in Zimbabwe is, by African standards, mature. Intermediaries do make long term loans, though, as may be expected, only to established borrowers who are considered very unlikely to default. Indeed, the writer at interviews found some reticence about the extent of this type of lending, and the criteria for making loans. There is a place for D.F.I.s in being prepared to lend more widely in the community, particularly in the small business sector, which is always starved of credit. Such a recommendation does not imply that D.F.I.s should make an overall loss, though it is not appropriate that D.F.I.s profit-maximise. (see Appendix 2). With externally-financed help and support, the risks that D.F.I.s face in more advanturous lending are reduced. And, given the extensive commercial bank branch networks in Zimbabwe, a system might be developed whereby D.F.I.s work in outlying areas through these bank office, and possibly employ some bank funds.

Though it was noted above that mainstream intermediaries are prepared to lend long to established customers, a major practical constraint on this business is that the money is generally not in foreign exchange. Since long term borrowing typically requires the import of equipment, this is a major problem, given the perennial Zimbabwe foreign exchange shortage. If D.F.I.s can become conduits into the country for foreign exchange from development agencies overseas which - typically - tend to prefer this route over others, they are useful facilitators of new real investment. Clearly a necessary proviso is that a workable formula for handling foreign exchange risk can be established.

Multinational companies have been reluctant to invest in Zimbabwe in recent years. Cooperation with D.F.I.s in partnership ventures may attract in some companies, who value not having to provide all the necessary capital themselves, and who expect advantages from being associated with official or semi-official bodies. On the other hand, of course, when the partnership arrangement for incoming firms is compulsory, those firms who do not like it stay away. D.F.I.s, therefore, have a role as willing partners in new ventures, if asked, but to maximise the inflow of new capital into industry and commerce, this type of linkage should be optional, both for the interested firm, and for the D.F.I.

Finally a stock market revival is necessary in order to create the conditions whereby an ever-widening group of businesses are able (and have the incentive) to raise capital funds by issuing shares locally. Government liberalisation measures and the relaxation of various restrictions are of paramount importance in this. However, D.F.I.s can have an important role buying shares of domestic firms that go public, joining with domestic firms in the finance of new ventures, and selling shares of mature firms on the stock exchange. This latter activity both stimulates stock market trading and releases funds for new D.F.I. investment.

SUMMARY

In all developing economies a number of 'difficult' financing areas can be identified which mainstream intermediaries tend to avoid but which D.F.I.s may plausibly be expected to try and cover. In the fulness of time, D.F.I. functions may well be more and more taken over by other intermediaries as they emulate the example set and as greater sophistication in business and finance lead to better understanding and management of risk. If, indeed, D.F.I.s work themselves out of a job, they can be seen to have been highly successful.

In both Kenya and Zimbabwe, the scope - in theory - for D.F.I.s seems to have been greater some years after political independence than at independence. In certain respects the existing existing financial systems were more cautious and less active than before. This seems to be due to overall economic circumstances and the effects of government policies. How the D.F.I.s slotted into this changing scenario is the subject of the next few chapters.

NOTES PART 2 CHAPTER 4

1. This need not be significant. Discount houses are a peculiarly British invention which were cloned in certain British colonies. Other countries have done without them.

2. An interview in 1990 with a senior official of Barclays Bank of Kenya corroborated these points. He observed also that though another supposed reason for not lending long was the riskiness of making long term loans from short term deposits, in fact savings deposits were a substantial part of the whole. Unfortunately figures of this degree of detail are not given in the Annual Reports.

3. A similar episode occurred in Nigeria 20 years before this. See C.V. Brown's book 'The Nigerian Banking System' (O.U.P. 1964).

4. Interviews led to some fairly devastating comments on the subject of foreign inward investment. Policy was felt to be very confused. On the one hand it was wanted, but (a) the process was cumbered by red tape, and (b) ministers only wanted it in on their own terms. This did not necessarily mean using the fairly objective and respectable device, whereby a multinational associates with a D.F.I.: ministers wanted to arrange the accrual of control and profits to themselves.

5. Anecdotal evidence has it that foreign exchange may usually be obtained if gratuities are passed to the right persons.

6. For a detailed account of financial developments in the period of the Central African Federation, see R.A. Sowelem - 'Towards Financial Independence in a Developing Economy' - Allen and Unwin 1967, 7. Rhodesian central banking during about half the U.D.I. period is analysed in J.E. Maynard - 'Central Banking in the Economies of Central Africa' - unpublished M.Phil. thesis held in Reading University library.

7. The merchant banks are Syfrets, the Standard Merchant Bank, the Merchant Bank of Central Africa and RAL Merchant Bank. Surprisingly, 'RAL' stands for Rhodesian Acceptances Ltd.

8. For convenience Zimbank is included in the 'private' financial system.

9. From an interview with a senior banking official.

10. Strictly speaking, Syfrets Merchant Bank is in the public sector, but since it appears, with its parent, Zimbank, to operate fairly independently of government, it is included, at this point in the text, with the other merchant banks, in the private sector.

11. A passage from 'Banks cut interest on business loans' in the 'Herald' of 21st Dec. 1989 reads,"..the legal provision that insurance companies and pension funds must invest 60% of their assets in prescribed assets will be eased to 55% to encourage them to invest more in the productive sectors". The trouble with this attitude is that it does not consider whether the demand for funds is there.

12. From an interview in Feb. 1990 with a senior officer of the Prudential.

13. From an interview with a stockbroker.

14. An industrialist explained that, not infrequently, when employers were obliged to take more inadequately qualified local people on to the management staff, they generally became 'personnel managers'.

# Chapter 5

# THE (KENYAN) INDUSTRIAL AND COMMERCIAL DEVELOPMENT CORPORATION

## INTRODUCTION

The I.C.D.C. of Kenya, a 100% government-owned organisation, was set up in 1954 during colonial days as the Industrial Development Corporation, and became the Industrial and Commercial Development Corporation - "a name which reflects the full scope of its activities" (I.C.D.C. c.1987 p.4) - in 1967 under the terms of a new Act.

Though, during its years of existence, it has concentrated on the the finance of secondary and tertiary industry, it has been prepared to put money into primary production, such as fishing, where such business was on a corporate basis.

From the outset it has been a government-sponsored and financed institution, though other interests have been involved in providing money, such as commercial banks and the Commonwealth Development Corporation. At first only equity finance was provided, but later the organisation began to undertake term lending as well, principally, according to an I.C.D.C. official, for rehabilitation purposes, since concerns in sufficient trouble to require such credit would not be able to acquire it from mainstream commercial financial intermediaries (1). Though certain loans, such as one in existence in the late eighties in favour of the Development Finance Corporation of Kenya, were not made for purposes of rehabilitation, these are exceptions.

## THE REMIT

The purpose of the original I.D.C. was to assist in the establishment and development of local industries in a financial context where there was little generation of equity capital. Though it was not specifically a tailored 'small business' organisation, the accent was on the smaller end of the market, and - perhaps unusually in a colonial context - it was understood that Kenyan African involvement in industry and commerce was to be supported. Leys (1984 p.25) reports that "...the political turbulence of the 1950s depressed local capitalism...the number of African private companies dropped from 15% of the total (in competition with European and Asian firms) to 2% in 1953, and zero in 1954..", and there was a desire to revive African business. However in this aim, given the problem of assessing the viability of much indigenous African enterprise schemes, the I.D.C. was not very successful, and foreign-owned subsidiaries and Kenyan European and Asian firms mainly benefitted. Leys (Ibid.) reports that, "As late as 1959, the bulk of the formal economy was in European hands".

The I.D.C. clearly saw itself as a 'revolving capital' organisation, for as late as 1967, four years after independence, the I.C.D.C. Act. 7 of 1967, echoing Act. 63 of 1954, stipulated that the Corporation (under its new name) "shall have regard to the desirability of requiring early liquidation of any loan or investment in order to ensure as far as possible that the liquid resources of the Corporation may be available for other purposes..." (s.3 [2c] quoted in Henley 1989 p.5). It is indeed interesting to note that the Kenya Stock Exchange was established in 1954, the same year as the I.D.C., and though there was no explicit identification of the I.D.C. as an agent for nurturing the stock market, the disposal of shares by it would contribute to this end.

Despite the superficial continuity, with independence came change. A more explicit commitment to the control of private enterprise within the terms of 'African' socialism led to a suggested higher profile for the - now - I.C.D.C. in its association with the private sector". The government expects the private sector to play a large role in development, subject, however, to firm controls and explicit guidance when necessary.......Partnerships with private capital will also be instituted by the D.F.C.K. and I.C.D.C". (Republic of Kenya 1967 p.42-3). More explicitly, though an attempt in 1970 to define the I.C.D.C.'s role and activities indicated an expanded remit, the lack of precision in the specifications allowed for much discretion and partiality amongst those who ran the organisation (I.C.D.C. 1970).

There was a move away from the theoretic emphasis on smaller business, and now large projects would explicitly qualify for I.C.D.C. participation, on the grounds that finance on a substantial scale was less easily procurable than modest funds.

Potentially profitable projects "needing encouragement" would be favoured, as would projects that were profitable but risky. Clearly there is something of a contradiction in terms here, though the implication suggests a notion to help local concerns that cannot raise capital easily. Indeed, elsewhere it is stated, "... it was felt that the commercial banks were not granting enough loans to Africans to finance reasonable business" (Ibid. p.8) and that therefore the I.C.D.C. should fill the gap. Also, the I.C.D.C. should favour "marginal" projects, or those in which there was a strong public interest, such as mining ventures. However in relation to all this guidance on operational behaviour, and potentionally very much in conflict with it, the I.C.D.C. was supposed to give a high priority to profitability, the saving or earning of foreign exchange, and the creation of employment. Perhaps more usefully, it had to consider the technical and managerial requirements for any project, and whether these were available, and also the necessity or not for foreign participation.

That the I.C.D.C. had moved to being much more than before a government pressured organisation is clear from a statement by the Chairman in a later 'Role and Activities' publication. "The Corporation must always take into account the various five-year Development Plans published by the government from time to time as well as other major Government policy statements and guidelines designed to accommodate changing economic realities and priorities". (Gatei from I.C.D.C. c.1987 op. cit. p. 1) This type of official suasion is indicated later in the same publication in the following words (p.4): "After independence the Corporation underwent several structural and policy changes in order to reflect the aspirations of a new nation..".. Gatei's reference to Development Plans is well illustrated by the statements that the I.C.D.C. "has been instrumental in increasing Government control of the manufacturing sector" (Republic of Kenya 1979 p. 153), and "The Government will continue to participate as necessary with the private sector in the promotion and profit of jointly-owned enterprises engaged in strategic economic activities". (Ibid. p.27).

However, by the end of the next decade a run of economic vicissitudes and poor D.F.I. experience had led to Development Plan recommendations more in keeping with the behaviour of the former I.D.C. "Some development companies will divest themselves of their present portfolios in the course of this Plan period and revert to their original roles as providers of venture capital". (Republic of Kenya 1989 p. 70).

The exact format of the I.C.D.C.'s remit since independence has not, therefore, been very well delineated. Annual Reports say little that is specific, 'Role and Activities' booklets hint but do not properly explain. This leaves the field wide open for operational behaviour that can be subject to political and personal pressures. A study of what the I.C.D.C. has actually done will therefore be more illuminating.

However, before looking into this matter, it is necessary to discuss two subsidiary arrangements that the I.C.D.C. supports beyond its mainstream activities. Firstly, in that the I.D.C. in colonial days had failed properly to address the problem of small business finance, in 1965 a Small Industries Loans Scheme was established. It "operates as a revolving fund ....for the purchase of industrial machinery and equipment, construction or purchase of industrial premises and, for limited cases, provides the initial working capital requirements for the project". (I.C.D.C. c.1987 op.cit. p.5). It was designed to operate through four channels, defined as the Property Loans Scheme, the Commercial Loans Scheme, the Small Industrial Loans Scheme and the Machinery Loans Scheme, though the lack of precision in the separate arrangements has meant that a prospective borrower can often quite logically apply for money from more than one of them. As is intimated, finance is meant to be provided as credit rather than equity.

Secondly there exists the I.C.D.C. Investment Co. Ltd., which has been the only obvious example of the I.C.D.C. being prepared to dispose of some of its assets to the public. The formation of this organisation - in all but name an investment trust - was in 1967, its purpose being "to buy shares in profitable companies and to sell its own shares to African citizens" (Leys 1975 p.164-5). To begin with it bought non-I.C.D.C.-owned shares, though later a number of I.C.D.C. stocks were spun off into it (Henley op.cit. p.5). In 1987 it held investments listed as worth KShs.83m. Of these KShs.3.5m were quoted investments, all in non-I.C.D.C.-linked companies, and KShs.79.5m unquoted investments, most in I.C.D.C.-linked companies (I.C.D.C.

Inv. Co. Annual Report for 1986/7 p.14). Since all the investments are given at cost, it is not obvious what the current market valuation would be. However, accepting the uncertainty of the figures, something like one tenth of I.C.D.C. investments appear to have gone to the I.C.D.C. Inv. Co. In the main, as the above quote from Leys would suggest, they are shares in I.C.D.C.-linked companies that are profitable (see later for discussion of this issue), such as N.A.S. (National Airport Services) and Minet Insurance, so the Investment Co. overall has been able to remain viable.

Most of the rest of this chapter will focus on the 'mainstream' activities of the I.C.D.C., that is the business of lending to and investing in substantial companies. Only towards the end will the work of the Small Loans Scheme be considered. There is no need to mention the I.C.D.C. Investment Co. again.

## OPERATIONAL BEHAVIOUR

(a) Introduction.

The actual behaviour of the I.C.D.C. towards investment and divestment seems to have been motivated more by pragmatism, whim and politico/ideological aspirations than by a clear and efficient conception of how financial resources might best be devoted towards the achievement of sustained economic development. The pragmatic stance is related to a desire to remain financially viable, however questionably financial viability may on paper be presented: the normative influence is related to (African) Kenyanisation, and not too well explained social aspirations.

(b) Partnership.

The move towards 'partnership' with foreign enterprise (and private enterprise generally) was under way soon after independence. The process was traced by Leys. "Perhaps a growing awareness of the ultimate limitations on the effectiveness of controlling foreign companies which, taken as a whole, disposed of far greater resources and skills than the government, contributed to a revival of interest in public ownership towards the end of the 1960s, especially since it had become clear by then that a certain amount of nationalization......was now widely accepted by international business". (Leys 1975 p.126). However it seems to have become quickly appreciated that nationalization changed the ownership of assets without altering the stock, and that an unlooked-for result was the migration of capital and skills. Hence the emphasis shifted to joint participation in new ventures. Furthermore, "Staking out a government interest in new investments had the additional advantage that the government would have some share in the profitability of enterprises which enjoyed a high level of protection. Moreover, joint ventures with foreign private capital could give the government control over investments without having to finance them fully itself..". (Ibid. p.131). And so, "The main instruments for this policy were the Industrial and Commercial Development Corporation (ICDC), which participated in the equity of foreign companies and also lent money to them..". (Ibid. p.131). To support this aim of government, the restriction on local bank borrowing by foreign companies to 20% of the value of the investment (Exchange Control Notice No. 19 referred to in Henley and Maynard (1991 p.232-233)) made foreign firms more ready to go into partnership with the I.C.D.C., unless of course the constraint discouraged them from coming at all.

In the years after independence, according to official comment (see Chapter 3), there was considerable foreign interest in partnership ventures, and hence the I.C.D.C. lists amongst its holdings a number of established multinational names: later, however,with adverse economic conditions and the bureaucratic and legislative disadvantages related to doing business in Kenya, foreign capital inflows all but dried up. Indeed it was remarked (2) that in 1975 the I.C.D.C. "pushed for" - successfully, as it turned out - General Motors to set up in the country. Furthermore, it is unclear how much new capital investment from abroad has been lost to Kenya because of the insistence on partnership with domestic organisations. Though some firms have valued the link - one expatriate executive said he would not want the I.C.D.C. to dispose of its holding in his company - others clearly prefer complete autonomy.

The I.C.D.C. did not only expand its assets via association with new incoming capital. Henley (1989 p.5) notes that it went in for buying existing stock through the Nairobi Stock Exchange. And rather more informally, as an official of Barclays Bank observed (3), the government negotiated with shareholders in some concerns to buy their holdings.

And in practice it has not necessarily been true that - as Leys suggested - equity participation with foreign interests has meant control by the I.C.D.C. An official of the organisation was quite prepared to admit (4) that, given foreign managerial and technical expertise, the I.C.D.C. was not in control of the most important aspects of the administration of a company even with a majority capital holding.

An interesting question arises as to what indulgences private enterprise/I.C.D.C. concerns were (and are) afforded by government in order to foster their prosperity, so that mutually acceptable rent income can be generated (see Appendix 1 for theoretical discussion). Evidence must be largely anecdotal, and the fact that I.C.D.C. income actually received comes mainly from the big multinational concerns with which it is linked may just testify to the superior managerial abilities and useful global connections of those multinationals. An official of one concern indicated that although competing imports were in theory kept out, appropriate payments made by firms abroad to the 'right' people in government and civil service could get round the ban. Hence in the case of his firm he found imported goods undercutting his products. Furthermore, he was still obliged to pay duties on imported materials and components, because government "needed the money". An official of General Motors enlarged on the - theoretical - ban on competing imports, but could see no further advantages beyond the fact that an I.C.D.C. subsidiary, being technically a parastatal, would be 'listened to', and that major ones (5) were authorised to sell at preferential rates in the regional Preferential Trading Area.

The policy of the Kenya Government towards ensuring that I.C.D.C. companies, whether foreign- or local-linked, are domestic monopolies, by disallowing the establishment of competitors, has been inconsistent. General Motors, for example, has two firms in Kenya competing with it, whereas N.A.S. and Kenya National Trading Corporation are on their own. Furthermore, whatever advantages I.C.D.C. firms were (or are) afforded can be soured by various restrictions. Tariffs on essential imports have been mentioned, and foreign exchange for imports and for profit repatriation by foreign firms is limited by a rather ad hoc system of currency allocation.

A further intended by-product of I.C.D.C./private enterprise association in industry was to further Africanization. Informal pressure on foreign companies in the post-independence period that they dispose of shares locally had resulted in a disproportionate amount going to Kenyan Asians, "since Asians possessed so much spare cash". (Leys op.cit p.129) (6). Hence, joint I.C.D.C./private enterprise ventures would mean that "a large share of the planned new expansion was African owned and managed". (Republic of Kenya 1963 p.30). There were, however, further ways in which the I.C.D.C. was used to try and further Africanization, other than at the official level. It appears, for example, that the bulk of the money loaned under the terms of the Small Loans Scheme went - in the early years of independence - to "finance the enforced take-over by Africans of Asian businesses (mainly in distribution) , which was made possible by new legislation implemented in 1968..". (Okello 1973 p.80) And to support these developments, in 1965 a subsidiary, the Kenya National Trading Corporation (KNTC) was established. A monopolist in the large scale wholesaling of a number of products, in general it was intended to work downstream only through African distributors.

(c) Acquisitions of abandoned companies.

As well as building up its portfolio of subsidiaries and associates by 'partnership' arrangements, the I.C.D.C. acquired a number of businesses, moribund and often heavily in debt, that their owners abandoned (7). There was a strong social aspect to this function, since the aim was partly to try and preserve jobs. However it was not necessarily true that all such firms were destined to be inevitable loss-makers. Some businesses abandoned by owners keen to leave Kenya or obtained at knock-down prices could plausibly be turned round and made to yield profits. However until the RBC Report on Kenyan DFIs in 1989, little appears to have been done to properly address the problems of these concerns, and for the most part they became drains on I.C.D.C. funds, or remained dormant.

### (d) Divestment.

Finally, the idea of divesting assets to raise fresh capital, while always permitted to the I.C.D.C., and indeed recently reiterated (see last section), has been approached in a very cautious and piecemeal way. The writer was advised that there were divergent views on the subject, and it needed to be established in each case what the reasons were for selling off assets. It was not desirable that the private sector, having taken over holdings in formerly I.C.D.C.-controlled concerns, should indulge in asset stripping. In general, therefore, selling I.C.D.C. assets was not even in theory looked at as an ongoing process, and would only occur when there was a deliberate decision to privatise a concern. Perhaps most significantly, there was no enthusiasm for selling off holdings in profitable companies, since the I.C.D.C. relied on returns from these, in order to help cover its expenses (8).

### (e) Summary.

The last chapter suggested a list of specific functions available for a D.F.I. in Kenya. Only to a limited extent have the activities of the I.C.D.C. been congruent with them. In the past some foreign capital may have been attracted into the country by the apparent advantages of I.C.D.C. linkage, but these advantages have not proved significant enough to counterbalance the unattractiveness of undertaking investment in Kenya in the last decade. Miller (1984 p.124) notes that, "In the Moi years" - that is since 1978 - "there has been a leveling off of foreign corporate investment". Apart from this, little divestment has taken place, nor is there much in the offing. Hence the I.C.D.C. has not been strong as a revolving capital organisation, nor has it contributed to stock market development. Money does not go to local enterprise except via the Small Loans Scheme, and here the main recipients have been small African businessmen wanting to buy out Asians in distribution. There has little taste for 'risk', (see remarks in last section) except in so far as buying up abandoned concerns qualifies, but in the light of later discussion on I.C.D.C. finances, this is not unsurprising. Lastly, the desire of the Corporation to hang on to its stakes in concerns that are - or ought to be - profitable, certainly makes accounting sense, but whether this activity qualifies as 'development' is another matter.

The next task is to consider how successful the I.C.D.C. has been in (i) ensuring its own financial viability, and (ii) assisting the process of economic growth by fostering the prosperity of the industrial and commercial ventures in which it has financial interest. The following sections consider these matters, after which it will be possible to assess overall the corporation's contribution to the development of the Kenyan economy.

## INTERNAL FINANCIAL POSITION

(a) Introduction.

Though the I.C.D.C. (and its earlier I.D.C. manifestation) has been in existence since 1954, the purpose of the present study is not so much to conduct an historical survey as to look into the present-day condition of selected D.F.Is. Hence in the main figures and analysis below will relate to recent years.

In general, official statements on D.F.I. s in developing countries call for financial viability, and, as was intimated earlier, the I.C.D.C. is no exception to this rule. The purpose of this section, therefore, is to establish whether the I.C.D.C. has been viable, and if so, how solvency has been achieved.

(b) Total funds employed.

The figures in the table below give an idea of the I.C.D.C.'s perception of the source deployment of the funds it employs.

**TABLE 1**

TOTAL FUNDS EMPLOYED BY THE I.C.D.C.(KShs.m)

| As at end of June | Kenya Gov. Funds | Local Bank Loans | D.E.G.* Loans | Cap. & Rev. Reserves | Total |
|---|---|---|---|---|---|
| 1981 | 581.1 | 26.7 | 1.3 | 83.6 | 692.7 |
| 1985 | 682.2 | 59.8 | 80.3 | 211.4 | 1033.7 |
| 1987 | 719.0 | 34.3 | 121.4 | 274.9 | 1149.6 |
| 1989 | 804.4 | 43.2 | 273.6 | 416.9 | 1538.0 |

SOURCE: VARIOUS I.C.D.C. ANNUAL REPORTS

* Deutsche Gesellschaft Wirtschaftliche, a German development finance agency.

As is clear, the majority of funds employed are from the Kenya government. Though as a proportion of the whole government funding has steadily fallen - from 78% in 1981 to 52% in 1989 - the increases in absolute terms have been substantial, and represent a continuous inflow of grants, loans - which tend to become de facto grants (see later) - and interest capitalisation. Furthermore, Annual Reports have shown some uncertainty about the categorisation and management of government money. As the Auditor in the 1986-7 Annual Report states, "In the previous year's report, attention of the Corporation was drawn to the fact that agreement had not been reached on loans and grants received from government particularly regarding the total amount, the analysis between loans and grants, the accrual of interest as well as on the terms of repayment of such funds. The Corporation has, as in the previous year, indicated that discussions with Government regarding the issue are still in progress. Until agreement is reached on the matter, it is uncertain whether or not the amounts shown in the Balance Sheet as Government Grants and Loans are fairly stated, whether or not the profit for the year and prior years will require revision for the accruals of interest payable on any of the funds that are finally agreed to be loans". (Okoth 1988 p.23). As late as the 1988/9 Annual Report, there was no sign that this matter had been cleared up.

The financial relationship with the government was further complicated by the fact that some government money was 'managed' by the I.C.D.C. For several years the status of these funds was in sufficient doubt for the auditor to comment, for example, "...I have not seen any confirmation from Government on the funds advanced or acknowledged that the Government would underwrite any losses that may ultimately accrue on these investments". (Okoth 1986 p.24). Fortunately by the end of the decade the issue appears to have been sorted out, and in 1989 the Corporation listed several companies into which it had put KShs.130m of 'managed' funds,"... against which no provision for losses is made in accordance with the Corporation's accounting policy..". (Annual Report 1988/9 p.26). There has also been some German money, as the Deutsche Gesellschaft fur Wirtschaftliche Zusammenarbeit (D.E.G.) has advanced several long term loans. These monies are advanced on concessional terms, and - unlike the D.F.C.K. and the I.D.B. (see later) - the

I.C.D.C. bears the exchange loss when repayment is due in the context of a depreciating shilling. However, there is some justice in this, for the loans seem more to do with making the Corporation viable rather than fostering development. As is observed in the 1988/89 Annual Report (p.5), "The Corporation's cash position improved from a net overdraft of KShs.31.2m at the close of the previous year to a cash balance of KShs.120m, as at 30.6.89. This was mainly attributable to a loan of DM15m (KShs.150m) received from D.E.G..". Temporary credit from local commercial banks is small and not significant as development capital.

'Capital and Revenue Reserves', a substantial and proportionately growing item amongst the sources of funds, is sufficiently complex to merit a separate sub-section below.

(c) Current sources of funds.

As implied above, the deployment of new funds to the I.C.D.C. has in recent years been different to the overall totals of funds employed. In the table below, government money constitutes small percentages of the totals, whereas 'capital and revenue reserves' loom large.

**TABLE 2**

I.C.D.C. CURRENT SOURCES OF FUNDS (KShs.m.)

| | **Kenya Gov. Loans and Grants** | **Cap.& Rev. Reservs.** | **Repayments & Interest Large & Medium Loans** | **Small Loans** | **New Loans Local** | **For.** | **Disposal of Invest-ments** | **Total** |
|---|---|---|---|---|---|---|---|---|
| 1980-1 | 43.2 | 34.9 | 12.7 | 32.4 | - | - | 0.1 | 123.3 |
| 1984-5 | 39.0 | 57.3 | 23.9 | 33.9 | - | - | 0.1 | 154.2 |
| 1986-7 | 7.9 | 96.4 | 14.3 | 33.1 | - | - | 2.7 | 154.4 |
| 1988-9 | 47.0 | 137.3 | 26.4 | 46.3 | 20.0 | 175.0 | - | 452.0 |

SOURCE: Various I.C.D.C. Annual Reports

('Capital and revenue reserves' are omitted from the present discussion and analysed fully in the next sub-section.)

Loan repayments are small relative to the amounts outstanding, which in June 1989 were listed as KShs.474m for large and medium size loans and KShs.366m for small loans (I.C.D.C. Annual Report and Accounts 1988/89 p.6). KShs26.4m is about 5.5% of KShs.474m, a rate of repayment which means an average loan period of 18 years. Admittedly, though, small loan repayments were rather better in 1988-89. However a number of disturbing factors related to loans have to be taken into account. Firstly considerable sums are regularly written off: for large and medium loans this was KShs.25m. in 1988/9 and for small loans KShs.9m. (Ibid. p.24). Hence the arithmetic relationships between repayments and total admitted credit are even less healthy than they appear. Secondly, how much money is recouped from past loans seems more a matter of chance than commercial correctness, and this seems especially to be true in relation to small loans. As the Corporation's Chairman noted, "The Corporation ...managed to raise KShs.46.3m from repayments of small loans as compared to KShs.31.4m collected in the previous year. This was mainly due to intensified debt collection efforts and cooperation from borrowers..". (Gatei in Ibid. p.2). Thirdly indiscipline is further apparent in the loan programme in relation to interest obligations, since it is unclear how much interest is actually received. Though income statements in I.C.D.C. Annual Reports tell of substantial annual interest payments, an ominous explanatory note in the 1988/9 Report states,"interest on loans and management fees include income received and accrued during the accounting period". (Ibid. p.22). In consequence, unpaid interest is formally indicated in the Accounts as becoming part of new loans.

The significance of the D.E.G. money was referred to in the last sub-section. Finally, in line with policies discussed in the previous section, virtually no funds have been derived recently from the sale of investments.

(d) Capital and revenue reserves.

As noted above, this item substantially contributes to employed funds, whether on an overall or current basis. Below are the relevant figures for 1988/9.

**TABLE 3**

CAPITAL AND REVENUE RESERVES 1988/9 (KShs.m)

| | |
|---|---|
| Profit before taxation | 49.3 |
| Adjustments for items not involving the movement of funds: | |
| Depreciation | 4.1 |
| Increase in government interest payable | 8.4 |
| Amounts provided for losses on equity investments and loans | 75.8 |
| Profit on sale of fixed assets and equity investments | (0.3) |
| Total generated from operations | 137.3 |

SOURCE: I.C.D.C. Annual Report and Accounts 1988/9 p.21.

The main source of 'profit' is 'income', which in this year stood at about KShs.238.5m. However, the bulk of this came from loan interest, which, as seen earlier, though due, may not necessarily have been received, and from dividends - making up nearly 50% of income - about which there is similar uncertainty. The 1988/9 Report (p.20) is rather coy about this when it observes, "Dividends are taken into account when declared during the accounting period", whereas earlier reports had been less guarded. For example the 1984/5 Report (p.5) had said, "..substantial amounts of interest and dividend arrears...had not been realised in cash at the end of the year". And in the 1986/7 Annual Report (p.3) are the words, "As at 30th June 1987, dividends amounting to KShs.86.7m. were in arrears". It must be assumed, therefore, that each year some of the expected income does not materialise.

From the 'income' was deducted interest charges - KShs.29m in 1988/9 (p.19 of the Report) - but interest due to government (see Table 3) was put back into the kitty. Nearly KShs.83m was allowed for 'amounts written off and provision for losses' (Ibid. p.19) but most of this reappeared as available funds (see Table 3).

Administration costs, - also, of course, deducted - came to KSh.77m.

Grosh, (1987 p.20-25) attempts to assess the significance of administration costs by comparing them with investment portfolios, and suggests that they ran at about 2-3% of them from the 1960s to the late 1970s, though with a gradual upward trend. On this basis, administration costs in 1988/9 stood at over 10% of investment portfolios, which suggests a considerable deterioration in efficiency. Now, by going on to compare costs with directors' valuations of investments, Grosh manages to produce a more or less static percentage relationship. However, this must be unreliable in the light of the optimistic total valuation that directors used to make. Given that many I.C.D.C.-linked companies are not quoted on the stock exchange - so that market valuations do not exist - and that others that are highly valued are doing no business, many published valuations can be questioned. It is reasonable to conclude that, given an approximate doubling of the consumer price level (U.N.D.P. 1989 p.23) between 1981 and 1989, a rise from KShs24m to KShs.77m in I.C.D.C. administrative costs - given that only a handful of new investments had been added to the I.C.D.C.'s portfolio by the later date - may represent some deterioration in efficiency.

In conclusion, therefore, 'Capital and revenue reserves' as representing funds available for I.C.D.C. operations embrace some very unreliable figures. 'Income' is uncertain, since it is unclear how much interest and dividends due are ever actually received. Again, although certain legitimate charges are deducted from the notional income, certain of them, such as interest to government, does not seem to have to be paid, so can be added back in after profit ('income' minus 'expenses') has been calculated. The whole exercise seems a rather unsatisfactory example of financial activity and accounting standards.

## THE APPLICATION OF FUNDS

(a) Investments.

An analysis of the lists of companies in which the I.C.D.C in recent years has had capital holdings, whether subsidiaries - where the I.C.D.C. has a majority of the equity - or associates - where it has a minority - indicates little or no disposal of assets, and hence turnover of capital. For example all six wholly-owned subsidiaries listed in the 1981/2 Annual Report appear amongst the eleven in the 1988/9 Annual Report, and of the eight 'other - that is majority but not 100%-owned - subsidiaries' in 1981/2, six make up the 'other subsidiaries' total in 1988/9. (The remaining two still remain in 1988/9, but have now become 'associates'). And the 'associates' list, in general, remained fairly static through the 80s decade.

Parallel with this, substantial funds invested have in recent years been devoted to rescue schemes rather than expansion. For example, in the 1981/2 Annual Report the Chairman states (p.3), "..the Corporation stepped up its outlays on the rehabilitation of ailing projects", and in the 1986/7 Report was saying (p.1), "..the weak and ailing projects continued to be given significant emphasis". Similar sentiments appeared in the 1988/89 Report (p.2): "...the Corporation disbursed KShs.43.3m in a combination of equity and loan funds to projects which needed rehabilitation, compared to KShs.73.5m spent the previous year, reflecting reduced cash requirements for the exercise. In making these rehabilitation efforts, the Corporation was convinced that projects which have potential to be successful should be assisted to overcome temporary financial or other difficulties so that they can bring their idle capacity to productive use, provide employment to Kenyans and otherwise make their expected contribution to the development of the country".

Ailing projects can, in the right circumstances, be turned round and made to pay, as the Chairman quite fairly observes. However, later discussion of company experience in Kenya does not show much evidence of this happening. Furthermore, though the supposed expenditure on rehabilitation in 1988-9, for example, was rather less than 1/4 of the funds disbursed to business - minus small business finance - it is not clear that much of the rest financed genuine expansion. During the year only one totally new project, a plant for bottling Coca-Cola, apparently was completed- though there were various ongoing studies and discussions about other commercial possibilities (Ibid. p.2) - and a lot of money went on emergency advances to firms.

Table 4 indicates I.C.D.C. investments at cost for 1981 and 1989.

**TABLE 4**

I.C.D.C. INVESTMENTS (KShs.m)

| | **1981** | **1989** |
|---|---|---|
| Wholly-owned subsidiaries | 27.6 | 143.1 |
| Other subsidiaries | 147.0 | 256.8 |
| Associated companies | 270.6 | 324.8 |
| TOTAL | 445.2 | 724.7 |

SOURCE: I.C.D.C. Annual Reports for 1981/82 p.32/3 and for 1988/9 p.28/9.

However, the figures are of little relevance as guides to the current value of the assets they cover since (i) most of the concerns to which the investments apply are not listed at the stock exchange, and (ii) trading of shares, whether via the stock exchange for those that are listed or more informally for those that are not, is virtually non-existent. Hence there is no reliable ongoing market valuation of the equity. Indeed, given that each annual report notes certain companies as 'liquidated' or 'in receivership' the current real values of the assets in question must be close to zero. Furthermore, it has been normal for only a minority of subsidiaries and associates to declare dividends, 17 out of 47 listed, for example, in 1985 and 16 out of 47 in 1986 (I.C.D.C Annual Report for 1985/6 p.35) - later reports guardedly refrained from publishing this type of information - and given that, as indicated earlier, it is not clear how much dividend money is paid over, the real value of many still extant companies must in most cases be low. In consequence, the conclusion in the following passage from Grosh (1987 p.9) must be regarded with considerable wariness: "I.C.D.C. carries its investments at cost on the balance sheet, but in the notes to the accounts it gives the market value for investments in firms quoted on the stock exchange and the directors' valuations of total unquoted investments (9). The reported valuations have exceeded cost, at least since the mid-70s. For example, in 1981 the directors' valuations exceeded cost by 61%. This suggests that the balance sheet has consistently unerestimated the value of investments".

In fairness, the I.C.D.C. does hold a minority of good investments, and considerable capital gains on these would probably be realised if they were ever to be sold. The RBC Dominion Securities 'Kenyan Development Finance Institutions Study' of 1989 - already referred to in Part 1 Chapter 1 - stated (p.32 of Component 3), "...the Project looked for, and found, what it perceived to be a number of significantly undervalued assets in the D.F.I. equity portfolios. These involved dividend-paying stocks, many of them old retainers, which did not appear key to the D.F.I.s' economic development role..". Of the ten companies I.C.D.C. companies listed (Ibid. p.10) only one, Kenya Wine Agencies, was not just an associate. However, despite a handful of performing concerns, there is no reason for optimism about the aggregate real value of I.C.D.C. investments.

(b) Loans and advances.

An unsatisfactory picture emerges from a study of the I.C.D.C.'s long and medium term loan portfolio. In June 1989, the 'principal outstanding' for loans to subsidiaries was KShs.209m. and for loans to associates KShs.57m, against which KShs.13.5m. had been allowed for bad debts. (I.C.D.C. Annual Report 1988/9 p.25).

Somewhat more ominous is the 'advances' portfolio. This is in the nature of emergency credit to ailing concerns, and has risen inexorably over the 80s decade to reach in 1989 KShs.144.7m. for subsidiaries and KShs.43.0m. for associates (Ibid. p.31). Several concerns in the 'advances' portfolio, such as Kenya Fishing Industries and East African Clothing Factory, have received help several times, often at zero interest (10), and in one instance the 'advance' is referred to as an 'overdraft facility'. However once again several benefiting companies are seen to be 'in receivership'. Perhaps wisely, if shockingly, the I.C.D.C. has had to allow money equal to more than half the advances outstanding as provision against bad debts. (Ibid.p.26)

PROBLEMS INTRINSIC TO THE I.C.D.C.

Despite the opacity of its accounts, it is clear that the I.C.D.C. has not been a financial success. The following sections examine the reasons for this. First are problems intrinsic to the I.C.D.C. itself, where as far as possible issues that centre on the recipients of its equity and loan funds will be ignored in the analysis. Secondly is the relationship of the I.C.D.C. with these recipients and how it is affected by the outcomes of their business operations. The subsequent two sections, on company and then on small business financing, cover these matters.

The Government is substantially at fault for the unhappy picture of I.C.D.C. finances that has emerged. Not defining how its money inputs are to be divided into loans and grants, not - until recently - being explicit about funds the I.C.D.C. manages on its behalf, regularly waiving interest, and never insisting on loan repayments, are not likely to induce rigorous management by the Corporation of its own finances. Thus the I.C.D.C., not being troubled about servicing most of its own debt, can afford to be coy about the interest and dividends it actually receives, and is too ready to capitalise unpaid interest and debt. Though much of the new money that has come its way has been devoted to rehabilitation, the beneficiaries have rarely seemed much improved from this help. As a result, the problems have mounted, as the fudging of one year generates more difficulties for the next, and government is increasingly the crucial 'subsidiser of last resort'. That the government is prepared tacitly to accept these arrangements testifies to "a dangerously uncritical attitude amongst the regulatory agencies of the state, both of the D.F.I. itself and of its specific investments" (Henley and Maynard 1991 p.233). They go on to observe, "Clearly it is unwise of the state to assume that one of its D.F.I.s has the capacity to evaluate an investment opportunity".

Furthermore, bound up with and compounding the apparent commercial laxity of the Kenya government are extra-commercial influences that impinge on the I.C.D.C.'s structure and conduct. Tough political and ideological guidelines have never meant much in Kenya in terms of consistent application 'on the ground', but at the personal level anecdotal evidence and relevant phrases in published material testify to potentially unsatisfactory practices. Apparently, according to one commercial bank official, all senior appointments to the I.C.D.C. have to be approved by Government. Though this could be just an innocuous desire to monitor the quality of appointees, it also gives scope for patronage.

I.C.D.C. SUBSIDIARIES AND ASSOCIATES

(a) The condition of the companies.

Apart from the internal weaknesses in the I.C.D.C., discussed in the previous section, the sorry state of many of the concerns in which it has had equity stakes is a principal cause of its poor financial condition. The year ending 30th June 1987 was the last year for which, in the relevant Annual Report, information on dividends from subsidiaries and associates was published (p.35-36), and, as noted earlier, only a minority of companies actually declared dividends, 4 out of 18 subsidiaries and 17 out of 48 associates. Of these, a number were Kenyan branches of established foreign firms, such as General Motors, Associated Battery Manufacturers, Chloride Exide, Firestone, Metal Box, and Raymond Woollen Mills, and others had powerful domestic monopoly positions, such as NAS. Superficially it is surprising that other monopoly concerns, such as Kenya Fishing Industries and Kenya Bowling Centres, failed to be profitable. Of course the actual declaration of dividends did not automatically result in the speedy payment of the money due, as discussion above on I.C.D.C. finances explained.

Furthermore all annual reports testify to the considerable credit that has been frequently poured into ailing companies to prevent them going under. It is interesting to note that of the 16 I.C.D.C. subsidiaries listed in the 1988/9 Annual Report (p.28,30,31) two were in receivership, one had just been liquidated, and all but two of the rest were in receipt of loans and advances. Indeed several had received more than one injection of credit, as also had the two concerns in receivership.

(b) Extraneous influences.

It is suggested (Henley and Maynard op. cit. p.233) that although until the mid-70s a number of I.C.D.C./multinational partnership ventures operating behind tariff barriers and substituting for imports were quite profitable - as indeed some still are - a later crop of ventures following the 1977 coffee boom had less to justify them. Firstly they were established largely in highly competitive markets, such as textiles, and secondly an "aggressively expansionary chief executive of the I.C.D.C." presided over a number of ventures where "foreign equity participation was on a minority basis and consisted of little more than capitalised management or technical services fees". (Ibid.p.32). The structural adjustment requirements of the early 1980s resulted in a substantial devaluation of the Kenya shilling in 1981, and continued creeping devaluation after that (see Pt 2. Chapter 3 for more details). Domestic inflation helped to protect some companies against the rising foreign exchange cost of imports, but others, unable to increase local prices in line with the trend due to price controls or slack demand as a result of recession, were hit.

(c) Company problems.

An important reservoir of data on the problems of many of the I.C.D.C. investments is the RBC Dominion Securities 'Kenyan Development Finance Institutions Study' of 1989. Most of its findings were borne out by the later more limited work the writer was able to do on Kenyan companies, and so many of the facts introduced below come from that source. Vol. 2 Component 3 (passim) (11) records the main results of its company investigations.

Of the I.C.D.C. subsidiaries considered in the Report, only General Motors - 51% held by I.C.D.C. - is referred to as 'successful', all the rest - if not in receivership - requiring monitoring or restructuring. RBC does not identify any 'successful' I.C.D.C. associates, but this is probably because its sample does not include multinational branch establishments like Chloride Exide that appear to have done well. As a result, the entire sample of associates require "monitoring", "restructuring", are "uneconomic" or are in receivership. Indeed in respect of the latter category, frequently no useful information, financial or otherwise, was available, so RBC could make no comment.

A number of reasons crop up for the companies' difficulties. These are: (i) raw material sourcing problems. Since this supply obstacle is partly in connection with Kenyan raw materials - for example 'cashewnuts' - clearly upstream production problems exist. Apart from this, there could be "import licence constraints" (Ibid. p.2) and the effect of devaluation (see previous sub-section); (ii) poor production facilities. This covers a number of possibilities such as frequent equipment breakdowns, and the use of obsolete equipment that cannot be replaced due to insufficient income; (iii) overmanning. This relates to general government employment policy and the habit of creating positions for people connected with influential officials; (iv) poor management, "resulting in the overestimation of market size and capacity planning, the lack of employee training, and the absence of strategic planning and direction" (Ibid. p.2); (v) competing imports. In the light of the Kenya Government's supposed policy of banning imports when local similar products are manufactured, this would be a surprising item in the list of problems, had not an indication of how the regulation can be breached been discussed in an earlier section. So as the 1986 Annual Report states (p.10) in relation to Seracoatings, "The company's volume of sales was slightly lower... due to continued stiff competition from imported similar products"; (vi) price controls. These mainly affected (and affect) essential products, so hitting concerns such as Salt Manufacturers; (vii) excessive financial expenses, largely due, in I.C.D.C. companies, to "imprudent capital structures". (Ibid. p.2). This, of course, implies a high proportion of loans relative to equity capital, and is an almost inevitable result of company difficulties, since financial intermediaries - principally in this context the I.C.D.C. itself - are understandably reluctant to bolster with equity a concern unlikely to pay dividends.

In general, RBC wrote of poor morale, and of firms working well below capacity: Pan Vegetable Processors, for example, was reported to be operating at only 6%-8% of capacity. Even RBC's occasional displays of optimism are not always well founded. Rift Valley Textiles was described as being "close to being a successful holding". (Ibid. p.30). However, given Rift Valley's frequent recourse to the I.C.D.C. for rehabilitation credit, the assertion is questionable.

(d) The I.C.D.C. connection.

Factors integral to the companies themselves, therefore, and to the politico/economic environment in which they operate, are of great importance in explaining their poor performance. However, it is necessary to consider to what extent the I.C.D.C. may be responsible for the rough condition of much of its portfolio. Principally must be cited its failure properly to address the problems of (i) companies taken over when abandoned and (ii) companies that, for whatever reason, at a later stage got themselves into difficulties.

The RBC Report noted that in 1987 56.4% of the companies in its sample - which of course does include, but does not only include, I.C.D.C. companies - gave "insufficient or untimely financial statements". (Ibid p.2). For the I.C.D.C. to be unable to insist on the provision of such information removes its ability to assess the whole range of financial decisions and practices on which the present and future efficiency and prosperity of the various concerns depends. Financial slovenliness leads back to management weakness, which was identified above as a frequent factor behind company difficulties. This again should be capable of being addressed by the I.C.D.C., particularly where it is the dominant or majority shareholder, but as is implicit in the RBC Report, this has not been well done. In general, then, it must be concluded that the I.C.D.C., in the crucial commercial sphere, has been inadequate in monitoring and guiding company operations.

The inevitable consequence, as the I.C.D.C. failed to address the outward manifestations of company problems, and saw companies continue in or slip into unviability, has been damage to the finances of the I.C.D.C. itself. Now once a concern has become unviable there are really only two options. Either the shareholders wind up the company without more ado, or, on the basis of a radical shake-up that expert advice supports, new funds are provided to genuinely rehabilitate the concern. Clearly, in relation to many of its weak subsidiaries and associates, the I.C.D.C. has been reluctant to follow the former course, and unable properly to carry through the latter, with the inevitable result that it holds for too long, on a minority or majority basis, concerns that are a drain on its finances, and contribute little or nothing to its income. Such behaviour is not inconsistent with government pressure to prop up dying firms with money for social (12), prestige and personal reasons, while sidestepping the issue as to whether this support be in practice anything other than straight subsidisation.

Furthermore, from the point of view of the companies themselves, too easily obtained rehabilitation credit from the I.C.D.C. may be detrimental to their efficiency, in that they have a reduced incentive to use the money carefully.

THE SMALL LOANS SCHEME

(a) The remit.

As was indicated earlier, the I.C.D.C.'s Small Loans Scheme comprised four separate sub-schemes, of which the 'commercial' scheme, involving largely loans in connection with distribution, is easily the biggest in terms of loans outstanding. For example, in June 1989, commercial loans outstanding stood at KSh.223.3m out of a total of KSh.412.7m (I.C.D.C. Annual Report for 1988/9 p.8). Despite the array of purposes for which small loans may in theory be had, it is accepted that a major reason for the establishment of the scheme was to enable indigenous Kenyans to buy out Asian traders, who were obliged after independence to dispose of their businesses. And furthermore, even amongst indigenous Kenyans preferences operated. As Leys (1975 p.201) observes,"Kikuyu traders and manufacturers took the lion's share of the I.C.D.C.'s loan programmes"(13). It is not possible to tell whether this tribal partiality has continued into more recent years, but certainly the move to transfer Asian firms to Africans foundered, as people without relevant abilities failed to succeed in their new business activities. (Later many Asians purchased businesses back, something to which the Kenya government turned a pragmatic blind eye).

Due to the problems with which many of the new African owners were beset, such that they failed to service loans, for a period of several years in the early eighties the Small Loans Scheme was suspended in its entirety. The Commercial and Small Industrial sub-schemes are now revived, and an indication of the type of approach by the I.C.D.C. towards the operation of them may be intimated from the I.C.D.C. chairman in the 1988/9 Annual Report (p.2). With regard to 'commercial' loans, "The demand....continued to rise. The service sector such as export-import, clearing and forwarding and medical clinics also benefited". As for 'small industrial' loans, "The demand... is expected to rise due to the Corporation's softer terms and the need to assist graduates .... to get started on their own. In this way we shall, in addition to helping develop human skills, create employment especially in rural areas". It is interesting to note that a 'rising' demand for commercial loans contrasts with an 'expected rise' in demand for small industrial loans, and this is reflected in approvals and disbursements, which, as in the case of the totals in the first paragraph of this section, are heavily weighted towards commerce. The table below expands on the above points by giving the distribution of small loans over time.

**TABLE 5**

'SMALL' LOANS OUTSTANDING (KShs.m) AS AT 30th JUNE

| | **1982** | **1986** | **1987** | **1989** |
|---|---|---|---|---|
| TOTAL | 241.4 | 267.5 | 292.3 | 412.7 |
| SMALL INDUSTRIAL | 45.9 | 60.6 | 65.4 | 95.7 |
| COMMERCIAL | 106.0 | 118.6 | 138.7 | 223.3 |
| PROPERTY | 77.6 | 71.8 | 69.6 | 69.8 |
| MACHINERY | 11.9 | 16.4 | 18.6 | 23.9 |

SOURCE: Various I.C.D.C. Annual Reports

(b) Financial aspects.

Discussion in earlier chapters has highlighted the difficulties of lending successfully to small businessmen. Administrative costs are high relative to the average value of loans; interest returns and repayments are uncertain. And extension services, which hopefully may render a borrower successful in his business, and can include mechanistic devices for recouping money owed, training schemes and so on, are themselves very expensive. As has been argued before, there is logic in separating some support costs from the basic financial intermediation costs, and having them covered by some other agency. The money may come from the government, a relevant foreign agency, or even - in the case of a multi-purpose D.F.I. - from the income generated by the non-small business operations. Unfortunately the I.C.D.C., though diversified, has not been in a position to cover a programme of extension services from profits generated elsewhere, due - as discussed earlier - to the indifferent state of its overall finances.

In general, it is not possible to know how much the small loans scheme has been costing to run, as the accounts fail to separate out the expenditure pertaining to it. The elaborate administrative arrangements reaching down to provincial and district level must be fairly costly, though admittedly this apparatus is not only in place for small scale lending. However the dismal record of interest collection and loan repayments (see later) is sufficient witness to the inability of the I.C.D.C. management to sift out unviable applications for loan funds (14) and to collect debt that is due. The politico/economic motivations for lending, referred to in the last section, are no doubt significant factors contributing to this unhappy state of affairs, since it means that applications from favoured groups of people asking for money for purposes supported at government level are likely to be approved before other commercially sounder proposals. A point made by an I.C.D.C. official, that the Corporation must be prepared to take losses on loans initially, until the businessmen in question "got on their feet" (15) is reasonable as long as viability is not too long in coming. Large and expanding arrears, however, suggest more than just teething problems.

The Small Loans Scheme was never intended to help completely new businessmen, the integral Small Industrial Loans Scheme in 1987, for example, being prepared to advance not less than KShs10000 and with an upper limit of KShs2m. Interest rates charged have not been wildly concessionary. 15% on industrial loans in 1987 is respectably above the Kenya central bank discount rate that year of 12.5% (African Economic and Financial Data 1989 Table 1-27), but as against this the borrowers in question would in most cases hardly have got money elsewhere, except on very onerous terms. And, of course, if the interest is not paid (see later), the rate is irrelevant.

Operational experience has been very unsatisfactory. As mentioned, the whole scheme was suspended in the early 1980s and later only revived for two of the four separate facets. The position is usefully intimated in the 1984/5 Annual Report (p.1): "Dividends and interest income remained below expectations due to the problems facing the Corporation's projects....The financial assistance from the Treasury continued to decline. ...In the light of the above, the Corporation's Small Loans Scheme remained suspended for the fourth year". Indeed, the interest income outturn from small loans is worse than 'below expectations': it is doubtful if much has ever been collected. Every year without fail the annual reports of the I.C.D.C. show interest as being capitalised as new loans. For example, in the 1988/9 Annual Report, the following figures are given:

**TABLE 6**

I.C.D.C. SMALL LOANS SCHEMES - A SUMMARY

| | **No.** | **Amount (KShs.m)** |
|---|---|---|
| Loans outstanding as at 1/7/88 | 2901 | 348.1 |
| Loans issued during the year | 468 | 49.4 |
| Interest charged during the year | - | 55.7 |
| TOTAL | 3369 | 453.3 |
| | | |
| LESS Repayments during the year | 142 | 40.6 |
| LOANS OUTSTANDING AT 30/65/89 | 3227 | 412.7 |

SOURCE: I.C.D.C. Annual Report for 1988/9 p.8

Capitalised interest has not only been regularly more than the value of new loans, it has also been regularly more than the value of repayments. Hence for a number of years borrowers have failed to pay back any 'real' principal, and only met some of the interest not paid at the due time. Furthermore, the I.C.D.C. is fairly realistic about the possibility of recouping many of the funds owed. As the 1985/6 Annual Report (p.27) explains, "Known bad debts are written off and specific provision is made against those loans, including accrued interest, which are doubtful of recovery. In addition a general provision is made on the balances remaining at the following rates: Industrial - 25%, Commercial - 20%, Machinery - 50%, Property -5%".

(c) Comment

Like so many small business finance arrangements in developing countries, the I.C.D.C.'s Small Loans Scheme is not viable. Apart from the well-known reasons for such an outcome, specific blame must attach to the I.C.D.C. for clearly being too ready to capitalise interest, and for the political considerations that supposedly motivated it, at least in the early years of independence.

It is not very useful shifting the focus to the recipients of loans, for there are many of them, and to investigate their conditions and problems is a research project in itself. It is fairly certain, though, that the management and financial weaknesses identified by the RBC as applying to companies are equally, if not more starkly true of small businesses.

REVIEW OF EVIDENCE

It was established in the last chapter that within the mainstream Kenyan financial system provisions that relate to the gathering in and application of development capital funds are weak. It was also suggested that economic uncertainties and government restrictions had, since the early years of independence, led more to retreat than to expansion in the capital market. This is seen in a massive decline in new share issues locally, a virtual cessation in the inflow of new private capital funds from abroad, and a moribund stock exchange. There would seem to be a place for D.F.I.'s, therefore, both to fill the gaps in the market for capital funds, and to help reverse the retrenchment of the private sector in this field.

Though, in theory, the I.C.D.C. had a major role in this process, it is difficult to find any empirical examples of unqualified success.

In its earlier independence years Kenya was able to attract in foreign capital. Normally incoming foreign firms had to enter into partnership arrangements with the I.C.D.C., or another D.F.I. So, given this regulation, in a passive sense the I.C.D.C. was instrumental in bringing about industrial development. However, to counterbalance that, it is clear that other foreign companies were alienated because they did not wish for partnership with the I.C.D.C. Furthermore, such advantages as foreign companies might have expected from government by being linked to the I.C.D.C. have been damaged by inconsistent application and by debilitating disadvantages. Protection from competing imports, though standard in theory, does not necessarily happen in practice, vital imports to service industry may be made expensive by indirect taxes, restrictions are put on the repatriation of profits, the local borrowing capacity of foreign investors has been limited to 20% of the investment, and an accent on Kenyanisation does not so much mean severe restrictions on the employment of qualified expatriate personnel as the necessity to take on indigenous Kenyans as well, which leads to overmanning.

There are many arguments against domestic monopoly power, but it may be offered as an incentive to foreign companies to attract them into a country. Concerns with strong multinational inputs do not appear to have been given this advantage in Kenya, but I.C.D.C. firms entirely held by Kenyan interests have benefited in this way, and for some it has meant large monopoly profits, as for example in the case of National Airport Services.

However, as the earlier section on I.C.D.C. companies indicated (see figures for dividends) profitability on average has been poor. The basis for this, apart from the reasons mentioned above, involves faults in company management, I.C.D.C. monitoring, and financial shrewdness. The result is a development corporation hanging on to its few good investments for the sake of income from them (16), relying on government financial indulgence, and devoting much of any new money that comes its way on rehabilitation exercises that rarely seem - in the light of RBC discussion - to successfully turn round ailing companies. The poor state of its small business arm adds to its difficulties.

The result is that the I.C.D.C. is no longer - and has not been for many years - appreciably fostering sound business expansion in secondary or tertiary industry. And by no longer being a revolving capital organisation, willing regularly to sell investments, it has done little to help develop the stock market.

Indeed it may plausibly be argued that the I.C.D.C. has not only failed in its primary functions, but has in fact damaged Kenyan development. Firstly, without the I.C.D.C. many unviable companies would have gone out of business, so releasing the funds devoted to propping them up for other purposes. Secondly its role as a necessary partner for multinationals considering investment in Kenya discouraged some from going ahead: though others went along with the arrangement for a number of years, experience in the last decade shows virtually no new foreign interest in an I.C.D.C. link-up (17). Thirdly, by obtaining blocks of some of the best shares in Kenya and keeping them indefinitely, it has denied the stock market the impetus to expansion that comes from active trading in sound securities. Fourthly the I.C.D.C. has sent quite the wrong signals to the small business sector by its mismanagement of this sphere of lending. Fifthly the generally unsatisfactory record of the I.C.D.C., supposedly a major player in the field of development finance, is a discouraging example to those, both internal and external to Kenya, who might consider real investment in the country, and to institutions that might be prepared to lend money to the country for financing development.

And behind the I.C.D.C., and organically connected to it, has been a government, clearly neither able or willing to properly monitor or control the Corporation, nor to follow through a consistent set of policies towards the companies under its auspices.

It is suggested, therefore, that the I.C.D.C., though initially suited to filling certains gaps in the capital market and to fostering the development of that market, has been undermined by the 'soft state' syndrome (see Pt.1 Chapter 1), so that it has become little more than a loss-making holding company.

NOTES PART 2 CHAPTER 5

1. This point was made by an official of the I.C.D.C.in 1990.

2. Interview of April 1990 with an executive at General Motors (Kenya).

3. Interview of April 1990.

4. Explained by an I.C.D.C. official in April 1990.

5. Any firm 25% or more owned from abroad would not qualify for preferential rates in the P.T.A. markets.

6. Technically, foreign investments in Kenya were protected by the 1964 Investor Protection Act. However Leys identifies an informal desire by government for foreign firms to sell shares: "..the emphasis of official policy had been on inducing foreign companies to 'go public', and thus enable citizens to become shareholders". (op.cit. 1975 p.128).

7. This is a sensitive issue in Kenya, and was explained to me by J. Henley, to whom I am grateful.

8. The dilemma is understandable, and is referred to elsewhere in this study. For an intermediary that aims to be financially viable to sell off profitable assets can seem unwise, even though it accords with a development stance. A rough rule of thumb could be that expected average returns from present investment should at least equal the past average returns from assets to be disposed of. (See Appendix 2 for a full analysis.)

9. In annual reports later in the decade, the directors stopped doing this.

10. Apart from this type of indulgence, technically the I.C.D.C. has not made loans and advances at concessionary rates. "Since 1980 I.C.D.C.'s yields on its loan portfolio have continued to approximate the commercial bank lending rate..". (Grosh 1987 p.10) Of course, this observation begs the question as to how much money due actually materialised.

11. The 1989 RBC Dominion Securities Report on Kenyan D.F.I.s, the source of much of the factual information below, is not referred to again except where specific quotes from it are included in the text.

12. A reference in the 1988/9 Annual Report, already quoted in an earlier section, may appropriately be mentioned again in this 'social' context. One of the reasons for justifying efforts towards rehabilitation was to "provide employment for Kenyans" (p.2).

13. Leys goes on to refer to Marris and Somerset, 'The African Businessman' where it is stated on p.71 that down to April 1966 64% of industrial loans and 44% of commercial loans "went to Kikuyu recipients".

14. ... despite the fact that many applications are rejected.

15. Interview at the I.C.D.C. April 1990.

16. ... apart, that is, from some disposal of equity to the I.C.D.C. Investment Co. Such activity, however, has slowed up in recent years. Indeed annual reports indicate that its portfolio of investments in 1986-7 was very little different to that of 1979-80.

17. General economic conditions are of course also responsible for foreign firms being reluctant to come to Kenya.

# Chapter 6

# THE DEVELOPMENT FINANCE COMPANY OF KENYA AND THE (KENYAN) INDUSTRIAL DEVELOPMENT BANK

## INTRODUCTION

This chapter considers the experience of the other two major D.F.I.s in Kenya, the Development Finance Company of Kenya and the Industrial Development Bank. Since the analysis continues to centre on the provision of capital funds in Kenya, obviously the political, ideological and economic landscape against which the two institutions operate is the same as for the I.C.D.C. Consequently, the span of the present chapter can - by avoiding unnecessary repetition - be shorter than that of Chapter 5.

## THE ORIGIN AND REMIT OF THE D.F.C.K.

The D.F.C.K. was established in 1963 with capital supplied by the C.D.C., the I.F.C., West German and Dutch development agencies, and the I.C.D.C. Other funds, in the form of advances and loans facilities, have been provided during the life of the D.F.C.K. - often on concessional terms - by a variety of Kenyan and non-Kenyan concerns, including the 5 shareholders.

There is thus a substantial weighting of non-Kenyan interests in the ownership of the D.F.C.K., and as such it has remained a private sector company, rather than being considered a parastatal. Foreign development agencies, prepared to put money into Kenya, but unwilling to be tied up with the government in the I.C.D.C., preferred to participate through a new concern, where their voice was - in theory perhaps - the strongest. A by-product of this was some reassurance to foreign firms interested in investing in Kenya, some of whom were thought to be reticent about financial links through the I.C.D.C. with a government as yet untried in managing economic and financial affairs, and which gave vent to various disturbing ideological intentions. The emphasis on non-Kenyan concerns is made clear by Leys (1975 p.131-2): "..the Development Finance Company of Kenya.. provided mainly loan capital for large-scale new investments by foreigners". Not of course that the D.F.C.K. was intended to be so biased, and it did not remain that way. From the Kenyan point of view the parameters of the scheme meant that most funds available to the Corporation were from abroad, and were denominated in foreign currency, and in so far as the prospect of loans and equity funding would attract foreign investors, there would in due course be further inflows of capital brought in by them, and also of managerial and technical expertise.

As amply discussed in earlier chapters, provision of long term credit has typically been lacking in economies where the banking systems have been formed on the British model, and at the outset the D.F.C.K. was designed to help to fill this gap in the market. Also its remit was only to direct money to large scale enterprise. As Grosh (1987 p.4) explains, "... the Development Finance Company of Kenya was started with the goal of lending to medium and large scale industrial projects". Thus in the beginning there was - in theory - a rough complementarity with the I.C.D.C. The I.C.D.C. was considered as more to do with smaller enterprise, and, although authorised to make loans, was more properly concerned with equity investment. The D.F.C.K. was directed at big business, and was a loan rather than equity organisation, though it was not barred from share ownership. And, given the sources of its funds - capital from non-private sector concerns, and over the years a series of loans from a variety of agencies, non-commercial as well as commercial - it was able to lend on concessional terms.

## THE OPERATIONAL BEHAVIOUR OF THE D.F.C.K.

A number of factors intervened, however, to shift the operational behaviour of the D.F.C.K. away from the original conception of the remit. Firstly, despite the majority non-Kenyan ownership, the I.C.D.C. remained the largest single shareholder. In 1988, for example, it held 30.5% of the capital, with the next largest holder, the German D.E.G., holding 28.8% (D.F.C.K. Annual Report and Accounts 1988 p.4). Hence, by dint of ownership, the government had (and has) via the I.C.D.C. a powerful voice in the direction of the company, with the Chairman inevitably being a Government nominee. The RBC Dominion Securities Report Vol.3 Component 1 (1) suggests that government influence must be greater than is implied by the size of its shareholding when it states (p.5), "... the Government appears to exercise a degree of control over management out of proportion with its shareholding". Though a glance at the list of senior managers tends to back up this observation, in that nearly all are Kenyans, it cannot necessarily be assumed that such salaried employees are automatically Government stooges. However, irrespective of any possible implication for D.F.C.K. business behaviour of a Kenyan senior management, 'behind the scenes' influence by the government has, as was made clear to the writer, been strong (2).

Secondly, but connected with the first point, is the nature of the D.F.C.K.'s portfolio, as it has been built up over the years. Though conceived of as principally a lending organisation, the company finished the 80s decade with many equity holdings. In 1988, for example, of 82 companies in which it had financial interests, there were 23 in which it held equity, though to a number of these 23 it had loaned money as well. It is easy to see the reasons for this substantial diversion of funds into equity. As explained in Chapter 5, after independence, government aimed at partnership between foreign firms and Kenyan interests, and, "The main instruments for this policy were the I.C.D.C. ... (and) the D.F.C.K". (Leys op.cit. p.131). The last paragraph made it clear that having through the I.C.D.C. only a minority stake in the D.F.C.K. did not mean that government was unable to make Kenyan interests paramount if it wished. Hence a number of foreign/D.F.C.K. concerns, sometimes also including direct I.C.D.C. participation as well, have been established. As to whether foreign firms linked with D.F.C.K. equity capital could expect any especial government favours as opposed to free-standing firms, the arguments looked at in the context of the I.C.D.C. (see Chapter 5) apply equally here, and need not be repeated. Indeed, confirming the Chapter 5 conclusions on this issue, a D.F.C.K. official observed in 1990 that the government was "inconsistent".

Thirdly, and as a result of the above, "Other investments, both by I.C.D.C. and by D.F.C.K., were in marginal new ventures which the government wished to encourage for political reasons; for instance large injections of capital were made or committed for sugar-refining and paper-milling in western Kenya (3), which foreign investors did not expect to be very profitable". (Leys op.cit. p.133). The initial focus on loans to incoming foreign business, noted by Leys, was lost, possibly inevitably, as an increasing number of domestic concerns, perhaps with foreign capital components, looked for credit, and as foreign companies lost interest in setting up in Kenya.

Not unexpectedly, these developments have led to the ominous word 'rehabilitation' being used in connection with money disbursed, and terminology similar to that noted in I.C.D.C. annual reports is found in D.F.C.K. Chairmans' reviews. For example, in the 1986 Annual Report (p.7) is the following: "...the amounts due from D.F.C.K. associated companies amounted to Shs 127,261,486 at the close of the year up from Shs 109,180,537 outstanding on Dec. 31st 1985. However, a large proportion of these arrears were due from a few problem projects whose rehabilitation proposals are being prepared by management. During the year management has striven to reduce the volume of funds tied in this way".

Fourthly was the formation of a small business subsidiary, the Small Enterprises Finance Corporation (4). Inevitably it soon became necessary to establish SEFCO in its own offices, and a specialised staff was recruited, who as a consequence duplicated (or competed with) the work of analogous staff elsewhere. Commercial concerns and aid agencies do not seem to have been impressed by SEFCO, as the Kenya Government has had to be by far the most important financier of it (5).

The discussion in this section bears out Grosh's (1987 p.6) observation, already referred to in Chapter 1, that "The chronology of the DFIs reveals a marked tendency to organizational proliferation and duplication". The duplication is apparent in the convergence with the I.C.D.C., shown in the thrust of the financing, the experiencing of similar problems, and even the formation of a small business arm (6). Nevertheless, and as implied above, duplication may not necessarily be a bad thing, if organisations doing similar work are spurred on to efficiency by competing with one another. Unfortunately, this does not seem to have happened, or to have been allowed to happen, in the case of Kenyan D.F.I.s, where government has been behind the scenes manipulating business in all cases (see passim in Chs. 5 and 6).

The one significant feature that is different between the I.C.D.C. and the D.F.C.K. is the heavy foreign currency content in the D.F.C.K.'s financing operations. This, however, carries with it its own burden, since borrowing companies have had to bear the exchange risk themselves, and have been hit as the Kenyan shilling depreciated, internal inflation not necessarily compensating for increased capital repayments.

Finally, a further point that was put to the writer in 1990 was that the D.F.C.K. as a lending organisation was latterly being supplanted by banks and N.B.F.I.s, who were increasingly going in for long term - or perhaps more usually roll-over short-to-medium term - lending. A further advantage was that this money, though more expensive, was in local currency, and could be changed into foreign currency via the Treasury, with no exchange risk to the borrower.

It is however important to put these rather surprising assertions into perspective. Firstly, though the writer did not find obvious enthusiasm in the banks for lending long, neither was there marked hostility to it, and it is reasonable to conclude that, as in the U.K., financial institutions with organic or inspirational links to the U.K. have in recent years been more prepared than formerly to lend long. However, of course, mainstream financial intermediaries will only be prepared to lend to secure borrowers, and the liberalisation in 1990 of the regulations as to how much foreign companies may borrow locally increases the size of this market. It is unlikely, therefore, that the D.F.C.K. would have its rehabilitation loan business taken away from it. Secondly, the Treasury, concerned about the foreign exchange reserves, has - in theory - a stringent allocation procedure for determining who may change shillings into foreign currency. However, concerns with good prospects have a better chance than unassessable applicants for obtaining foreign funds for essential imports. Hence the D.F.C.K. has increasingly become a source of finance for those applicants in which mainstream intermediaries would not be interested, and who would not otherwise easily get foreign exchange.

<u>THE FINANCES OF THE D.F.C.K.</u>

The finances of the D.F.C.K., as presented in the annual reports are considerably more transparent than those of the I.C.D.C., and so more amenable to interpretation. However the picture that emerges is almost as bleak as that of the I.C.D.C.(7).

In the text of the reports are numerous references to difficulties. In the 1986 Report (p.7) it is reported that "..some project companies continued experiencing difficulties due to competition in the market resulting in lower margins, exchange losses and inability to raise prices to meet rising costs". Later, concerning an expansion programme by Aberdare Oil Millers, "During implementation of the project the sponsors were faced with cost overruns and approached D.F.C.K. for further finance". (Ibid. p.9). The previous section has already introduced evidence indicating substantial financial preoccupation with rehabilitation, and in 1987 a further step was the establishment of 'Rehabilitation Advisory Services Ltd' with D.F.C.K. and German money. The aim of R.A.S. is to ".. offer rehabilitation services to non-performing companies by providing them with equity or other funding with equity features, and management services at a fee". (1988 Annual Report op.cit. p.8). Though this represents a timely determination to address a debilitating condition, it is unfortunate that the condition was so serious as to require such organised, institutional treatment.

In the light of the ongoing situation implied by the above remarks, it is not surprising that dividends from the D.F.C.K. have been spasmodic and low. For example, in the 1986 Annual Report (p.7), "..D.F.C.K. was able to resume payment of dividends to shareholders - 5% (p.9) - after a break of 2 years". And in the 1988 Annual Report (p.6), "No dividend is proposed". Indeed, it would seem that in recent years dividends, when paid, have been more a function of realised capital gains than of profits from current operations, as the following analysis shows.

Taking as an example the group Profit and Loss Account for 1986 (1986 Annual Report p.14) 'Income' is KShs.84.1m, of which KShs.6.3m are dividends and KShs.61.4m is loan interest. However, as with the I.C.D.C., this does not represent money actually received. As is explained (Ibid. p.18), "Credit is taken for dividends receivable at the date of the declaration of the dividend". Even assuming that all this dividend income materialised, it still leaves the majority of D.F.C.K. investments non-performing. For of equity investments of KShs.75m at cost, KShs.24.8m were "not yielding dividends and developing as planned", and KShs.28m were "not yielding dividends and not developing as planned" (Ibid. p.25). With regard to interest, "Interest receivable and payable is included on an accrual basis" (Ibid. p.18).

Expenditure on administration accounts for KShs.24.7m of the income, and financial charges, including KShs.34.9m interest to be paid, another KShs.42.5m. This leaves KShs. 16.9m profit before tax and 'exceptional' items. However a major 'exceptional' item is bad debts of KShs.25.9m, a not surprising discovery given the past as well as present uncertainty over interest receipts. This would put the Profit and Loss Account heavily into the red, were it not for a KShs.33.3m profit on the sale of investments. Most of this was due to the sale of the D.F.C.K.'s equity investment in Firestone E.A. Ltd.(Ibid. p.11). Though this disposal of shares - with a handful of other smaller disposals - might be represented favourably as an indication that the D.F.C.K. is a revolving capital organisation with an eye on stimulating the stock market, a more likely explanation is that the sales were a necessary sacrifice to preserve ostensible viability. After all, the D.F.C.K., as a private company with many commercial creditors, does not - like the I.C.D.C. - have the Kenya Government behind it as a financial cushion.

The group Profit and Loss Account for 1988 (p.14) shows minimal gains from the sale of investments, and so profit for the year, after certain other adjustments, was negative. As a result, there was no dividend. And it is worth reiterating that for 1988 as for 1986 such decisions as are reached on final profits and recommended dividends are built on an inflow of interest and dividends that is rather speculative.

THE ORIGIN AND REMIT OF THE I.D.B.

The Industrial Development Bank was set up in 1973 largely at the instigation of the I.B.R.D., which was prepared to channel long term money into Kenya, but needed a banking institution through which to work. From the start the capital of the I.D.B. was in the hands of Kenyan government and parastatal interests: in 1973 the I.C.D.C.

owned 51% of the capital and the Treasury 49%. This arrangement was changed in 1976 when a capital restructuring left the I.C.D.C. with 12.75%, further tranches of 12.75% going to the National Bank of Kenya, Kenya National Assurance and Kenya Reinsurance Corp. Though this change was ostensibly to "mobilise local resources"(8), apart from the capital, these institutions have been reluctant to put more money into the I.D.B.

Loans and lines of credit in favour of the I.D.B. have, throughout the years of its existence, mainly been denominated in foreign currency. As was pointed out in relation to a similar situation in the D.F.C.K., though this gathers in foreign resources, it also means a potential exchange risk. However in 1988, for example, substantial funds had been received, or were due, from the I.B.R.D. - KShs.910m equivalent -, with lesser sums from the German Development Co.(DEG) - KShs.26m equivalent -, the African Development Bank - KShs.44m equivalent - and some others (I.D.B. Annual Report and Accounts 1987/8 p.18-21). All of this credit was concessionary in the context of current interest structures, and hence onward loans could be concessionary. Also all loans were to be guaranteed by the Kenyan government.

The I.B.D.'s 'Statement of Policy and Regulations' (Ibid. p.4-5) is a fairly standard and uncontroversial list of assertions. The organisation, described as a "financial institution", is "for the purpose of furthering the economic development of Kenya by assisting in the promotion, establishing, expansion and modernisation of medium and large scale industrial enterprises, including mining, agro-industries, engineering, tourism, transport, shipping and such other enterprises as the Board may approve". It can make loans and hold equity, but not enough to have a controlling interest in a concern. As a corollary it may not manage enterprises itself, but will "use its best endeavour to ensure the acquisition of competent management". There is little of a political/social nature in the Statement, except for a gesture towards "special consideration to enterprises utilising considerable local material and labour resources, and to export- orientated projects". Furthermore, although "The I.D.B. will normally finance or otherwise assist enterprises where new productive assets are to be created", and will "revolve its funds by selling its equity investments", with an eye to its own viability it may "purchase or acquire shares in profitable companies". Finally, ,and very significantly, the Bank is supposed to "seek to protect itself against exchange risks of foreign borrowings".

Clearly the remit of the I.D.B. is very catholic, more or less permitting it to operate in the field of investment at its own discretion, avoiding - in print - the strict partiality and politically-motivated straitjacketing that the World Bank would have disliked.

THE OPERATIONAL BEHAVIOUR OF THE I.D.B.

However, despite the fact that vitually all credit to the I.D.B. came from non-Kenyan development agencies, the great bulk of it from the I.B.R.D., ownership, as noted, was vested in Kenyan financial parastatals, and as a result the Board of Directors has consisted of Directors of these institutions, plus senior government officials and one or two others. It was to be expected, therefore, that constraints would be put on the organisation's independence, and that it would operate very much in accordance with official priorities, however pragmatic, changeable or temporary those priorities might be. Some evidence for this is found in the discussion below.

In June 1988 the I.D.B.'s called-up capital was KShs.257.6m as opposed to long-term borrowing of KShs.903.3m (Ibid. p.11). Consistent with this, and to be expected in a development institution termed a 'bank', the great bulk of I.D.B. assets were long and medium loans. The I.D.B. came too late on the scene to be a significant participant in the 'partnership with multinationals' remit that applied to the D.F.C.K. and the I.C.D.C., and most of its equity investments - KShs.49.2m in 1988 after 'Provisions' (Ibid.p.31) - consisted of minority holdings in existing multinational company branches or companies in which the I.C.D.C. and/or the D.F.C.K. also had major holdings. Indeed of its 26 separate equity holdings, 7 were in companies where there was I.C.D.C. participation, and in 4 there was D.F.C.K. involvement. Furthermore the companies held jointly with other D.F.I.s were heavily weighted to those that discussion in Chapter 5 showed to be having problems, for example Salt

Manufacturers Ltd., Kenya Cashewnuts and South Nyanza Sugar Co. It appears, therefore, that government pressure induced I.D.B. to buy equity in companies it would not on financial grounds have selected if it was independent of government influence.

Indeed, as with the I.C.D.C. and the D.F.C.K., statements by the Chairman indicate considerable concern about non-performing companies into which the Bank has put money. For example, the 1985 Annual Report refers (p.7) to, "...provisions for possible losses on portfolio investment due to the continued deteriorating financial and economic performance of some of the Bank's projects". In the 1987/8 Annual Report (p.7) the situation sounds to be more serious. There was "..an increase in the number of non-performing loans...The rehabilitation exercise continues, with packages for some projects already drawn up, while others are in the pipeline. Rehabilitation funds remain a constraint, but we are hopeful that soft funding will be found, for the companies experiencing financial difficulties, including some of those under receivership"(9).

Though a later discussion will give the RBC Dominion Securities overview of the disabilities affecting the work and prosperity of the I.D.B. (together with the D.F.C.K.) some indication of I.D.B. problems from the I.D.B. itself is appropriate at this point. For example, there are veiled indications in the annual reports of project appraisal and monitoring inadequacies as well as of burgeoning administrative growth. The 1985 Report (p.7) observes, "It is hoped that the (Research and Promotion) Unit will be strengthened further..". And in the 1987/8 Report (p.8) is the announcement that, "During the period under review, the Bank found it expedient to reorganise the Operations Department by creating two new functional divisions namely:- Consultancy and Rehabilitation Division and Appraisal and Implementation Division".

However, of very great significance in the business history of the I.D.B. has been the exchange rate. All its debt has been foreign, and so outgoing loans have been in foreign currency. Borrowers have been obliged to accept the exchange risk, and, as the Kenya shilling steadily depreciated in the 80s, only those borrowers whose income, due to inflation, rose in line with the depreciation, were able to meet growing repayment obligations. For many, especially those with fundamental weaknesses, this was not the case. Thus, by the end of the decade the Bank was a very unattractive source of long term funds. Credit-worthy borrowers were increasingly able to get credit from N.B.F.I.s, who loaned in shillings, and, as with the D.F.C.K., the I.D.B. was left with the more dubious applications. It was put to the writer in 1990 that the only persons presently borrowing from the I.D.B. were those who did not intend to repay!

THE FINANCES OF THE I.D.B.

The observations of the last section are starkly reflected in the accounts of the I.D.B.

In the 1987/8 Annual Report 'Income' (p.12) is put at KShs.128.8m, of which KSks.115.2m is 'loan interest' and KShs.4.4m is 'dividends'. Miscellaneous other income puts the total to KShs.186.5m. The biggest item of expenditure is 'charges on borrowings', in other words, predominantly outward interest, which during this financial year was KShs.86m. 'Administration expenses', which included an item defined as 'bad debts and provisions on portfolio investments' brought total expenditure up to KShs.175.4m. Though this produced a 'profit' of KShs.11.1m, 'accumulated losses brought forward' turned this into a loss of KShs.10.2m. It is a little surprising, therefore, to read in the Auditors' Report (Ibid. p.10),"..the Bank is required...to maintain a Reserve Fund out of its net profit each year...During the year under review, the bank made an operating profit of KShs.11,111,681.00 out of which KShs.1,388,960.00 should have been transferred to the Reserve Fund. The Bank did not, however, make any such transfer nor did it maintain a Reserve Fund".

The technical question as to whether operating profit before applying accumulated losses represents net profit, is quite subsumed by the fact that the interest income, similar to the situation in the other D.F.I.s, does not represent income actually received. Though this is not actually stated in the annual reports, accounting data elsewhere make this abundantly clear. For example 1987/8 Balance Sheet 'Assets'

(Ibid. p.11) refer to 'project debtors' of KShs.439.7m. The table below shows how this figure was computed.

**TABLE 1**

I.D.B. PROJECT DEBTORS (30th June 1988)(KShs.m.)

| | |
|---|---|
| Arrears of capital and repayments | 361.7 |
| Arrears of interest and charges | 201.3 |
| Unbilled accrued interest | 27.9 |
| SUB-TOTAL | 590.9 |
| Less: Provision for losses on:- | |
| Capital repayments | 38.5 |
| Interest and charges | 112.7 |
| TOTAL | 439.7 |

SOURCE: I.D.B. Annual Report for 1987/8 p.15

The figure for 'arrears of interest and charges' is over KShs.20m more than the figure for 1986/7, and has in fact been going up steadily for a number of years. Hence the 'interest' which contributes very substantially to each year's 'income' is a very unreliable figure.

Even more worrying is the state of 'capital and repayment' arrears. As is clear from the Table, they stood at KShs.361.7m, and a mere KShs.38.5m had been allowed to offset them. As the Auditors' Report points out (Ibid p.10), "The arrears now represent 42% of the total loans (KShs.751m) and have shown significant increase due to some projects not servicing loans in accordance with the relevant loan agreements which, as indicated in my last year's report, forced the Bank to reschedule for some projects". And in the light of harsh experience, the KShs.78.3m 'current maturities on portfolio loans' would probably add to the arrears! Rescheduling loan repayments due has been matched by some flexibility in I.D.B. repayments to its own creditors. With all I.B.R.D. borrowings, for example, the codicil appears, "The schedule of the loan repayment is subject to amendments in accordance with the loan agreement". (Ibid.p.18). However, despite these concessions, the I.D.B. has still been faced with annual repayments to its creditors - KShs.130.7m in 1987/8 (Ibid. p.11) - and it would have been impossible to find this money without activating the government guarantee.

In the circumstances it is not surprising that the I.D.B. does not easily acquire new tranches of long term capital. However lines of credit negotiated in the early 80s and not yet fully drawn still provided some funds in the late 80s, together with one or two new loans from institutions such as the African Development Bank. Thus during 1987/8 KShs.90.6m - including KShs.0.8m from sales of investments (Ibid.p.13) - became available to the I.D.B. for disposal on projects.

## THE BASIS OF THE POOR PERFORMANCE OF THE D.F.C.K. AND THE I.D.B.

There are several similarities between the D.F.C.K. and the I.D.B. Both lend - the D.F.C.K. mostly, the I.D.B. wholly - in foreign exchange, both have smaller equity rather than loan portfolios - though the I.D.B. is much more heavily weighted towards loans than is the D.F.C.K. - both began life with strong extra-Kenyan connections. Furthermore, though the I.D.B. is a parastatal, whereas de jure the D.F.C.K. is not, the latter has been subject to more government influence than may be expected from the deployment of ownership. There is no necessity, therefore, to discuss for each separately the causes of their poor performance.

In the case of the I.C.D.C. considerable obscurity in the accounts was cited as symptomatic of a lack of administrative rigour in the organisation. The accounts of the D.F.C.K. and the I.D.B., in contrast, are clear, and starkly bear witness to serious financial difficulties.

Though in both institutions there was during the 1980s a drastic fall in the amount of new incoming money, it did not totally dry up, and certain new loan facilities were arranged as from 1988. However, in the case of the I.D.B. all incoming loans have been automatically guaranteed by the Kenya Government as a matter of course, and it is interesting to note that the great bulk of the new 1988 funds to the D.F.C.K., as coming from the E.I.B., were,"... under the ACP-EEC Lome Conventions .. guaranteed by the Government..". (D.F.C.K. 1988 Annual Report p.21). Thus the I.D.B. and - to some extent - the D.F.C.K. owe their survival to the Kenyan government being ready to 'pick up the tab'. Such a scenario is well-fitted to ensure that the staffs of these bodies do not feel it urgent to try and put their houses in order.

Apart from this weakness, criticisms that the RBC Dominion Securities Report Component 3 Vol. 2 (p.2) directs at the I.C.D.C. are levelled equally at the D.F.C.K. and the I.D.B. Such is, in particular, "the DFIs' inability to successfully monitor too many of their assets", leading to a dearth of "timely, accurate and sufficient financial statements". (Ibid. p.1). As a warning, the text observes,"Until this problem is solved, effective assessment and portfolio decisions regarding these holdings is seriously impaired, if not impossible". Furthermore, as has been mentioned earlier, a feature that proved very damaging to the D.F.C.K. and the I.D.B. was that, unlike the I.C.D.C., they were (and still are) sourced largely by foreign money, and the shilling value of their debt liabilities went up as the Kenya shilling steadily depreciated through the 80s. Borrowers from the two D.F.I.s had to bear the exchange risk, and many found it difficult to find the money for the expanding interest payments and capital repayments. And those that had an imprudently high debt/equity ratio were of course hit especially badly. Technically, of course, the effects of inflation on company revenue could compensate for the increase in the shilling value of debt. Inflation induced by dearer imports and the possibility of larger export revenues from cheaper exports would lead to bigger incomes for borrowing companies, enabling them to service nominally expanded loans. This happened in some instances, especially businesses involved in tourism, where demand elasticities were shown to be low. However, in many other cases compensation was weak, due to inelastic demand, competition, and an inability to address the chance of selling abroad more cheaply than before (10).

Depreciation of the shilling was felt to be right in the context of the economy as a whole, but it was inevitable that as a matter of course D.F.I.s and their clients would be affected by it. The RBC Dominion Securities Report Component 3 Vol 1 addressed the issue by suggesting the creation of a specialised Government Finance Co., for bearing the D.F.I.s' exchange risk (p.ix of Summary). The RBC observed that, "...the Finco approach does not eliminate the Government's contingent liability with respect to the foreign currency risk exposure inherent in these loans and advances. It aggregates the risk faced by the D.F.I.s, permits it to be placed in the hands of specialised professionals, and hence makes it more subject to management". This is all very well, but the Report avoids confronting major problems. For example, (i) government is subject to an open-ended commitment, (ii) D.F.I.s can become lax about forex dealings if they know government is there to support them, (iii) in the long run there is not much specialised professionals can do. The solution is not so much monetary tinkering and subsidisation at the tax-payer's expense as sound macro-economic policies which reduce the frequency and scale of currency depreciation, and sound companies which can cope with the effects of occasional falls and/or whose income and profits rise in line with the almost inevitably accompanying inflation. Nevertheless, in 1990 a scheme for protecting against exchange risk was under consideration in Kenya (11), though the details of it had yet to be properly worked out.

Though the RBC Report identified the depreciation of the shilling as a major cause of the poor operational and financial condition of many concerns into which the D.F.C.K. and/or the I.D.B. had put money, rarely did this appear to be the only damaging agent. The features referred to in the I.C.D.C.-related discussion, such as overmanning, low quality management, inadequate supply of domestic raw materials, run-down production facilities were equally present. And even when foreign debt exposure was the main feature in a company's problems, it was often linked to other financial weaknesses. Thus Mohan Meakin, a multinational-linked distiller, with a D.F.C.K. loan in D-marks, "..is currently experiencing a working capital shortage. It would seem that if the Company is financially restructured, it could be a going concern" (RBC Report Component 3 Vol.2 p.19). Canvas Manufacturers, the recipient of an I.D.B. loan, has "..an imprudent capital structure, and excessive foreign currency debt exposure...the debt/equity imbalance needs to be rectified and the foreign currency-denominated debt reduced". (Ibid. p.20). In Gnanjivan Screws and Fasteners, also a borrower from the I.B.D.,"..its financial expenses including foreign currency loan have drained its working capital to a crisis point". (Ibid. p.21). With regard to the sugar refining industry - referred to earlier - into which the D.F.C.K. in particular was encouraged to put capital (12), a World Bank 1987 Report notes (p.292), "The majority of the sugar companies in Kenya have incurred huge trading losses .... Overall, the sugar industry in Kenya is a poor performer, plagued with problems ranging from inadequate supply of cane to less than satisfactory sugar recovery rates as well as poor management and financial condition at the factory level".

Many other examples might be given from the experience of D.F.C.K.-financed and I.D.B.-financed companies, but it is unnecessary to do so, as they repeat and support the above observations. Suggestions by the RBC in relation to certain companies that "D.F.C.K. should negotiate to convert its loan to equity" (Ibid. p.21) or "..D.F.C.K. should negotiate to convert its D-mark loan into Kenyan shillings". (Ibid. p.20) are nothing more than ad hoc methods for passing the exchange risk on to third parties.

## THE D.F.C.K. AND THE I.D.B. - AN ASSESSMENT

A quote from Grosh in the first section of this chapter pointed to the overlapping of functions between the different Kenyan D.F.I.s. Though at that point in the text only evidence from the I.C.D.C. and the D.F.C.K. was available, it is clear that the operations of the I.D.B. also largely duplicate the work of the others. If differences in the approaches to doing business had been a consequence of the differing circumstances surrounding the origins and the ownership profiles of the institutions, a situation akin to imperfect competition would perhaps have come about, and duplication could have been justified by each of the institutions trying to enhance its profile before the others. In the event, however, a number of factors, not least the interventionist stance of the Kenyan government, brought about a convergence, not only in business behaviour, but also in level of (in)efficiency.

How significant were (and are) the D.F.C.K. and the I.D.B. as gap fillers in the Kenyan financial system, and what is the overall conclusion about their experience?

A very important feature in relation to both of them in a country short of foreign exchange was the foreign source of most of the funds at their disposal. For the D.F.C.K. to be able to lend long in foreign currency to incoming foreign firms helped to attract in foreign capital and expertise until a wider spectrum of circumstances discouraged new incoming businesses. To go on to finance purely domestic concerns as well was an appropriate move, always assuming that the D.F.C.K. encompassed supporting services comprehensive and efficient enough to identify good propositions and to follow them up. Other things being equal, the role of the fledgeling D.F.C.K. was clearcut, and it had the potential to be a catalyst in the finance of development. The move of the mainstream financial system into long term lending might have come earlier than it did, and to have been more adventurous in its scope, had the D.F.C.K. become an example of success in such business (12). However, a number of factors intervened to impair its progress, and turn it into an institution on the razor edge of financial collapse.

Firstly, as the RBC Report indicated, there have been severe management weaknesses in both the D.F.C.K. and the concerns linked financially to it. Secondly, as the earlier quote from Leys makes clear, it was obliged to finance 'marginal' projects. Now a 'marginal' project can mean different things. If for example, it is little more than a politically motivated exercise, as Leys seems to be assuming (see earlier) it results in a misuse of resources: if however it is thought to be marginal in an objective commercial sense, there is scope for a good D.F.I. to show what can be done to make it successful. However, coming up against the management drawbacks mentioned above made success elusive. Thirdly, there was the depreciation of the shilling, which affected the size of many loan repayments.

The plight of the I.D.B. has been similar to the D.F.C.K. Despite its all-embracing remit, it has remained principally a lending organisation, and as such in its early days helped - with the D.F.C.K. - to fill a gap in the financial markets, especially as its loans were in foreign exchange. Again, sound business operations could have turned it into a model for others. Unhappily, organisational weaknesses not only damaged its own procedures, but through a lack of disciplined control on the business behaviour of its beneficiaries, affected their own efficiency in turn. And, as with the D.F.C.K., the depreciation of the shilling greatly added to company difficulties. As a result, given the I.D.B.'s low income, without the Government guaranteeing all its debts, it could not have survived.

Because most of the credit the D.F.C.K. and the I.D.B. have been receiving has been 'soft', they have been able to lend at below commercial bank base rate. Now there are strong arguments against concessional loans (see Pt.1 Chapter 3), which centre mainly on resource misallocation, and it is fair to assume that in the first years of the lives of both organisations, many borrowers with dubious projects were attracted by the lure of cheap money. Furthermore, as the quote from Leys in an earlier section about marginal projects makes clear, there was political pressure with regard to the disbursement of funds, and cheap credit tends to attract those who can use leverage to obtain the subsidy.

A full treatment of the issue must be postponed till Part 3, but much of the above comment accords with the influence of features associated with the 'soft' state. Both the D.F.C.K. and the I.D.B. might have become established as sound long term finance organisations, in particular developing lending business towards borrowers whom the mainstream financial system would prefer to avoid, but who in due course would follow the example set, and move down the same road. Sound rehabilitation business, where firms are turned round and not just propped up, is a plausible part of the role of the two institutions. However both have become weakened by a wide spectrum of administrative and managerial failure at their own level, the level of the companies below them, and at government level. To this must be added political partiality and pressure.

Because of the record of these two bodies, it is suggested that Kenyan economic growth has been hindered rather than helped. Resources have flowed into unviable projects, only to be topped up with yet more as projects had to be rehabilitated. In so far as firms felt they would always be propped up, there has been no incentive to become more efficient. Finally, the financial system might have developed faster, had the D.F.C.K. and the I.D.B. given a clear lead rather than an awful warning.

NOTES PART 2 CHAPTER 6

1. The RBC Report on Kenyan D.F.I.s - commissioned in 1989 - has already been referred to extensively in Chapter 5.

2. Much of the material in this section was communicated to the writer at interviews in April 1990.

3.a) In all the sugar companies established after independence government was by far the biggest shareholder.

3.b) In 1988 the D.F.C.K. had 156,000 shares in Panafrican paper mills.

4. When the writer was in Kenya in 1990, it proved impossible to get any detailed information about S.E.F.C.O.

5. At the end of 1988 the fund sources for S.E.F.C.O. were as follows:

**TABLE 2**

S.E.F.C.O. - SOURCES OF FUNDS (KShs.m.)

| | **Advances** | **Facilities** |
|---|---|---|
| Government of Kenya | 54.1 | 8.0 |
| Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V. | | 18.5 |
| TOTALS | 54.1 | 26.1 (rounded) |

SOURCE: From D.F.C.K. Annual Report and Accounts for 1988 p.21

6. A further example of duplication is with the Kenya Tourist Development Corporation, since the D.F.C.K. has hotel businesses, such as Panafric Hotels Ltd., in its portfolio.

7. From various annual reports and interviews.

8. I am indebted to notes - including the quote - made by John Henley of Edinburgh University, for miscellaneous pieces of information in this section.

9. Allocating money to firms for rehabilitation purposes is a perfectly legitimate function for a D.F.I. to perform, and in the text there are various references to the technical functions that support financing arrangements of this variety in Kenya and Zimbabwe. Unfortunately in all the D.F.I.s investigated, rehabilitation exercises do not seem to have turned many firms around. In practice, 'rehabilitation' too often seems to have been a euphemism for 'subsidy'.

10. When depreciation occurs, exporters can (i) maintain the same prices in foreign exchange and receive higher profits, or (ii) lower prices in forex terms in the hope of getting more sales, in which case price elasticities of demand are crucial.

11. This was explained to the writer at I.D.B. and D.F.C.K. interviews in April 1990.

12. An example of this in the U.K. is 3i, referred to already in Pt. 1, Chapter 1. It was set up to finance small to medium firms making, for example, components, and such was the success of the organisation that banks, following its example, set up subsidiaries for the same sort of lending.

# Chapter 7

## THE (ZIMBABWEAN) INDUSTRIAL DEVELOPMENT CORPORATION

### INTRODUCTION

In certain respects the Industrial Development Corporation in Zimbabwe is analogous to the Kenya I.C.D.C. Both are totally in government ownership, both are -in the respective countries - the principal D.F.I.s with mainly equity investments in manufacturing and commerce, and both substantially antedate the achievement of independence by Kenya and Zimbabwe. However one of the most striking differences is that the I.D.C. appears to be financially solvent, whereas the I.C.D.C. - without government subsidies - is not. Indeed in contrast to the situation in the I.C.D.C., the I.D.C. Chairman (Annual Report and Accounts for 1988 p.7) observed, "I.D.C. holds a proud record of not ever having been subsidized by Government during its 25 years of existence". It is a pertinent question as to why the I.D.C. seems to have done better than the I.C.D.C. Have many of the shortcomings that plague D.F.I.s and the companies linked to them in Kenya somehow been avoided in Zimbabwe, or can the basis of the I.D.C.'s viability be questioned and criticised?

### THE I.D.C.'s REMIT

(a) The early years.

The I.D.C. was established in 1963. The initial capital was fixed at Z$10m, though only half of this, from a number of financial institutions in the U.K., South Africa and - what was then - Southern Rhodesia, and from the territory's Government, was taken up.

The aim was to supplement existing capital market provisions by providing a fresh source of equity capital so as to "promote the accelerated development of the private sector". (Ibid. p.5). It was prepared to associate in new and expanded ventures with foreign and domestic interests, and there was some attempt to favour business that because of the rather higher risk or longer gestation period, would be less attractive to private industry alone (1). Also the I.D.C. was to provide loan capital in the absence of sufficient provision (2). And when the recipients of I.D.C. equity capital were established, the Corporation was to sell its holdings to raise money for new ventures. Although the accent was on the fostering of manufacturing and commerce, in its early days the Corporation had interests in mining and tourism.

Very few - if any - ventures of ethnically African origin benefitted from I.D.C. money. Eventually, as a gesture towards helping aspiring African businessmen, and also in the light of the rapidly changing political situation, the Corporation in 1979 established a small enterprise subsidiary, the Development Finance Company (3).

In terms of the parameters laid down in Chapter 5 of Part 1, the I.D.C., as conceived of in its early years, appears to represent a very standard D.F.I. It was to fill gaps in the capital market, and channel money to those who might have had difficulty raising it elsewhere. And as a revolving capital organisation, it was to help stimulate the development of the the stock market. However, it was in operation for less than three years before Rhodesia was uniterally declared to be independent, and the territory was soon subject to trade sanctions. Hence, though the Corporation's remit remained in theory as it had always been, in practice it had an expanded role addressing certain of the economic difficulties that resulted. In particular, it took over a number of firms that otherwise would have collapsed.

(b) The independence years.

Almost inevitably, given the predilections of the incoming Mugabe government towards embracing socialism, with legal independence in 1980 came a change in the direction of the I.D.C. The 'partnership' approach to industry noted in Kenya appears in the Transitional Plan (p. 38): "Government intends to increase the level and control and participation by the State through establishment of new public enterprises, share participation in some existing ones, and joint ventures in key and strategic areas of the economy". More explicitly, at a later point in the Plan (p.73) it is observed,"The Zimbabwe Development Corporation (4) will promote coordinated State participation in the economy and will, through its subsidiary, the Industrial Development Corporation, which will be revamped and reorientated, accelerate State participation in manufacturing".

This commitment to government involvement in industry was further reiterated in the 1986-90 Development Plan (p.16), though some years after independence the tone is softer, with an implied acceptance that government may have to be left out: "It is estimated that during the Plan period foreign investment will amount to about Z$200m (5) and most of it will be in the form of direct investment or joint venture with Government and local industrialists". And at the end of the decade, in the light of lessons to be learned from international politico/economic changes, and when a commitment to some variety of socialism in Zimbabwe was ceasing to be even rhetorically fashionable, partnership in industry was played down even more. As was stated in 1989 in 'The Promotion of Investment: Policy and Regulations' (p.5): "It is Government policy to take part in the investment process by entering into joint ventures with private (local and foreign) investors in the strategic and basic infrastructure sectors. However, participation will not be the general rule unless dictated by special circumstances".

The 'revamping' of the I.D.C. after independence was quite substantial. The Smith government in the U.D.I. period had already increased the government share in the organisation to 80%, and in 1984 it was made 100%, this being considered necessary to "strengthen the development of public investment in the manufacturing sector". (I.D.C. op.cit. p.6). At the same time the I.D.C.'s interests in mining and tourism were transferred to the Zimbabwe Mining Development Corporation and the Zimbabwe Tourist Development Corporation. And the potential capital base was raised to Z$100m.

Even more radically, "The Board took a decision in 1984 to change from a policy of merchant banking activities to one of permanent long-term investment in equity in those affiliate companies in which the Corporation had an interest" (I.D.C. Annual Report and Accounts 1987 p.21), though in the 1988 Report (p.6) it was noted that the cessation of merchant banking activities was "except to its affiliate companies". In other words, the I.D.C. was to become a sort of investment trust cum holding company in relation to its equity portfolio. Thus was made explicit what in the case of the I.C.D.C. of Kenya was implicit and only to be deduced from operational behaviour.

Furthermore a policy intention that has been standard in many other D.F.I.s. including the Kenyan I.C.D.C. (see Chapter 5), and that is the attempt to satisfy social objectives while still remaining financially sound, was - rhetorically at any rate - firmly eschewed. The 1980 Annual Report (p.12), reminding the public of the objectives of the I.D.C. by quoting from the enabling Act, that the I.D.C. was, "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", added the principle that "consideration of every application and proposal (must be) strictly on its economic merits, irrespective of all other considerations whatever". Later, in the 1988 Annual Report (p.13), the Chairman stated, "At certain specific moments in its history, I.D.C. could have let the problem of meeting conflicting social and economic objectives detract it from the good performance of the Group, particularly during the first half of the 1980s. This was not allowed to happen, or at least such tendencies were checked before the rot could set in".

In these changes of direction it is a matter of debate to what extent the I.D.C. was any longer a truly 'development' organisation. Capital spending, as noted in paragraphs above, was largely to be associated with the furtherance of government participation in industry, both existing as well as new. Shareholdings were not to be liquidated to raise money for new investment, and so as a consequence the Corporation would be doing nothing for the stock market. And the recognition of the dangers of 'social' financing, together with the determination to avoid it, seems to have precluded any willingness to tackle 'difficult' areas of lending and equity capital provision.

Later sections will consider what actually happened.

OPERATIONAL BEHAVIOUR

In its operational behaviour, the I.D.C. added somewhat to the functions that it was supposed - in terms of the changing official conception of its purpose - to perform.

Firstly, during the U.D.I. period - that is, from 1965-1980 - it was, as already mentioned, a convenient vehicle for addressing some of the effects of economic sanctions. As is stated in the 1988 Annual Report (p.6), "The I.D.C. engaged various of its subsidiaries and other phantom companies (sic) to provide services which had previously been provided by overseas companies before economic trade sanctions were imposed. It is particularly during this period that I.D.C. strengthened the development of private capital in the private sector to the total exclusion of black entrepreneurs except in the late 1970s". New industrial ventures that took root - and some surprising products appeared, such as locally-manufactured perfume (6) - were very much a hot-house development, since they were protected not only by locally-imposed import restrictions, but also by an international embargo on exports to Rhodesia. It is a continuing matter of debate whether this enforced programme of import substitution and diversification was in the long term interests of the economy (7), but the World Bank seems to be favourably impressed. For example, in a 'country report', it observes (1985 p.47) "Zimbabwe's manufacturing sector is highly developed and markedly diversified, especially by African standards. It produces nearly all types of consumer goods as well as many producer goods". And later (p.49) it states with what what appears to be approval, "A remarkable feature of the industrialisation process under UDI was the reorientation of the industrial structure towards producer goods and heavy industry". Hence at official independence in 1980 the territory had a very varied industrial base (see Pt.2 Chapter 3 for more details). Import substitution - which must imply further diversification - remained (and still is) a standard policy aim of the government in Zimbabwe.

Secondly, the I.D.C. has from time to time been prepared to take over firms that would otherwise have collapsed. According to a Confederation of Zimbabwe Industries official, this did occur during the U.D.I. period. However the main period for this behaviour was during the early 1980s. Two major reasons were identified in the 1988 Report (p.6) as to why some firms were in such a condition that if they were to survive they required saving by the I.D.C.: "With an increasing number of sick firms going to the wall during the period of severe drought and international recession between 1982 and 1984 (see Pt.2 Chapter 3 for further details) and heightened disinvestment by foreign firms, confidence in the future of the manufacturing sector would have been greatly undermined without the intervention of the I.D.C. in rescuing ailing firms or acquiring companies of withdrawing foreign investors".

Although the text at this point goes on to a conventional justification of the policy in terms of employment protection, the preservation of skills and technology, and balance of trade equilibrium, later some apparent disquiet is evident. As the Chairman of the I.D.C. observed (Ibid. p.13), "Where there is a multitude of objectives, the usual tendency is to lose direction as a result of lack of priorities. Social objectives are then allowed to become an excuse for poor performance. The period 1982-1986 which involved extensive rescue operations of ailing companies could have witnessed an irreversible slide of the performance of the I.D.C. as Government attempts were made to prevent company closures and maintain employment in industry".(8) And the May 1988 edition of 'African Business' refers scathingly (p.31) to "..the Industrial Development Corporation, famous for bailing out ailing companies". However an interesting codicil to the observations in this paragraph is the fact that in 1985 virtually the whole Board of Directors was changed. Perhaps this is connected with the determination to prevent the I.D.C. going into an 'irreversible slide'.

Apart from the above, the I.D.C. carried out its post-independence remit of buying into existing profitable and established companies, such as Almin Industries. Furthermore stakes in existing companies were sometimes increased, even where the Corporation already had a majority holding. Hence, for example, in 1982 the holding in G and W Industrial Materials was taken up from 70% to 91%. However, the drive towards partnership with new incoming companies has not amounted to much during recent years, because of the collapse of interest by foreign multinationals in bringing new investment into Africa, and this of course includes Zimbabwe. Increases in I.D.C./multinational business cooperation have been more to do with expansion of existing operations than the initiation of brand new ventures. Also there has been some initiation of new ventures in cooperation with various local interests.

However, overall the expansion of I.D.C. activity in industry has hardly been spectacular. During the year ending in June 1987 for example one new concern came on stream, and there was some new plant at an existing firm (1987 Annual Report p.8). In the year ending June 1988, nothing new got under way. There were also a number of feasibility studies, most of which failed to lead to anything concrete.

Perhaps somewhat sinister has been the anecdotal but widely reported habit of the I.D.C. 'poaching' projects (9). This has occurred when a private sector concern seeks permission to go ahead with some new project that appears to have a good prognosis. The venture is disallowed at the Investment Centre (or prior to this by the more cumbersome monitoring arrangements then in place) but then the I.D.C. proposes a very similar project of its own (10). In general, pervasive Government influence in the work of the I.D.C. can be intimated from the following (Ibid. p.7): "Government requested the Corporation to take over the Zimbabwe Defence Industries (Pvt.) Ltd. as its wholly owned subsidiary". The fact that the I.D.C. Chairman for most of the 80s was a powerful official figure, as well as being a cabinet minister, could facilitate these types of operation!

## THE CIRCUMSTANCES OF I.D.C. COLLABORATION WITH PRIVATE SECTOR INTERESTS

(a) Introduction.

In the previous section reference was made to (i) the limited amount of new foreign investment coming into and (ii) the withdrawal of some private commercial interests from the Zimbabwe economy, in recent years. Both of these outcomes had implications for the I.D.C. as a major partner in industrial and commercial ventures. Secondly, and with obeisance to the 'rent-seeking' discussion in Part 1 Chapter 3, must be considered what advantages government may have been prepared to bestow on companies that were the result of I.D.C./private sector collaboration. The paragraphs below discuss these two issues.

(b) Foreign investment in abeyance.

Though there is a dearth of detailed information and comment on overall foreign direct investment in Zimbabwe, Bennell has some useful observations on British company involvement, and, given Zimbabwe's history, this represents by far the major element in the total. It is interesting that Zimbabwe, by coming to official independence rather later than most of the rest of sub-Saharan Africa, 'missed' the main period of hostility by the developing world towards foreign company investment. As Bennell points out (1989 p.3), "The strident criticisms of FDI (foreign direct investment) and TNCs (transnational corporations) so prevalent in policy-making and academic circles in the majority of SSA countries up until the early 1980s are .. rapidly being submerged in a tidal wave of official support for foreign investment". On the other hand, the disadvantage of 'late' independence was that while other countries were changing their official stance, Zimbabwe had to go through a truncated period of xenophobic muscle-flexing before pragmatism set in. Hence the regulations of the early 1980s giving the I.D.C. a higher profile than before with regard to company ownership and investment.

Indeed there has been a substantial contraction in U.K. company interest in sub-Saharan Africa. As Bennell observes (Ibid. p.8), "The importance of Africa as a location of British overseas investment has, in global terms, declined considerably since the mid-1970s. In fact, net industrial investment in Africa in Africa by U.K. companies has become relatively inconsequential, amounting to less than 0.5% of total industrial FDI in 1986 compared with around 4% in the mid-70s". Not only this: in addition, companies have been actively disengaging from sub-Saharan Africa. "..nearly one third of the British companies who had industrial involvements in ESA (Eastern and Southern Africa) in the late 1970s had already disposed of these investments by mid-1989..by far the largest number of companies have withdrawn from Zimbabwe [37], Nigeria [23] and Zambia [17]. Zimbabwe was in the grip of 'disinvestment fever' in 1987-8 with leading British companies selling out.."(Ibid.

p.16-17) The corollary to this was the I.D.C.'s policy in the early 80s of obtaining - at bargain prices (11) - some of these abandoned businesses.

There are a number of reasons for the lack of foreign interest in existing and new real investment in Zimbabwe (and in other African countries). First is the unsatisfactory - in a comparative sense - rate of return on capital. Bennell supplies a number of figures showing the 1988 post-tax rate of return in various industrial sectors for a sample of British transnationals in Zimbabwe compared with their global rates of return. In virtually every case the Zimbabwe outcome is inferior. A few examples are given below.

**TABLE 1**

SELECTED TRANSNATIONAL CORPORATION
RATES OF RETURN IN 1988(%)

| Sector: | Zimbabwe | Global |
|---|---|---|
| Metal | 17.9 | 20.1 |
| Electrical | 18.8 | 24.9 |
| Chemical | 13.7 | 21.2 |
| Textiles | 11.0 | 11.9 |

SOURCE: Bennell (op.cit.) Table 9

Though service industries do rather better - "the RORs on non-industrial FDI in Africa were nearly double those from industrial FDI between 1978-1984" (op.cit. p.15) - the Zimbabwe government has not been keen on new foreign investment in that area. As is stated in 'The Promotion of Investment: Policy and Regulations 1989' (p.4), "foreign capital is not encouraged in the services and services-related sectors such as banking, retail and wholesale trading and consultancy services".

Secondly have been (and are) the serious problems over sufficient foreign exchange. Indeed one aspect of this relates to the above issue concerning profitability, for only limited dividends may be repatriated abroad, so making effective profitability for foreign shareholders much lower than rate of return on capital might suggest. The

'Promotion of Investment: Policy and Regulations 1989' (p.7) explains that 50% of dividends from 'new', that is, after Sep. 1979, investment may be repatriated, but only 25% related to 'old' investment. The remaining percentage of declared dividends are treated as blocked funds, and have to go into low interest government stock. Remittance of capital abroad from disposal of assets is subject to substantial deductions, as noted in the last section.

Foreign exchange constraints have not been confined to the export of profits and capital, but also to the import of goods. Though funds are not meant to be issued for imports, especially consumer imports, if the goods in question are made locally, firms can normally hope for allocations for equipment, materials and components. However, allocations are made after various large deductions for government needs, and - according to the applicants - usually fall short of requirements. In general the foreign currency allocation system for imports has been fairly obscure, as is highlighted in the following: "The Green Book, a publication detailing regulations and guidelines on exchange control, published by the Reserve Bank, has deliberately not been made available to the public". (Financial Gazette 15-9-89 p.6-7). Indeed, the whole business has become complicated and clouded by allegations of corruption, as the following indicates: "(Albert Dube, Minister of Industry and Technology) refused to answer a question when a delegate asked whether allocations were ever made on the strength of political recommendation".(Ibid. p.6). And an observation by Sam Gozo, a local businessman (Ibid. p.7) that, "Industry in Zimbabwe has stopped managing business and is now managing currency" was reinforced for the writer by an official of the I.D.C.-held company, Berkshire International, when he explained that one employee's sole job was to try and secure more foreign exchange. The inability to secure enough foreign exchange has - according to a survey reported by Bennell (12) and the statements made to the writer in 1990 by financiers and businessmen in Zimbabwe - been the main factor undermining business, leaving firms undercapitalised and unable to reequip (13).

A third fairly wide-ranging complaint made by foreign interests about doing business in Zimbabwe has been the level of bureaucracy (14). This was particularly cumbersome in the matter of getting permission to go ahead with new investment - so discouraging many from bothering - and the 'one-stop' Zimbabwe Investment Centre set up in 1989 was meant to streamline the process. Richard Wilde, the acting director, observed that its reputation would depend on its ability "to drastically reduce the time taken for investment decisions to be made". (Fin. Gazette 8.9.89 p.3). Not more than 90 days was the goal. As in the not dissimilar Kenyan context, there was a tendency in business circles to regard the Investment Centre as just a further level of bureaucracy. And with reference to the previous discussion, a complex system of forex rules still dogs moves towards new real investment.

Fourthly is the matter of local borrowing. A company with more than 25% of its capital in the hands of foreign shareholders is very limited as to what it can borrow locally. Before 1989, however, the cut-off point had been 15%.

Fifthly, there has been (and is) a system of price controls which have been resented as keeping down profits and bringing in market distortions. They have also led to corruption, which has been per se a further cause of disquiet amongst foreign business interests. A celebrated instance, which led in 1989-90 to a government commission of enquiry, concerned Willowvale, a 100% I.D.C.-held importer of motor vehicles. Allocated only limited amounts of foreign exchange, it imported far fewer cars than domestic demand would warrant. Ministers and others in high places obliged Willowvale to dispose of many of these vehicles to themselves, which they then promptly resold privately at a large profit.

Sad though the above is, other more structured methods of getting round price controls have developed. The World Bank in a 1987 Report (p.43) observed, "businessmen have established superfluous distribution layers in order to boost the price between factory and final consumer".

The above paragraphs have investigated foreign business operations in general in Zimbabwe, rather than keeping to purely I.D.C. matters. Since, however, much I.D.C. operational behaviour has been largely geared to partnership with foreign-based concerns, the temporary change in focus is justifiable, since the scope and expansion of I.D.C. business interests is very much a function of foreign attitudes towards investment in the economy. However, it is fair to ask if in practice concerns with I.D.C. involvement have been less affected by the above disabilities than totally independent concerns. Evidence on this is mixed. The official line is very much that Corporation subsidiaries and associates have had no advantages. For example, in the 1988 Report (p.13): "The I.D.C. affiliates have to queue up for forex allocations, project approvals, price increase applications, and bank loans like all other industrial enterprises. Our affiliates are as much affected by exchange control regulations, rules governing the entry and exit of companies into the manufacturing sector, trade and industry specific policies and the high cost of commercial borrowing as every other enterprise in the land" (15). However the vociferousness of these assertions is a little suspect, and testifies to an awareness that allegations had been made to the effect that the I.D.C. had received favourable treatment. Since the I.D.C. Chairman, before his resignation at the end of the decade, had been not only a cabinet minister, but also in charge of forex allocations, it could be that at times I.D.C. companies were at an advantage in respect of foreign exchange allocations. Or such was a view from the C.Z.I. (But see above on Berkshire International). Nevertheless if companies affiliated to the I.D.C. ever were looked at in a more kindly light than others, it was insufficient to interest and attract foreign capital.

(c) The protection of firms.

The final part of the last section asked whether the disadvantages of doing business in Zimbabwe bore less heavily on I.D.C. affiliates than other firms. From the discussion it was deduced that this may have happened from time to time, but there is no evidence of consistent policy. Almost by default the personality link-ups and overlaps between I.D.C. and government must sometimes mean a balance of advantage to the Corporation (16).

This sub-section asks what indulgencies may deliberately be granted to I.D.C. affiliates. The main ones relate to import protection and monopoly status, and as such are likely to apply to all companies, whether I.D.C. or not. However, from a fiscal point of view, it is important for I.D.C. to be profitable so as (i) to avoid needing government subsidies, and (ii) as - in one sense - an investment trust, to make money for its one shareholder, the government: the state therefore has had good motives for wanting I.D.C. companies to be successful.

Protection of industry against imports has been fairly comprehensive, and the writer did not become aware of any evasion of the rules, as had been the case in Kenya. Until the moves towards liberalisation - which in fact means a graded system of tariffs (17) - at the end of the 80s decade, imports were kept out quantitatively. The World Bank (1987 p.37) explains the situation fairly bluntly, "..importation of goods that would compete with domestic production is not permitted, allowing industrial firms to operate within the domestic market without external competitive pressure".

The results of this policy are almost to be expected. Import substitution has been far more popular than trying to expand export markets, and the comfort of protection has tended to make firms unable to compete in exports. As a (U.S.) A.I.D. publication asserted in 1989 (p.vi), "Typically, value-added in domestic sales is 72% higher than in exports". A point it had made earlier (p.v) to the effect that, "Little attention has been paid to R and D, industrial marketing, product diversification" - within a product range - "and preventive maintenance", is no doubt partly a consequence.

Both C.Z.I. and interviewed merchant banking officials (18) felt that Zimbabwe had reached the limit - for the time being - of import substitution, and this was echoed in the 1988 I.D.C. Annual Report (p.8): "The primary phase of import substitution is rapidly drawing to a close, if it has not done so already". Recently there have been moves - such as consideration of the possibility of setting up export zones - to secure more exports, and there have been success stories. Berkshire International, for example, 37% I.D.C.-owned, increased its export earnings by over two thirds from 1987 to 1988 (Ibid. p.21).

With regard to Zimbabwe firms being domestic monopolies, the picture is somewhat clouded. As far as I.D.C. affiliates are concerned, in the 1988 Annual Report (p.13) the Chairman states quite adamantly, "To date, not a single I.D.C. affiliate company has total monopoly in its area of production". However, this affirmation conveniently lacks precision, and begs the question as to quite what 'area of production' means and how significant the competition might be. In practice some of the most successful I.D.C. affiliates, such as Almin Industries, making copper tubing and related products, and Zimglass, making glass containers, present as monopolies. And the World Bank (1986 p. xiii), though - admittedly - writing about 1982, reported that half of manufactures were produced under monopolistic conditions, and up to four fifths under oligopolistic (defined here as not more than 3 firms in an industry) conditions.

Indeed, according to the World Bank 1987 Report, cited earlier, the government actively works towards preserving domestic monopolies (p.37): "foreign exchange is denied to entrepreneurs wishing to start new firms that would produce goods already in domestic production, protecting established firms from domestic competition". It is, then, fair to conclude that government does try and generate industrial rents from the creation and perpetuation of domestic monopolies. From the point of view of foreign investors, a protected market would seem likely to result in profits, and from the point of view of government, there would be a chance of income via the I.D.C. from monopolistic affiliates. However, with regard to the level of profits, Bennell's figures, quoted earlier, show that British transnationals could expect less from capital invested in Zimbabwe, than could on average be earned globally. The reason for this is the battery of constraints put on companies (see last sub-section), the efficiency of the companies themselves (see later discussion) and the price controls government feels obliged to impose to try and curb inflation. Monopoly power, then, keeps companies in the black: a cluster of constraints hold them back from reaping large monopoly profits, and also from remitting abroad the profits they do make. (Refer to Appendix 1 for an analysis of this type of scenario).

## THE FINANCES OF THE I.D.C.

As was observed at the beginning of the chapter, one of the most striking features of the I.D.C., which contrasts it very strongly with the Kenyan I.C.D.C., is its apparent financial viability. In this section, the accounts of the Corporation will be investigated to establish the accounting basis of that viability.

As noted earlier, when it was founded, the I.D.C. began life with an authorised capital of Z$10m. When government took it over, the authorised capital went to Z$100m, and by June 1988, the amount issued had risen to just under Z$25m (I.D.C. 1988 Annual Report p.38). Though this represents a substantial increase, even allowing for inflation, the fact that it is still nowhere near the limit shows that both government and I.D.C. have exercised caution in the matter of expanding the Corporation's interests.

The nature of the funds at the disposal of the I.D.C. gives it a useful advantage. Since it has never gone in for long term borrowing, there has never been an obligation to pay interest. Government is the one and only shareholder, and given its organic links, both legally and via personalities, with the I.D.C., it is impossible that it should demand higher dividends than the Board of Directors want to declare. Thus the way is open for capital to earn less than its shadow price or opportunity cost without the Corporation being embarrassed.

And indeed, this is what has been happening. The table below gives the return on capital over a number of years, and, given that certain I.D.C. subsidiaries were borrowing from banks in the late 80s at concessionary rates of between 7% and 9%, and at non-concessionary rates of between 12% and 16% (Ibid. p.39), clearly the I.D.C.'s performance has been indifferent.

## TABLE 2

THE PROFITABILITY OF THE I.D.C.

| | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 |
|---|---|---|---|---|---|---|---|---|
| Profits (Z$000) | 2641 | 3518 | 2716 | 2274 | 1633 | 1726 | 2898 | 5694 |
| Shareholders' interest (Z$000) | 37344 | 40652 | 40859 | 43871 | 46640 | 55170 | 58546 | 86350 |
| Return on capital employed at beginning of year | 7.9% | 9.4% | 6.7% | 5.6% | 3.7% | 3.7% | 5.3% | 9.6% |

SOURCE: I.D.C. Annual Report and Accounts for 1987 p.32 and Annual Report and Accounts for 1988 p.38 and p.33

The dividend paid to the government has for many years been curiously static at Z$800th per annum. This represents a low and decreasing return on the capital the government has been putting into the Corporation, and an even more trivial percentage of 'shareholders' interest' (19) and the rather lower - in 1987 Z$47.6m - current value of investments. Therefore, in spite of everything, it may be concluded that the government has not been extracting much income from its I.D.C. parastatal.

A further look at the profits reveals a downward trend from 1982, with an even more drastic decline in their real worth. However these years were times of depression and drought, and witnessed the I.D.C. taking over some ailing and abandoned companies. In recent years the financial outcome appear to have been showing a substantial improvement.

However, it is now important to investigate the calculations from which profits figures have been derived. Unlike the I.C.D.C. in Kenya, interest and dividend income to the Corporation appears to be real enough: there is no mention of dividends being declared but 'having not been received'. Indeed, there appears to be a very disciplined approach to the responsibilities of affiliates, as the following indicates.

"Boards of affiliate companies also highlight financial objectives such as return on assets or capital employed, dividend payouts, gearing ratios etc. The principle of paying a dividend by an affiliate, no matter how small, is very important to the I.D.C. in fostering improved performance of the Group". (I.D.C. 1988 Report p.13). The table that follows shows the I.D.C.'s income over a number of years. It also shows expenditure, which, when deducted, leaves the profit.

**TABLE 3**

I.D.C. INCOME AND EXPENDITURE

| | **1981** | **1982** | **1983** | **1984** | **1985** | **1986** | **1987** | **1988** |
|---|---|---|---|---|---|---|---|---|
| Income (Z$th) | 3132 | 4091 | 3352 | 3160 | 2668 | 2818 | 4151 | NA* |
| Expenses (Z$000) | 490 | 574 | 635 | 885 | 1035 | 1092 | 1253 | NA |
| % increases in expenses | | 17 | 11 | 39 | 17 | 6 | 15 | - |
| Expenses as a % of income | 16 | 14 | 19 | 28 | 39 | 39 | 30 | - |

SOURCE: I.D.C. Annual Report and Accounts for 1988 p.32

* As from the 1988 Report the I.D.C. began to present its accounts in 'Group' rather than 'Corporation' form. Because of this, certain figures can no longer be deduced.

Income, paralleling the trend in profits, falls in the mid-80s, before picking up again. However, given the rate of inflation - approximately 14% a year on average (Quarterly Digest of Statistics for March 1989 Table 8.1) - real income in 1987 was still lower than it had been in 1981. Expenses, however, growing at about 17% a year on average, increased faster than the rate of inflation, and present as a growing proportion - until 1987 at any rate - of income. Whether the rise can be justified in terms of the expansion of I.D.C. activities is a research project in itself. Certainly the time of the quickest rate of increase coincided with the purchase of a number of companies in difficulties. However, as against that, a number of companies have become dormant, and the book value of investments rose on average from 1981 to 1987 by only 10.5% per annum (from I.D.C. 1988 Annual Report p.32).

Finally, it is illuminating to look at the sources and application of funds, where certain features require comment. In 1987 - later figures are not used owing to the obscurity introduced by presenting the accounts from a Group rather than Corporation viewpoint - the sources of funds (I.D.C. Annual Report for 1987 p.31) consisted, in addition to the profits, of substantial loan repayments, increase in shares issued. and one or two miscellaneous small items, making over Z$14.5m in total. However, of this less than Z$6m went on new purchases of shares and new loan facilities, and so working capital went up by Z$8m. This appears to show a combination of investment caution and a lack of viable demand for capital, though it is fair to add that this gap between funds available and funds disbursed does not happen every year. Furthermore with regard to the working capital, over Z$2m was extended to the affiliate companies. This type of lending business would seem more suited to a conventional commercial bank than a concern labelled a development corporation, though the World Development Report of 1989 does support a the idea of a D.F.I. lending companies working capital, in that it keeps it in constant contact with their business activities.

In conclusion, unlike the Kenya I.C.D.C., there does not seem to be any question, from an accounting point of view, over the I.D.C.'s financial viability. However, in order to fully pronounce on the integrity of this viability, it is necessary to look at the companies under the I.D.C.'s auspices.

## THE BASIS OF I.D.C. VIABILITY

(a) Introduction.

The I.D.C. has been shown to be financially solvent, though with a relatively poor average rate of return on capital. The following paragraphs investigate the nature and state of the companies from which the I.D.C. obtains its operational income (20). Later there will be a sub-section on the features integral to the Corporation itself that influence its financial condition.

(b) The affiliate companies.

In 1988, the I.D.C. listed 11 associate companies - with share ownership up to 50% of the capital - and 17 subsidiaries, where the I.D.C. held the majority of the capital. Of the latter group, 6 companies were held 100% by the I.D.C. (I.D.C. Annual Report for 1988 p.43). As will be seen, scrutiny of the 28 firms shows the Corporation's viability to rest on a shaky foundation. Indeed, it may be noted that in a list of 'top' companies (21) in a supplement on Zimbabwean companies (p.1) in the Financial Gazette of 18th Aug. 1989, no I.D.C. affiliate is included.

Five of the I.D.C. affiliates, one associate and four subsidiaries, all with 100% I.D.C. ownership were listed as 'dormant'. The associate, Allied Motor Distributors, dated from 1954, and had been set up for the import of a variety of consumer goods. It had not traded for a number of years, and had been partially bought by I.D.C. for a consideration that was not made public. Of the subsidiaries, one was a bankrupt small business credit company - see next section - , a second was D.S.O. Asbestos, taken over in 1979 soon after its underground mining ceased to be technically viable, the third was Mutari Exploration, bought up in the early 80s when the original owners wished to opt out, and the final one was Industrial Assets Corporation, about which no useful information was available.

However, apart from the above, there were five other companies which, though not listed as dormant, were not actually running profitable business operations. Communications Systems of Zimbabwe Ltd, an associate owned by the I.D.C. and Plessey, though set up in 1966, had never done any business till the late 1980s, when the Corporation decided it should make telephonic communications equipment. (This company was referred to in the second section of this chapter, when a prior independent proposal to make these types of goods had opportunely been rejected.) Nevertheless, as the I.D.C. 1988 Report admitted (p.22), "The company has experienced some delays in shipment of components for the manufacture of products ordered by customers". In connection with National Glass, a subsidiary set up in 1988 to manufacture sheet glass it was remarked (Ibid. p.17), "Equipment has already been ordered from Rumania". In February 1990 this equipment had still not arrived, perhaps understandably, considering the political upheaval in that country. The sole reason for buying Rumanian was the soft terms that surrounded the deal, and business opinion in Harare had no confidence in the quality of the goods on order. Nitro Nobel, a subsidiary established in 1986 in partnership with Swedish interests for the manufacture of explosives, had done no business by 1990.

Zimbabwe Pencils is a more dismal example of delays. The I.D.C. 1988 Report (p.17) is fairly bullish: "The project to produce pencils received government approval in 1988. Moves to implement the project are now under way in Mutare". However a June 1989 Financial Statement (p.6) is more guarded: "The company was incorporated on 9th Nov. 1983 to conduct the business of manufacturing and marketing pencils. Since the date of incorporation the company has acquired land and buildings, and is in the process of acquiring plant and machinery". In fact, the pencil project has been an excellent example of the type of lack of cooperation that bedevils the P.T.A. While the Zimbabwe pencil project was gestating, Botswana got into pencil manufacture, with the ability to supply the needs of its neighbours, and given the agreed preferential access to the Zimbabwe market, could undercut the projected Zimbabwe pencil price. The impression gained from discussions at the I.D.C. was that the project would come to fruition by virtue of its own momentum, rather from conviction or necessity.

Finally there is Zimbabwe Pulp and Paper, an associate incorporated in 1987 by the I.D.C. with a number of local interests. By 1990 only a handful of shares had been taken up, and nothing else had happened.

It is apparent that I.D.C. income comes from a relatively small group of largely monopolistic companies that were (i) set up in cooperation with private sector business interests in pre-independence days, for example Berkshire International in 1971, (ii) bought into when the owners wished to decamp, for example G. and W. Industrial Minerals (though I.D.C. had a minority holding before 1981), Willowvale Motor Industries, and Zimglass and (iii) companies bought into because of their profitability, for example Almin Metal Industries. (It must be added that it is not always clear whether a company fits type (ii) or (iii)) Also there have been occasional successful new projects in recent years, for example, Zimbabwe Grain Bags.

The question of the I.D.C.'s future solvency rests largely on the continued profitability of these companies. There are, however, some causes for concern. Government policies have kept them in protected, monopolistic positions, and with more liberalisation, this could change. As is openly stated in the I.D.C. Annual Report for 1987 (p.5), "Price increases cannot be the panacea to corporate liquidity and viability problems in the long run. Neither can demands by firms on Government for more trade protection from both domestic and foreign competition as well as the maintenance of the status of monopoly and oligopoly in business be the answers to problems of long term viability and investors' confidence. Price control, protection of infant industries and monopoly are double-edged weapons which are now tending to create complacency amongst some of our affiliate companies which fail to adjust to changing economic circumstances when the warning signs are flashing". Another on-going problem hitting I.D.C. affiliates, and discussed in general earlier, has been the inability to get enough foreign exchange to finance reequipment.

Another cluster of problems that have affected I.D.C. companies - and others of course - centre on manning. Until official independence in 1980, immigration of skilled and qualified people from Europe was encouraged. Furthermore the established white population enjoyed high levels of education. Hence was established an intellectual stratum that occupied the senior positions in economic life. In the early 80s many of these people left the country, so causing skill shortages. Government policy has been to surround the import of new relevantly skilled expatriates with stringent constraints, while at the same time requiring that more - frequently less well qualified - African people be employed in senior positions. The result, confirmed by one industrialist, is a shortage of some types of executive personnel. (U.S.) A.I.D. (op.cit. p.iii) sees the matter as a government policy shortcoming, "Manpower planning is weak in terms of skill contents..coordination between manpower planning and program implementing needs to be strengthened".

Management shortcomings do not appear to be as serious as in Kenya, but an I.D.C. comment makes it clear that this area does require attention. "..I.D.C. needs to evolve Group management structures with adequate support units for personnel training and management development, corporate finance, procurement of materials and services, marketing and export promotion and quality systems". (I.D.C. 1988 Report p.14)

In conclusion, though to some extent I.D.C. companies face the same problems as I.C.D.C. companies in Kenya, overall the picture is somewhat less bleak. Nearly all of those actually in business have been making profits, and to have been paying dividends. But, as the above paragraphs testify, there is hardly room for complacency.

(c) Financial solvency.

To what extent may the behaviour of the I.D.C. itself be directly contributory to its own financial solvency? Firstly must be considered the state of its internal organisation, which appears to be considerably more efficient than that of the I.C.D.C. in Nairobi. (If outward appearance witnesses to inner integrity, the I.D.C. has a lot going for it. Its premises are spacious, well-ordered, and bright, whereas those of the I.C.D.C. are slovenly and run-down) Nevertheless, there are management problems, and the I.D.C. is prepared to highlight them. One is the "poor conditions of service of head office management" (Ibid. p.14) which are applicable to the Corporation as a parastatal. The complaint is that qualified and experienced staff cannot be retained because of the better rewards in the private sector. Were the Corporation permitted to spend more on staff emoluments, however, expenditure, already creeping up in relation to income, could soon threaten viability.

Secondly, the impression is gained that the I.D.C. is rather better at monitoring companies than is the Kenya I.C.D.C. To quote from the 1988 Annual Report (p.13): "The I.D.C. affiliates are required to observe strict financial discipline". Furthermore various extension services are listed as being necessary (Ibid. p.14).

though it is not made clear who should pay for all this support.

Finally, of course, the main contributions I.D.C.'s behaviour has made to its own continuing solvency are:- (i) buying into established companies. Indeed, by keeping its stakes in 'good' subsidiaries to - in most cases - 51%, it has ensured that the erstwhile owners had little option but to continue running the enterprises much as before. This point is confirmed in the following observation from African Business May 1988 (p.31), "Another economist notes that even though the government has acquired shares in private companies, apart from appointing a few managers and directors, the policies of these companies have not changed much despite government involvement"; (ii) avoiding breaking much new ground into new ventures, with all the risks this entails; (iii) calling a halt to the absorption in the early to mid-80s of ailing and abandoned companies. In other words, the I.D.C. has 'played safe'. The final section in this chapter assesses the integrity of this policy.

THE DEVELOPMENT FINANCE COMPANY (22)

Before the late 1970s, there were no specialised credit facilities for small and emergent businessmen outwith the agricultural sector in Zimbabwe. However it became politically important to make a gesture in this direction in 1979. The U.D.I. government had embarked on its short-lived policy of reforging the political profile of the territory under the new name of Rhodesia-Zimbabwe, and, as part of the attempt to gain support from the African population, it set up the Development Finance Co. for making small loans. Initially it was financed by Z$1m capital from the government and a Z$1m soft loan from the central bank. In June 1980 soon after official independence there was a further loan of Z$1m from the I.D.C.

The company had been established in a hurry without the proper assembling of an experienced management team and a clutch of extension workers, and so almost from the outset there were financial problems. Loans were concessionary, demand was massive, and many received money who, in the context of proper commercial assessment, would have been refused. Very quickly interest and repayment arrears mounted, and in June 1981 new loans were suspended (23). The Board of Directors was obliged to resign, and the I.D.C. took over the administration. The state of the D.F.C. was - rather guardedly - made clear in the I.D.C. 1981 Annual Report (p.6): "The present record of interest payments and capital repayments is not good. Some quite substantial sums will have to be written off as irrecoverable".

In 1982 the company - with new directors and managers - fared better in terms of debt service, but large arrears remained. Under 100% I.D.C. ownership, considerable juggling of figures occurred in order to hide a dismal financial condition. For example, there was an admitted operating loss of Z$0.25m in the 1982-3 financial year, but, "..following a reduction in the provision for doubtful debts, a loss of only Z$3307 appears in the Annual Accounts". (I.D.C. 1983 Annual Report p.10). At the same time, it was determined that small business lending should be taken over by a totally new and independent organisation, the Small Enterprises Development Corporation. (See Appendix 3 for a limited investigation of S.E.D.CO.) There was now little for the I.D.C. to do but wind up the D.F.C. while continuing to try and collect some of the outstanding debts. A loss of nearly Z$0.5m in 1984 was admitted, and in 1985 D.F.C. assets - such as they were - were sold to S.E.D.CO. After this it was in liquidation, though as late as 1987 the I.D.C. was successful in collecting Z$192000 arrears.

The commercial problems of successfully lending to small businessmen have been amply discussed in earlier pages. When to this is added what seems to be overriding political motivation, which relegated to a secondary position business integrity, it is hardly surprising that the D.F.C. failed.

## AN ASSESSMENT

(a) General.

As became apparent in an earlier section, the I.D.C. has under its auspices quite a small number of companies. In 1988 there were only 28, of which 11 were associates, and 17 subdiaries. The value of the stake is given below, though, given the inactivity of the stock market, the market share valuation can only be rather impressionistic.

## TABLE 4

VALUE OF I.D.C. COMPANY ASSETS IN 1988 (Z$000)

| | | | |
|---|---|---|---|
| Subsidiaries: | | | |
| Ordinary shares | 29644 | | |
| Loans and advances | 7854 | | |
| Total | | 37498 | |
| Total at cost | | | 19074 |
| Associates: | | | |
| Ordinary shares | 22498 | | |
| Loans and advances | 277 | | |
| Total | | 22775 | |
| Total at cost | | | 11917 |
| OVERALL TOTALS | | 60273 | 30991 |

SOURCE: I.D.C. Annual Report for 1988 p.40

The above figures are put into perspective when - according to the published figures - the registered increase alone in the nominal capital of all existing companies in Zimbabwe was - with the usual proviso about valuation - nearly Z$460m for the first 9 months of 1988 (Quarterly Digest op. cit. Table 26.2). Furthermore, the scope of the I.D.C.'s operations is much smaller than that of Kenya's I.C.D.C., which in 1988 had equity holdings in 66 or so companies. Without taking into account the loans outstanding, equities at cost were worth KSh678.1m (I.C.D.C. Annual Report 1988/89 p.29) - very broadly Z$100m - and at a very rough current valuation KSh1420.2m (Ibid. p.24) - very broadly Z$250m.

However, despite the evidence from the data, which in statistical terms presents the I.D.C. as a fairly modest player on the Zimbabwean industrial and commercial stage, its influence on development might be much greater than its size might suggest, if its business operations were directed accordingly. Now though Zimbabwe in recent years has experienced (i) an insufficiency of new real investment, especially new incoming investment, and (ii) some retrenchment in its financial system, especially with regard to capital funds provision (see Pt.2 Chapter 4), it is still - by sub-Saharan African standards - well-endowed with manufacturing capacity and financial services.

It is not, suggested, therefore, that the I.D.C. become the dominating vehicle for the achievement of industrial and commercial development, but that it act, in the terminology of the RBC Report Component 3 Vol.1 (p.iv) as a "catalyst", a "demonstration vehicle" and - possibly but more questionably - as an "entrepreneurial talent bank". How, and with particular reference to reference to the discussion in Part 2 Chapter 4 on the role for a Zimbabwe D.F.I., has the I.D.C. fared? Very significant has been the deliberate shift in gear, determined upon in the early 80s, towards permanent investment in companies, and the cessation of loan business, except to affiliates. (Although it is nowhere explicitly identified as such, this type of lending may safely be assumed to be of the 'rehabilitation' variety, since the mainstream financial sector only will lend to prosperous companies). It might be concluded from this that the I.D.C. has become nothing more than a holding company/investment trust, in which case further discussion is redundant. However, the word 'development' remains in the organisation's name, and jargon used in statements about the Corporation's future, for example "developing new investment in greenfield industries", "increased use of local resources, and job creation" (I.D.C. 1988 Annual Report p.12), witness to an approach that still includes a development-orientated constituent.

(b) The 'development' context.

The review of the I.D.C.'s contribution to small business finance can quickly be disposed of. Though this area of lending in Zimbabwe has never been properly addressed by the mainstream financial system, so leaving a gap in capital provision, the unsuccessful I.D.C. foray into it was largely determined by political necessity. Not designed to diversify into such work, it failed to rescue a concern that was dogged by political chicanery and financial decline.

A further development-orientated shortcoming of the I.D.C. has been its failure to nurture the stock market. Unlike the Kenya I.C.D.C., however, where policy was never made explicit but to which a similar criticism can be levelled, this was an automatic outcome of the decision to hang on to shares rather than dispose of them. Of course, given the scale of I.D.C. investments in the 1980s, it is unrealistic to suggest that willingness to sell equity would have massively stimulated securities trading and the issue of new financial paper. However, what is being noted is the move by the I.D.C. into more or less the status of a conservative investment trust rather than as an outgoing revolving capital development organisation. The gap was there, but the I.D.C. has shied away from filling it.

The establishment of new partnership ventures with foreign concerns has been a theoretical feature of I.D.C. business expansion, but very little of this has happened in recent years. Before official independence in 1980, international sanctions precluded the overt movement of capital into the country, but the 80s and after have not seen any turnaround. Some of the reasons for this are outside the I.D.C.'s control, being more to do with government attitudes, policies and practices, and the general economic situation, and there is no need to repeat the earlier discussion in this chapter on those topics. For the rest many foreign firms are hostile to partnership arrangements, unprepared to see ownership diluted in exchange for advantages - or the intimation of advantages - which in practice have little substance.

Finally the I.D.C. in the 1980s took the initiative in establishing new ventures with local capital, and occasionally with - what appears to be - fairly unenthusiastic foreign participation. There have been only a handful of these, all mentioned before - National Glass, Nitro Nobel, Communications Systems of Zimbabwe, Zimbabwe Pencils, Zimbabwe Pulp and Paper, and Zimbabwe Grain Bags. With the exception of the last one, all have been constrained by delays, dubious dealings and miscalculations. This study has been sceptical of a D.F.I. being successful in a supply leading role, but does not rule it out if both institution and any bodies acting with it are sufficiently matured and sophisticated to support such a development. Given the age of the I.D.C. and the relatively advanced - by African standards - profile of the economy, I.D.C.-led business developments would seem plausible. But though there are - as annual reports amply describe - numerous projected ventures, feasibility studies and pre-feasibility studies, carrying through the few ideas that are accepted does not proceed easily.

(c) The I.D.C. and the 'soft' state?

The I.D.C. has not done much for industrial development in Zimbabwe, and there has not been (and is not) another specialised - and active - institution in the economy geared to supporting general manufacturing and commercial growth with equity capital. To suggest that the inadequacy of the I.D.C. in relation to economic development is due to the 'softness' of the politico-economic system may perhaps be countered by the riposte that since the early 80s it has not been trying to be primarily a development organisation, so that its low profile in this sphere is due more to choice than unfavourable influences. However the shift in direction seems to be at least partly due - though certainly not wholly due, given the government's determination after independence to increase its stake in industry - to caution about a more positive development-related role. The developing world was seen to be full of insolvent development finance institutions that, burdened with the impedimenta of conflicting economic, social and ideological objectives, and fuelled by rashness and ill-considered enthusiam, had stumbled before the cold winds of economic reality and disordered administrative apparatuses. Zimbabwe, coming to independence 'late', when these realities were now clear, was not going to be distinguished by the spectacle of its main development corporation going in the same sad direction. Such an attitude is very clear from statements already quoted, as in the following from the I.D.C. 1988 Annual Report (p.13). "Where there is a multitude of objectives, the usual tendency is to lose direction as a result of lack of priorities". And, very positively, "such tendencies were checked before the rot could set in".

Therefore it may be concluded that concern about the effect of features that are associated with the concept of the 'soft' state played a part in bringing about the I.D.C.'s change of direction. And indeed, the limited amount of I.D.C. activity that does more or less qualify as supporting economic development tends to justify the anxiety. The machinations behind the establishment of concerns making glass and communications equipment, the remarkable slowness in getting new projects off the ground, the miscalculations in the case of pencil production, all suggest that if the I.D.C. were more adventurous in going in for new projects, its integrity could soon be in doubt. And overshadowing the I.D.C. has been the government, with questionable personnel overlaps between the two, and the inconsistent application of conflicting policies that in general upset company operations, and may or may not favour I.D.C. affiliates. In this context are the advantages (for the companies though not for the economy) of monopoly status and protection, coming up against the disadvantages of price controls and foreign exchange shortages. Furthermore, plenty of evidence is available (see earlier quotes) that shows corrupt allocation procedures for foreign exchange. Fortunately Zimbabwe has continued to have a fairly open political system, so the Willowvale episode became a public scandal, but anecdotal evidence supports a widespread belief that profiteering of the same type occurs in the context of other companies as well.

There may be overt economic and ideological reasons why foreign companies are reluctant to invest in Zimbabwe, but the disorder presented in the paragraph above compounds the basis for the reluctance. Similar constraints bear down on the real investment of capital funds by Zimbabwe residents. Given its low 'development' profile, it may be intellectually rash to try and support too positively the second part of the hypothesis in this study by suggesting that the I.D.C., in the light of experience, actually inhibits industrial growth. However, with regard to new investment from abroad, though 100% foreign ownership is not ruled out, the objective is that there will be cooperation with domestic interests. As the 1989 publication 'The Promotion of Investment: Policy and Regulations' (p.4) makes clear, "the Government prefers majority Zimbabwean participation in new investment projects". Though the I.D.C. is not specifically mentioned, partnership with it is the most straightforward way by which a foreign company could obtain Zimbabwean participation in a new venture. However, given the I.D.C.'s 'development' record in the 1980s, it is questionable how keen a foreign company would be to come to Zimbabwe if partnership with the I.D.C. was a condition.

## PART 2 CHAPTER 7 NOTES

1. This latter point was put to the writer during an interview at the Confederation of Zimbabwe Industries in Feb. 1990. Since it refers to an era long past, a substantial research project would be necessary to properly investigate it. However,

there is no reason to doubt C.Z.I. integrity, and it does testify to a D.F.I. trying to behave very much in accordance with some of the parameters laid down by many writers on the subject. (See Chapter 5 in Part 1 for further discussion).

2. Again it was not that the relatively sophisticated financial system in Salisbury never provided industry with term loans. However, it kept - understandably perhaps - to established and assessable borrowers.

3. The Development Finance Company is fully discussed in a later section.

4. The Zimbabwe Development Corporation was established by a 1984 Act of Parliament. It aimed to 'set the stage for a coordinated approach to public sector investment in the Zimbabwean economy. As the major Government holding Corporation, Z.D.C is peculiarly placed to identify and promote development opportunities in most sectors of the economy'. (Z.D.C. 1989 p.5). In practice the Corporation turned out to be an organisation looking for a role, and by the end of the decade, and having only a handful of assets, it had not made much of an impact. As a holding company of industrial companies it duplicated the I.D.C., and as a potential holder of the D.F.I.s themselves, it looked to be just an unnecessary bureaucratic imposition, well suited to be an employment refuge for the favoured, and a user of scarce resources. Its marginal significance in 1989 and 1990, when field research for the present study took place, disqualified it from investigation in the main text.

5. A very optimistic estimate, as it turned out.

6. .. as was observed by the writer in Salisbury (now Harare) in 1975.

7. A C.Z.I. official was critical of the fact that the result had been the creation of a number of high cost firms.

8. The fact that the points of view implicit in this and the previous quote differ need not be significant. The earlier passage comes from a ritualistic speech by the

President on the occasion of the Corporation's 25th anniversary and reprinted in the Report.

9. Information from the C.Z.I.

10. Supposedly the intention to produce communications apparatus in conjunction with Plessey (see the I.D.C. Annual Report and Accounts for 1987 p.7) was the result of such machinations.

11. To quote Bennell (p.18) again,"..an increasing number (of U.K. companies) are prepared to accept very large discounts on their current market values in return for being able to remit the proceeds of disinvestments to their British shareholders".

12. (Ibid. p.16), "Nearly 75% of respondents ranked foreign exchange availability as the most serious constraint facing their companies in ESA".

13. At an interview in Feb. 1990, a leading merchant banker observed that a lot of reequipping was needed in the Zimbabwe economy but was not happening due to forex shortages.

14. This of course is part and parcel also of the foreign exchange problem.

15. Replies to questions put by the writer to I.D.C. officials at interviews in Feb. 1990 were - not surprisingly - in the same vein.

16. One is reminded here of Adam Smith's remarks on the restraint of trade.

17. In the publication 'Zimbabwe: a field for investment', the following (p.44) appears, "the Government is slowly working towards a regulated and planned import liberalisation programme, although local industries will have to be protected". Indeed during 1990-91 the Open General Import Licence system was widened to a much larger range of products than before, and, with demand apparently greater than

expected, the Zimbabwe dollar fell fast. However, it was widely believed that government, with a budget deficit at 10% of G.D.P., was largely to blame. The moral is that trade liberalisation must be accompanied by macro-policy reform.

18. Merchant banking officials and others.

19. This consists of 'share capital', 'capital reserves' and 'retained earnings'. In fact in the 1988 Report the term 'shareholders' interest' is changed to the more practical 'capital employed'.

20. The information about companies in the following paragraphs comes mainly from interviews, I.D.C. Annual Reports, and material in the Harare Company Register office. Frequent acknowledgement of the latter source would be tedious, and will not appear in the text. The details about companies held in the office consists of bundles of documents stuffed into files, and are frequently incomplete and obscure. It is believed, however, that there is sufficient data in the paragraphs that follow to give an accurate and useful picture of the state of companies under the I.D.C. umbrella.

21. In terms of net earnings in relation to turnover.

22. Much of the information in this section comes from anecdotal and interview evidence, since, given the disastrous record of this organisation, little official reference is made to it in print.

23. It was remarked to the writer that the U.D.I. prime minister Ian Smith had not really worried if the loans turned out to be de facto grants if thereby the new constitution got the support of those who benefitted.

# Chapter 8

# THE ZIMBABWE DEVELOPMENT BANK

## ORIGIN AND REMIT

(a) Origin.

The Zimbabwe Development Bank was founded in May 1983. A major aim behind its establishment was to provide a semi-official conduit for foreign development funds into the country, given that the I.D.C., with its ownership structure and remit, had little appeal to outside donor agencies. A new organisation, involving a much lower government profile, was necessary if 'official' foreign money was to be obtained (1).

No business was conducted until 1985 after "some concerted preparatory work" (Z.D.B. Annual Report 1989 p.3). By June 1989, of an authorised capital of Z$50m, Z$20m had been called up, with the Zimbabwe Government having subscribed 51%. Other subscribers were the Reserve Bank, and a number of non-Zimbabwean development finance agencies, including the Commonwealth Development Corporation. In addition to share capital, the Z.D.B. has negotiated some lines of credit from abroad, generally on concessionary terms. However, to date, the great bulk of incoming funds has been in the form of equity. As was observed in heroic understatement (Ibid. p.22), "As at June 1989, the debt-to-equity ratio stood at 0.06:1 which compares quite favourably with the current statutory limit of 5:1".

Officials of the Confederation of Zimbabwe Industries believed that the Z.D.B., in line with the philosophy behind its conception, remained independent of government, and they pointed out that it received no government guarantees (2). It was explained that the foreign shareholders aim, through their representatives, to approve all loans, and would always block financing that had a political ambience.

However, by virtue of the government's 51% holding, and also - in practice - because of the Reserve Bank's involvement, the Z.D.B. is a parastatal, and so, despite the presence of a minority of directors appointed by the outside shareholders to monitor and guide policy, it is unrealistic to assume that the state would not be in a position to exert influence over the business the Z.D.B. conducts, if it so wanted. And indeed, the substantial amount of money devoted to rehabilitation loans, a function which is not laid down in the fairly comprehensive remit, suggests that the government did to some extent bias Z.D.B. lending in a direction it favoured.

(b) Official remit.

Though the Z.D.B. is termed, per se, a 'bank', there is no indication that at the outset it was intended to be almost entirely - as subsequently happened - a lending organisation. The remit, as laid out in the Zimbabwe Development Bank Act of 1983, and referred to in the Annual Report for 1987 (p.2) gives equal weight to "(providing) capital which is needed for the expansion, modernisation or creation of new enterprises" and "(engaging), alone or with other persons or institutions, in financing loans or bonds, whether medium or long term, guaranteeing loans, underwriting and other related activities". Furthermore, its remit in terms of fund disbursement and further resource generation was very wide. It was authorised to "mobilise internal and external resources for economic development and..finance development projects in all sectors of the economy". Thus the Z.D.B. could not only do everything the I.D.C. did, but also everything relevant to the more specialised Zimbabwean D.F.I.s that exist for tourism and mining.

It is almost obligatory for a developing world D.F.I. to state some social goals, and the Z.D.B. does make some gestures in this direction. These will be looked at later. However, by the mid-80s, when the incubus of loss-making parastatals was making its presence felt (see Pt.2 Chapter 3), it was becoming virtually mandatory that new organisations of this legal type put viability above other considerations. Thus, in the 1989 Report (p.3) are the words, "..Government would prefer, and, in fact, does tirelessly encourage parastatals to generate adequate income to enable them to stand on their own feet and be less dependent on the state budget. Indeed the Bank is specifically required to be run on commercial lines at all times".(3) Thus guidelines for Z.D.B. operations are some distance from the socialist rhetoric that accompanied the winning of independence: pragmatism and the necessity for avoiding causing irritation to foreign shareholders have precluded any references to the achievement of grandiose new societal structures.

Nevertheless, to take up the 'social' theme, supposedly priority is given to projects which "provide permanent employment", "promote Zimbabwean ownership and management", "utilise or raise the value added of local materials", "generate or save foreign exchange". (Ibid. p.2). Furthermore, in 1990, the Bank established a 'soft lending window', called the Zimbabwe Development Fund. With money from the existing institutional shareholders, certain other agencies, the Government and the Bank itself, its purpose is to provide equity for new entrepreneurs, and also technical support and training for them. Writing in early 1991, it is impracticable to judge on the experience of this subsidiary. As a 'bank', the Z.D.B. has reason for wanting to parallel the efforts of other domestic banks in this direction (see Pt.2 Chapter 4). Though as a development-orientated parastatal it could be accused of duplicating the work of the Small Enterprise Development Corporation, the competition may be considered a spur to efficiency.

OPERATIONAL BEHAVIOUR

(a) Z.D.B. business.

1. Extension support.

Congruent with the reported determination of foreign agency shareholders to supervise Z.D.B. business, a substantial apparatus for project screening, appraisal, analysis, monitoring and so on, plus the assistance of outside advisors and consultants was established (Z.D.B. 1988 Annual Report p.6). Indeed the deployment of arrangements is - in print - more comprehensive and impressive-sounding than that of any other Zimbabwe D.F.I. (4). As the 1987 Report states (p.15), "The technical assistance extended by external agencies during the year has enabled the Bank to fill in critical gaps and move faster than would otherwise have been possible in a number of directions. Specific mention must be made of the continued support received from United Nations Development Programme, the European Economic Community and the Government of the Federal Republic of Germany through the German Agency for Technical Cooperation". And in the 1989 Annual Report (p.23) there is recognition of support, including Harare-based expatriate staff, from the European Development

Fund, and again from the U.N.D.P. and the aforementioned German agency.

In Part 1 it was recommended that riskier forms of lending - such as are likely to be undertaken by D.F.I.s - legitimately qualify for extension support financed by exogenous agencies. From the above it appears that Z.D.B. lending was to be so supported.

2. The broad features of lending.

Despite the term 'development' in the organisation's title, there appears to be little about the Z.D.B. that suggests a pioneering approach to business, though perhaps the establishment of the Zimbabwe Development Fund witnesses to the beginnings of a more adventurous role. Aside from this, applicants for loans are expected to be wanting at least Z$100000, a stipulation which more or less cuts out new or small businesses.

The portfolio of the Z.D.B. consists predominantly of loans to existing companies in the light manufacturing sector, and a number of well-known international conglomerates appear on the list of recipients, such as Metal Box, Blue Ribbon Foods and Bata Shoe Co. Other things being equal, financing companies such as these can be expected - relatively speaking of course - to constitute unadventurous, but safe, business. Furthermore, according to the 1988 Report (p.20) more than three-quarters of the Z.D.B.'s portfolio is in plastics, textiles and leather, metal products and food and beverages. Though these categories, given that in the main they cover protected import substitutes, should be fairly safe areas to which to make loans, official comment is critical. As the 1988 Report asserts (p.21), "Deliberate efforts will continue to be made to diversify the portfolio into other, high development value areas".

Indeed much of the Z.D.B.'s build-up of lending has led more generally to concerned comment. Already by 1987 (Annual Report p.13) references to rehabilitation had crept into official statements. To quote, "While rehabilitation work (such as has tended to dominate investment activity in the past few years) is important and helps to preserve the existing jobs, increase in work opportunities can only emerge from expansion of established operations and the opening up of new ones". And the 1988 Annual Report (p.21) observes, "The Bank's portfolio ... has a predominance of projects in the size category of $100000-$500000. This reflects the weight of rehabilitation type investments, which generally do not require substantial capital outlays".

A note of anxiety comes through clearly in the following quote from the 1989 Annual Report (p.22), "In overall terms, the majority of commitments now fall into the category of small to medium scale, where there is often limited in-house capacity to successfully implement the projects". The Report (p.39-40) goes on to classify commitments into "new project/new product" investment, expansion" investment and "replacement" investment. Of the 58 "cumulative commitments" only 13 were classified as 'new', the rest were 'expansion' or 'replacement'. However the practical distinction between these two categories is never very clearcut, and 'expansion' can mean something as unadventurous as 'removal of production bottleneck and inhouse maintenance'(5).

Indeeed, this profile of investment approvals has led to some presidential criticism. President Mugabe remarked (1bid. p.3), "It is also my fervent hope that the Zimbabwe Development Bank will now be in a better position to render assistance to new projects rather than concentrate on replacement and expansion projects".

(b) The 'social' criteria.

As pointed out earlier, despite the accent on financial viability the Z.D.B. remit states normative aims, even though - in practice - the achievement of them might damage that viability.

Annual Reports frequently refer to the importance of employment generation, though the Z.D.B. has not been markedly successful in this. In the 1987 Report it is stated (p.13) "..employment generation remains a priority of great national importance and becomes more so with each successive year". And in the 1989 Report (p.3) the

President states (p.3) ".....new projects have a greater potential for employment creation and will thus assist in the fight against unemployment in the country". The anxiety apparent in these remarks is perhaps justifiable in the light of data in the 1988 Report, where it is claimed that Z.D.B. money - with other funding - had to date resulted in the creation of a trivial 415 new jobs (6). This figure is suspiciously exact, but apart from that, since it is a consequence of loan approvals rather than disbursements, it is not certain that all this new employment actually came into being. Nearly thirteen and a half thousand 'existing' jobs have been associated with Z.D.B. financing, which is to be expected in the light of the Bank's heavy commitment towards replacement and modernisation loans. Lack of sufficient data makes it impossible to judge how many of these existing jobs have been preserved due to successful rehabilitation exercises (7).

Though there is nothing specific in the Z.D.B.'s remit about the desired geographic spread of Z.D.B.-supported projects, Harare and Bulawayo, the two main centres, have been the locations of most. Of 58 'cumulative approvals' in 1989 (Annual Report for 1989 p.39-40), for example, 32 were in Harare and another 12 in Bulawayo. Location theory would tend to support this situation, but it has meant less development elsewhere. A remark in the 1988 Annual Report (p.23) indicates some official concern: "Although the geographic spread continues to be biased in favour of Harare and Bulawayo, it is pleasing to note that of the fifteen projects approved during the year 6 were from smaller centres".

With regard to the goal of "promoting Zimbabwean ownership and management" (see the first section) there is no evidence to show much specifically Z.D.B.. action here, and in any case the phraseology is lacking in precision. To promote Zimbabwean management in industry has been a general government aim for the economy in general, but of course as with the companies connected with the I.D.C., this does not - given the relatively small but generally highly-qualified population of European origin in the country - have to mean indigenous Zimbabwean management, as in an analogous sense it would in most other African countries.

THE FINANCES OF THE ZIMBABWE DEVELOPMENT BANK

In the light of the above, how has the Z.D.B. fared financially? To begin with, the Bank, in common with the I.D.C., has, since its inception, apparently been a viable organisation. The following table gives some 'profit' details.

**TABLE 1**

Z.D.B. PROFITS

| Year ended 30 June | **1989** | **1988** | **1987** | **1986** | **1985** |
|---|---|---|---|---|---|
| Net profit (Z$m) | 3.3 | 3.1 | 0.6 | 1.5 | 1.4 |
| Return on total assets(%) | 10.0 | 11.0 | 4.0 | 17.0 | 19.0 |

SOURCE: Z.D.B. Annual Report for 1989 Table 6.2

However, the above data must be qualified. Firstly, details on Z.D.B. administrative and related expenditure are by custom not given in the annual reports, so it is impossible to gauge how the 'operating profit', a sum rather less than the 'profit' figures given above (see below for clarification) is arrived at. Very significantly, it is not stated how much interest income is received from borrowers, and how much - if any - remains in arrears. Secondly, the operating profit in 1989 was in fact only Z$2.3m, the rest of the overall profit being accounted for by an exchange gain on unused capital resources, from which total probably a rather low - in the light of later discussion - provision for doubtful debts had been subtracted. Given the secular depreciation of the Zimbabwe dollar, an exchange gain has been a feature every year of the Z.D.B.'s existence. However, for this type of windfall to continue to accrue, there must be a steady inflow - and under use - of funds from foreign sources, and obviously this cannot be guaranteed. Thirdly, the percentage relationship with total assets gives a rather distorted picture of the financial situation, since 'total assets' includes an item termed 'current loan maturities', in other words, loans due to be repaid, but presently still outstanding. In 1989, of Z$33.4m total assets, Z$6.5m were these current maturities (Ibid. p.29), and they have been increasing every year, going up in 1988-9 by Z$2.2m. Did 'current loan maturities' not exist, then either the money due would have been repaid, in which case it would have become new liquid or capital assets, so keeping profit to the same percentage as before, or more debts would have been written off, so reducing profits. Lastly, despite profit being in the black ever since the Z.D.B.'s inception, only for 1988 and then again for 1989 was it considered prudent to grant - very small - dividends to shareholders.

To turn again to 'current loan maturities', these have been steadily rising each year and must eventually therefore (i) have a detrimental effect on profits if they bring in no income and/or (ii) mean a reduction in the funds available for new loans or of course for reimbursing creditors. However, at the time of writing comment on this issue was made to sound optimistic. The 1989 Annual Report asserts (p.22), "By year-end only two clients were in arrears (by a total of under Z$20000)", though, in the light of 'current loan maturities', this must be a fairly liberal interpretation of the word 'arrears'.

Funds for new loans have been available from a variety of sources, including negotiated credit lines, calls on share capital, profits and loan repayments. Commitments to new lending bear only scant relationship to actual lending during the same time period, and it is not clear to what extent some agreed loans are ever activated. In June 1989 the loans portfolio stood at Z$14.1m (Ibid. p.29), and the only other major, but rather different, fund disbursement was a Z$3.5m housing development investment through building societies (Ibid. p.32).

In conclusion, though Z.D.B. finances have ostensibly remained healthy, analysis reveals a less happy situation. Rehabilitation loans - though not necessarily a mistake if firms are successfully turned round (see later) - can degenerate into straight subsidisation, as appears to have occurred extensively in Kenya. And the build-up of 'current loan maturities' suggests that increasing numbers of beneficiaries find it difficult to pay back on time. There can be no certainty, therefore, that profits will remain positive.

## AN ASSESSMENT OF THE WORK OF THE Z.D.B.

The previous sections have revealed a picture of the Z.D.B. as a rather ambiguous organisation. There would appear to have been an uneasy compromise not only between the attitudes of foreign shareholders and the goals of government, but also between the government's commercial and social aspirations.

Foreign shareholders and loan providers want their money to be safe and efficiently used so (i) aim to exert influence through directors they appoint, (ii) oversee the creation of elaborate monitoring arrangements, and (iii) forbid the making of political loans. Although, by channelling money through a development organisation, they are by definition prepared to target projects that mainstream intermediaries would be wary of financing, the necessity of ensuring the integrity of the money advanced must set a limit to the level of riskiness accepted. Furthermore the elaborate extension arrangements are meant to identify potentially sound projects and, by supporting beneficiaries, to increase the likelihood of commercial viability. However government, while wanting financial solvency, has built social goals into the remit, with the result that the Z.D.B. has - in the interest of preserving jobs - become a vehicle for rehabilitation loans.

Although, as was seen to be especially evident in the context of Kenyan D.F.I.s, rehabilitation loans can come to mean little more than subsidies to keep sick companies in being, such an outcome is not inevitable. Some companies may be in terminal decline, but others, given conducive supporting circumstances, may benefit from an input of capital. For the Z.D.B. to channel some of its money in this direction is not therefore automatically a misguided policy, especially as companies needing rehabilitation funds would not easily get them from mainstream financial intermediaries. Furthermore, the extension services provided through, and in association with, the Z.D.B., are there to ensure the wisest and most efficient use of funds by business, and this includes rehabilitation funds. However, the serious build-up of loan arrears suggests that much rehabilitation financing has not been successful. Though other types of lending may also give rise to arrears, money for reequipping is unlikely to be responsible (see later), so rehabilitation seems to be a major culprit. Apart from extraneous macroeconomic reasons, the causes behind this unsatisfactory financial outcome are the government, pushing the Z.D.B. into work it would not otherwise undertake and/or the relative ineffectiveness of the extension services.

So, given this burden, what has the Z.D.B. done to ensure a more or less reliable source of income? It seems that it has been necessary for it to cash in on the profits of successful firms, in other words, to extract some of their rent income. Some of the firms in question, mainly established multinationals, were mentioned earlier.

Now there has been little call for long term loans in local currency by Zimbabwe industry, especially by successful companies. As was observed in the 1988 Annual Report (p.21), "Business in local currency loans remained at a very low level. Established manufacturing firms generally held substantial internally generated funds as evidenced by the relatively high own contributions in projects financed by the Bank and the low level of debt in their capital structure". However, very crucially, the Z.D.B. is a source of foreign exchange. In a country with a foreign exchange scarcity, the funds derived from foreign development agencies have constituted a pool of currency that lies outside the official allocation arrangements. Furthermore - and unlike the situation in Kenya - although borrowers from the Z.D.B. bear the exchange risk, in recent years the Reserve Bank has been prepared to protect them against it on a 5-year roll-over basis. (There is a substantial interest premium for this service.) Successful companies in the Zimbabwean economy may not need to borrow local currency, but they do need foreign currency to obtain equipment and materials from abroad. Merchant banks having links with agents and head offices abroad can obtain short term forex credit for reputable borrowers, but this facility has to be backed by government approval, which is not necessarily forthcoming, since it would imply the Reserve Bank being prepared to switch local currency into foreign currency when repayment was due. Hence unnecessary long term borrowing from the Z.D.B. may come to be the only way of being able to purchase capital imports. Indeed, comment from officials in interviews suggested that in general companies wishing to go ahead with new or expansion projects were often directed to the Z.D.B., permission to go ahead being dependent on using Z.D.B. facilities. And this ensures income for the Z.D.B. (And it clarifies a point made earlier. Companies wanting to reequip or expand are less likely to be the sort that run into loan repayment arrears) However the casualty of the pattern of Z.D.B. lending discussed in the above paragraphs has been the finance of totally new projects.. There is little indication in the annual reports of interest in such business, and indeed various intended expansion or replacement schemes often appear to come to nothing. Understandable caution in the face of projected ventures which would fail must be tempered by the protestation that the substantial extension support at hand is there to guide, help and monitor new projects such that the Bank would not lose out. Concerned official comment on the nature of Z.D.B. lending was quoted earlier.

Chapter 4 identified gaps in the Zimbabwe financial markets, one of which was the provision of long term loans to borrowers other than sound established companies, where conventional banks - except of course when forex is required - will accommodate applicants. The Z.D.B.'s remit clearly authorises it to fill the gap, but it has as yet hardly done so, except in certain rather specialised ways. Indeed, in 1990 a Reserve Bank official was moved to make the rather extreme comment to the effect that he wondered what the Z.D.B. was for.

To investigate the basis of this unsatisfactory situation beyond the causes mentioned above is to reveal cumbersome bureaucracy. A few quotes indicate the ways in which this interfere with both the Bank itself and the companies it finances. Thus, "There have..been delays in the implementation of projects due to shortages of building materials, electricity supply transformers.." (1988 Annual Report p.21) and "(due to) the processing of necessary approvals by the authorities". Furthermore (Ibid. p.21), "The Bank will continue to review its procedures and its support services to clients to shorten the time it takes to get projects to implementation stage". Also the very fact that passages in the annual reports criticise the pattern of Z.D.B. lending, while members of staff in the same organisation are making the loans shows lack of coordination and harmony amongst the various officials. Though the features of Z.D.B. behaviour identified by the above remarks and quotes are not in themselves aspects of the 'soft state' features, clearly they can easily give rise to practices which may be identified as such, and which, in that eventuality, would compound Z.D.B. problems.

Also to be mentioned is government macro-policy. As observed in Chapter 7 in relation to the I.D.C., any shortcomings that may be ascribed to the intermediaries and associated agencies are enhanced by environmental weaknesses which are due largely to mistakes and inconsistencies in government policy. These cut down the incentives to go in for new projects and hence on the demand side the desire for term loans is reduced.

To address these shortcomings largely means the government engineering a more logical, consistent environment in which companies can operate. In this context problems presently besetting Z.D.B.-assisted companies are much the same as those which affect I.D.C. associates and subsidiaries, and require the same solutions. And to some extent contributing to the situation is the I.D.C. itself, which has shown little interest in buying the equity of unknown but up-and-coming businesses. A properly geared firm would require to issue both debt and equity. If it cannot dispose of equity, then it has no opportunity to borrow from institutions such as the Z.D.B.

NOTES PART 2 CHAPTER 8

1. This point was made at an interview with Z.D.B. officials in 1989.

2. It is clear from the text that follows that the C.Z.I. was probably too optimistic about the extent to which the Bank could avoid government pressure on the business it conducted. Certainly the lack of government guarantees was a constraint, but even so work was undertaken that gave rise to anxious comment.

3. Admittedly this situation could have occurred anyway, whatever the circumstances of ownership, given that the organisation began to operate at a time when considerable disillusion was setting in in developing countries with the effectiveness of normative interference by the state in business activity. It will be

recalled that at the same time - the mid-1980s - the I.D.C. was setting its face against this sort of thing.

4. References from page 3 of the 1989 Annual Report come from a speech of President Mugabe, given on the occasion of laying the foundation stone for Z.D.B. House.

5. ...from the writer's survey of a number of all other Zimbabwe D.F.I.s in connection with this study, excepting those in agriculture (See Appendix 3).

6. This was in relation some work carried out in a sub-sector entitled 'production of moulds for plastic extrusion'.

7. On the basis of 415 new jobs, a rough calculation reveals that each job cost $100000. This looks to be very capital-intensive. See Helleiners's article referred to in Chapter 3 of Part 1.

8. A Z.D.B. official implied in 1990 that some of the associated jobs were preserved jobs as a result of rehabilitation.

# PART 3:

# SYNTHESIS AND SUGGESTIONS

## INTRODUCTION

The last few chapters have investigated in turn the experiences of the main D.F.I.s in Kenya and Zimbabwe that have been concerned with the finance of secondary industry and commercial services. This chapter takes an overview, synthesizing the discussion across the institutions. The procedure in the following paragraphs will be first to review the extent to which the D.F.I.s can be viewed as 'gap fillers' in the financial systems. Deductions from the analysis will indicate what was in practice the nature of D.F.I. business operations, and hence will throw light on the institutions' financial conditions. Necessarily contributing to the discussion, and as a consequence also to the conclusions, are politico/ideological influences on D.F.I.s. Finally, in the context of the overview, the pervasive and - to anticipate - the crucially damaging effects of the soft state syndrome may be isolated.

It then remains to consider how the development of Zimbabwe and Kenya has been affected by the D.F.I.s with which they have been endowed. Lastly there is scope for recommendations for D.F.I.s in developing countries in the future.

## A RESUMÉ OF THE RATIONALE FOR D.F.I.s

A standard policy aim of the post-independence governments of the developing world has been to achieve sustained economic growth, and, as an associated aim, to enable indigenous people - on a private and/or official basis - to participate in the business developments that are implicit in it. An important factor behind the establishment and expansion of business undertakings in any context is a sufficiency of capital funds, and so the obvious theoretical rationale for the establishment of D.F.I.s would seem to be to fill capital market gaps, in other words to supply equity and loan funds to those sections of economies that mainstream financial intermediaries neglect.

An awkward but very pertinent issue that was discussed in Chapter 5 of Part 1 questions whether specialised development finance institutions can by definition be financially viable. The argument suggests that if a form of financing is profitable, mainstream financial institutions would undertake it (1): if it is not, then dedicated D.F.I.s must fail. And indeed, by taking on financing work mainstream banks avoid, D.F.I.s are opening themselves up to greater risks.

However, there are ways in which the risks may be addressed. Firstly, trained indigenous officials, albeit advised - ideally - by others not in this category, ought to be able to assess local indigenous demand for funds better than conventional bankers steeped in European traditions. Secondly, it is quite appropriate to surround 'difficult' lending and investment with more extensive monitoring and extension services than would be normal in the context of conventional bank finance. Such support is expensive, and so it is proposed that much of this type of work is financed by government or other extraneous agency who operate through, or sometimes independently of but in association with, D.F.I.s. Thirdly, a D.F.I. with - typically - most of its funds in the form of capital, grants, or very long term loans, can often afford to take a longer view of a project than can a mainstream intermediary, which relies for resources on deposits with varying periods of time to maturity. (Not of course that the absence of deposits from a D.F.I.'s liabilities is necessarily commendable, in that deposits acquired at full cost on the market, having to be serviced more readily than do softer forms of finance, usefully discipline operational behaviour.) Assuming that a D.F.I. is successful in its prosecution of more 'adventurous' financing than conventional banks, it becomes an example for others to follow (2). Ideally, a D.F.I. starts as a pioneer, becomes a model for others to copy, and ends by becoming one of several merchant banking- type institutions.

Sometimes D.F.I.s are detailed as convenient channels for the inflow of funds from foreign official finance organisations. Foreign and international agencies typically prefer not to work through truly private financial intermediaries, and use official D.F.I.s or semi-official ones in which they may have ownership power. Also, D.F.I.s are more clearcut allocators of such funds than central government, which can too easily or by default direct what should be earmarked development money into general capital or even current spending. As a consequence of the accrual to them of foreign funds, D.F.I.s become sources of foreign exchange for business.

Furthermore, some foreign firms interested in establishing businesses in developing countries may prefer to have local partners. Though there are other financial institutions which might fulfil this role, D.F.I.s are often tailored for the job, and it may be hoped by firms that association with them will bring government help and protection. The function discussed in this paragraph may be considered an extension of the 'gap filling' role, since the capital funds available to a country for industrial growth are increased.

Parallel to, and supporting the work of D.F.I.s, a number of other factors ideally should be present. Firstly, given that some limited arrangements for facilitating the finance of economic growth may have existed before independence, such arrangements, if financially sound, and effective in fostering business developments, should be allowed to continue, and not inhibited or obstructed on the basis of some prejudiced politico-economic rationale. The governments in European colonial territories were not politically unbiassed in the area of development finance, and such facilities as they promoted or encouraged did little - in general - for the business aspirations of indigenous people (3). However it makes no commercial sense to go to the opposite extreme and make things difficult for the non-indigenous afterwards.

Secondly, though linked to the first issue, the over-enthusiasm of a government towards some radical politico/sociological objective, where - almost inevitably - the role of the state is enhanced, can distort the thrust of development, causing a misallocation of resources and producing economic and financial tactics based more on emotion than commercial good sense. To recommend that governments should go easy in this area is no longer provocative. Many are prepared to believe that pervasive state interference bears much responsibility for the problems with which developing countries in the 1980s were beset, so there is now less faith than there was in the virtues of centralisation of power ideology as a panacea.

Thirdly, governments of developing countries need to act, and be seen to be acting logically, efficiently, and without corruption. This is not just a question of avoiding setting a bad example, but of setting down macroeconomic and regulatory background conditions that are favourable to development and the finance of it.

## PRE-INDEPENDENCE DEVELOPMENT FINANCE ARRANGEMENTS IN KENYA AND ZIMBABWE

For obvious historical reasons, the establishment of modern financial systems in Kenya and Zimbabwe - and of course most other African territories - did not get under way till early in the 20th century. In the main, banks in the early days kept to short-term business, and such long-term finance as was required came from foreign direct equity investment. However with time, as the approach to financial provision became more sophisticated, and economic growth went ahead, came a willingness to address the issue of local capital provision and allocation. Hence in the years prior to each country becoming officially independent, some facilities in this area existed.

Thus in Kenya there was the I.D.C., whose initial aim was to provide equity finance for companies operating locally, and which, as a revolving capital organisation, contributed to the development of the stock market by in due course selling off holdings. Banks also became prepared to lend money for longer periods to established concerns. All of these arrangements very much focussed on the demand from European-dominated business, and - to a lesser extent - from Asian business, and with financing criteria based on metropolitan European standards, the institutions involved were not subjecting themselves to abnormal risk. Inevitably, indigenous small business was not accommodated, and other larger enterprise that was locally-based found it difficult to get funds for expansion or to realise capital. The Rhodesian (Zimbabwean) scenario was very similar, in that indigenous business was not really accommodated, while the Industrial Development Corporation was in place to channel local money into new - in practice European-dominated or wholly owned - ventures and as a corollary to nurture the local capital market and stock exchange.

The history of the Rhodesian I.D.C. was soon affected by the onset of U.D.I. and consequent economic sanctions against the country, and it was obliged to take over certain concerns that otherwise might have collapsed. Otherwise, up until near the end of the U.D.I. period, there were no further significant moves towards the establishment of other D.F.I.s. in that country.

ADDRESSING GAPS IN THE FINANCIAL SYSTEMS

(a) The Kenyan I.C.D.C. and the Zimbabwean I.D.C.

In Kenya after independence, as was discussed in Chapter 5 of Part 2, the cautious I.D.C. was soon transformed into the much higher profile I.C.D.C., with potential for a hugely expanded capital base, and a set of guidelines that to some extent showed it as addressing the previous relative neglect of indigenous Kenyan business interests. A glance back at the 'remit' section of Part 2 Chapter 5 indicates an intention to focus on local people who could not get capital from the mainstream system, projects that were 'potentially profitable' but which 'needed encouragement', profitable but risky (sic) projects, 'marginal' projects, and larger projects. In all of this the I.C.D.C. had a supportable set of objectives, though it would be hard to be optimistic about the likely viability of an institution that applied itself in toto to this collection of financing goals. However, this study has stressed the utility and importance of an intermediary supporting the distribution of capital funds with sufficient and substantial monitoring, guidance and extension work financed - to some extent at any rate - exogenously: as a result, the risks integral to more adventurous financing should be reduced. And indeed, the I.C.D.C. has not been wanting for apparatus surrounding the business of finance. According to 'I.C.D.C.: Role and Activities' (1990 p.9 and 10), the I.C.D.C. 'Project Cycle' involved (and involves) 'project identification', 'project preparation', 'feasibility study', 'project appraisal', 'board decision', 'implementation', 'start-up and operations' and 'supervision and management guidance'. Though some of this is standard, other elements are impressive, particularly when as with 'feasibility', it is explained that (Ibid. p.10), "The Corporation liaises with international organisations like UNDP/UNIDO, Centre for Industrial Development, Brussels etc, for classification on certain project parameters".

In contrast with the Kenyan I.C.D.C., the post-independence Zimbabwean I.D.C. was little concerned with providing finance for indigenous African Zimbabweans who might be unable to get capital elsewhere. (see Part 2 Ch 7). Though the original enabling act which - in theory - advocated this still operated, a new and major role for the Corporation was to become an agent of government in the purchase and holding of shares in existing profitable firms.

Why, in this crucial aspect of their raisons d'etre, did the two corporations differ? Two plausible reasons may be advanced. Firstly were the political philosophies that supposedly motivated the leaderships. In Kenya the principles of 'African socialism' were never fully spelt out, and the philosophy very quickly became a justification for autocracy and capitalism. Marxism in Zimbabwe was taken more seriously at first, and saw virtue in a strong state involvement in industry, whereby industrial profits could be siphoned off to the government. Secondly, and perhaps more importantly, Zimbabwe became independent sufficiently 'late' for the government to be able to observe the dire financial straits into which many African D.F.I.s, including the Kenyan I.C.D.C., had fallen. Hence the I.D.C. could avoid the adventurous 'open hand' policy, that had been at least partly responsible for the others' problems.

(b) The D.F.C.K., the I.D.B. and the Z.D.B.

The D.F.C.K. differed (and differs) from the I.C.D.C. in terms of ownership, source of funds and a much heavier weighting towards loans rather than equity. However the basic aim was to behave much as the I.C.D.C., and involve Kenyan interests and businessmen in the promotion of new projects. To support this were a number of divisions for monitoring, appraisal, and so on. Hence, in terms of the fundamental rationale for the establishment of D.F.I.s, the company was designed as a financial gap filler subject - in theory if not eventually in practice - to the prudent guidance of foreign shareholders. The I.D.B., coming on the scene much later, and representing a channel for the inflow of World Bank funds to Kenya, was given such a generalistic remit (Part 2 Chapter 6 p.6-7) that a specific 'gap-filling' function is not evident. The impression is gained that the object of the exercise was to take advantage of the fact that 'official' money was available from abroad: what exactly should be done with it was not properly thought out.

The Z.D.B. shares with the D.F.C.K. and the I.D.B. a substantial foreign involvement in ownership and provision of resources. And, like the I.D.B., its remit is very generalistic (see Chapter 8), though it makes some obeisance to social goals. And, like the I.D.B., it has been principally a lending organisation.

(c) Assessment of remits.

Earlier discussion identified gaps in the financial systems of less developed countries that D.F.I.s might plausibly be expected to fill. Though the remits of the five institutions under consideration make gestures towards filling these gaps, empirical evidence is a much more reliable guide as to the actual operational behaviour of the institutions than the interpretation of intention.

FINANCE FOR SMALL BUSINESS

As explained in Part 2 Chapter 1, the subject of small business finance in Kenya and Zimbabwe is not emphasized in this study. Thus, the work of the Small Enterprise Finance Corporation (in Kenya) and Kenya Industrial Estates, and the Small Enterprise Development Corporation (in Zimbabwe) has not been investigated in the main text, though the latter two do appear in Appendix 3. However, both the Kenyan I.C.D.C. and the Zimbabwean I.D.C. did, as noted, set up small business divisions, and it has been appropriate to look at the experience of these in the main text, so as in order to give a comprehensive picture of the two D.F.I.s' operations (4).

The small business divisions proved to be financial disasters, with rapid and massive build-ups of unpaid interest and repayments. Similar reasons appear in both cases to account for this outcome (5). Firstly the diversification into small business lending was undertaken without sufficient adequately experienced and qualified staff being available, and hence applications could not be properly assessed and followed up. Secondly, and related to the first reason, were the political factors involved. The Zimbabwean scheme was very much a peremptory move to get funds into the hands of those who, at the end of the 1970s, were targetted as supporters for the short-lived 'Rhodesia- Zimbabwe' political experiment. In Kenya a major aim was to enable Africans to buy up Asian business: also tribal supporters of the new independence government expected to be rewarded with credit (see Leys quote in Part 2 Chapter 5). This meant that, in both countries, money often went not just to small businessmen, but to new businessmen, who usually had inadequate appreciation of the circumstances of commercial life. Fourthly, in neither country did government shoulder any of the financial burdens of extension. Again, early discussion stressed the appropriateness of this type of support, given (i) the high cost of operating small business finance schemes relative to other directions of funding and (ii) the more extensive services that can help small businessmen.

In Zimbabwe the I.D.C.'s small business scheme was in due course subsumed by S.E.D.CO, which, on the basis of a very conservative, cautious approach, managed to maintain in the 80s a precarious viability (6). In Kenya the I.C.D.C.s arrangements were kept in place, but for much of the 80s the scheme was largely inoperative.

THE PROVISION OF EQUITY CAPITAL:

(a) Introduction.

The organisations to be considered in the context of equity are the I.C.D.C. and the D.F.C.K. in Kenya, and the I.D.C. in Zimbabwe: in practice the other two kept mainly to loans.

(b) The disbursement of funds to domestic firms.

1. Kenya

Earlier investigation of the work of the I.C.D.C. and the D.F.C.K. indicated numerous shareholdings in domestic companies. It is not easy to unravel the history behind all these interests, but it is not clear that any fit into the 'small businessman makes good' category, in other words the successful private indigenous concern that wishes to realise or raise capital for further expansion. In one sense this is not surprising, for without the availability of small business finance - more or less true till after political independence - small businessmen had little opportunity to graduate to the position where they could plausibly approach the I.C.D.C. or the D.F.C.K. However, by the 80s, this might have been occurring, but the modest expansion of assets during this period does not indicate it.

The involvement of the institutions in domestic companies is characterised more by (i) taking over moribund companies, (ii) collaborating with other official interests, and often at government instigation, in new projects, and (iii) buying into the local branches of foreign firms.

The moribund companies which the I.C.D.C. took over when their owners abandoned them were typically saddled with debt. Plausibly, some should have been capable of being successfully revived. However, as Chapter 5 of Part 2 indicates, in general these concerns remained in the doldrums and were not profitable.

In the earlier years a number of new concerns came on stream under I.C.D.C./ government or D.F.C.K./government auspices. This of course ties up with the lack of private entrepreneurship in medium size business, as noted above. A desire to keep new business developments indigenous appeared to necessitate promotions by the D.F.I.s, typically in collaboration with other official or semi-official interests. In theory, given that these were mainly protected import substitution firms, and/or producing goods based on local materials, prospects should have been good (7). However this has not been the case.

Buying into viable foreign-based concerns has little that is 'developmental' about it, since it uses funds to change the ownership of existing resources rather than doing something new with the money. Indeed, when the recipients take their money from the country, potential development resources are being lost. Should the investment be paid for with incoming foreign funds, there is an opportunity cost, for otherwise new projects could have been financed. The main motives for buying into foreign companies were partly political and social, but also cynically commercial, in that the D.F.I.s - and their government - were given the chance to earn some income.

2. Zimbabwe.

The Zimbabean I.D.C.'s experience differed from that of the Kenyan I.C.D.C. Though there was a chance it may have gone down the same road, Chapter 7 of Pt.2 showed that an early 80s indulgence in buying up abandoned and ailing companies was quickly brought to an end, and the Corporation became little more than a holding company/investment trust. Expansion was favoured only in partnership with foreign companies, and there was little scope for indigenous nationals to get funds.

(c) Partnership with foreign firms.

Not only the I.D.C. in Zimbabwe, but also the two Kenyan Corporations, were used as vehicles for bringing foreign investment and technology into the countries. Though the theory was that foreign firms would be the prime movers in the process, at times the Corporations have actively tried to interest firms in new projects, as with the production of telephone equipment in Zimbabwe (see Pt.2 Ch.7). Though in the early years some foreign investment in association with D.F.I. money did come to Kenya, by the 1980s it had all but dried up. Earlier pages have identified economic and bureaucratic reasons for this and the parallel lack of new money at the D.F.I.s' disposal further reduced opportunities for partnership.

Equally, very little foreign investment came to Zimbabwe in the 1980s. Unlike in Kenya, the I.D.C. had - technically, at any rate - much uncalled capital at its disposal, so lack of money at the Zimbabwe end need not have been a constraint.

D.F.I.s AND LONG TERM LENDING (8)

The financial systems of Kenya and Zimbabwe were, by African standards, relatively well-developed at the time of independence, and so banks and N.B.F.I.s were known to lend for medium to long periods, though often on a roll-over basis. However, there were some associated factors which meant that specialised development banks could still be justified. Firstly, the writer still found considerable caution amongst reputable banks, especially in Kenya. One senior bank official said that he "didn't see why they shouldn't lend more long term money".(9) Secondly, but of course very much connected with the first reason, banks of standing only loaned to those who, on the basis of strict European banking criteria, they regarded as the safest customers. Thirdly, the Kenyan and Zimbabwean development banks were prepared to lend for longer 'long' periods than the mainstream banks. Fourthly, most development bank credit was in foreign currency, but this was not necessarily true of mainstream banks. Though banks might obtain short term credit from abroad for their customers, long term credit was rarely forthcoming, particularly in the eighties, when western banks, chastened by the debt crisis, stopped lending long to developing countries. Also, of course, in both countries permission had generally to be obtained for foreign bank credit, since repayment necessitated a switch into scarce foreign currency.

It is tedious to rehearse again the published objectives of the credit institutions, especially as those of three of them, the I.C.D.C., the D.F.C.K. and the I.D.C. - which are subsidiary lenders - have already been reviewed in the context of these institutions' main role as buyers of equity. The I.D.B. and the Z.D.B. paralleled the others in presenting broad development finance objectives, and both made gestures to social goals that did not necessarily square with the desire for profitability. However in practice they moved away from their natural niches as supporters of the gearing of companies' capital structures. The Kenyan institutions, especially the I.C.D.C., became burdened with rehabilitation credit, and both the D.F.C.K. and the I.D.B. faced mounting repayment arrears from concerns unable to repay loans due to their enhanced domestic value consequent on the steady devaluation of the shilling. The Z.D.B., supposedly firmly under the control of foreign financing agencies, in practice slid into giving out rehabilitation credit to firms without those firms necessarily becoming profitable as a result. To ensure some income for itself, it has provided loans to sound businesses who often have not needed to borrow but have needed the foreign currency the Z.D.B. has had on offer.

## THE STATE OF THE KENYAN AND ZIMBABWEAN D.F.I.s

This study has attempted to prove that there is a place for D.F.I.s in developing economies. It has also identified financing gaps in the economies of Kenya and Zimbabwe that D.F.I.s may plausibly fill. There are a number of D.F.I.s in existence in these countries, and five of them have been looked at in depth. All three Kenyan D.F.I.s have reached a parlous financial state, a situation which is often glossed over or disguised in the accounts. Though the Zimbabwe D.F.I.s have remained more or less viable, in the case of the I.D.C. this has been at the expense of virtually being no longer a 'development' institution. The Z.D.B. hovers on the brink of insolvency. All five D.F.I.s have under their wings companies in a state of disorganisation and unprofitability, into which money has sometimes fruitlessly been poured in attempts to stave off collapse. Practically this is a gross misallocation of resources in countries which are, by world standards, poor, and it is a shabby example to the business and financial communities.

What have been the causes of this lacklustre performance?

## EXOGENOUS FACTORS

To some extent factors that are external to the D.F.I.s and the economic environments they operate in have affected performance. The oil price rises of 1974 and then 1979, which caused massive borrowing by developing countries, led to the debt crisis of the early eighties, and world recession. This affected the sales of firms that had been recipients of D.F.I. money, so they could not pay dividends or interest, or repay capital. And governments, faced with balance of payments problems, cut back on what firms might have considered essential industrial input imports. Structural adjustment was urged on many countries in the 80s as an approach to their economic difficulties (10) and, amongst other measures, this frequently meant currency depreciation. This affected the ability of some firms in receipt of D.F.I. credit denominated in foreign currency to service the loans. Other influences have been the collapse of the East African Community, which affected Kenyan exports to its neighbours, and the desire of countries close to Zimbabwe to develop manufacturing industry and not rely so much on their more industrialised neighbour. As against this, more recently there has been the establishment of the Preferential Trading Area, which aims at freer trade throughout Eastern and Southern Africa. However, the long term success of the P.T.A. is uncertain, and both Kenya and Zimbabwe would probably do better to look to Europe and South Africa for markets.

Mention must also be made of the effects of the droughts in the early eighties on both the Zimbabwe and Kenyan economies, and the unsuccessful coup in Kenya in 1982 on commercial confidence there.

THE POLITICO-IDEOLOGICAL DIMENSION

Though some external economic - and other - factors certainly affected the economies of Kenya and Zimbabwe adversely, and, by implication, the prosperity of business undertakings and the D.F.I.s with which they were associated, earlier chapters amply bear witness to damaging internal influences on the development finance scenario.

After independence most African countries - sooner or later - embraced some variety of socialist and/or nationalist ideological apparatus. In practice, as is clear from the discussion in Chapter 3 of Part 1, the two philosophical stances invariably tended to become more or less one and the same, and to mean little more than strong state intervention in the economy. Thus though in Kenya there was much rhetoric about 'African' socialism, and in Zimbabwe much about Marxist socialism, in neither country did it all come to much, and the two countries soon became centralist quasi-dictatorships.

In the early years of Kenyan independence the government was at pains to mollify and protect foreign investors in the country by measures such as the 1964 Foreign Investment Protection Act, and not to suggest that 'African' socialism constituted a coherent operational policy with an anti-foreign flavour. Hence new foreign investment into Kenya continued, normally in partnership with the D.F.C.K. and the I.C.D.C. Later, however, foreign investment tailed off, as the increasingly assertive government under President Moi accumulated obstacles before existing foreign concerns, such as curbs on profit repatriation, restrictions on local borrowing, Kenyanisation regulations, forex allocation shortages in relation to essential imports, and much bureaucracy. Also, there has been a substantial move by the state into industrial ownership. As Miller (1984 p.124) observes, " .. the government has evolved from a minority partner in a few enterprises to a major investor". Partly as a result of these developments, D.F.I. s have had little opportunity for partnership with new foreign entrants in the 1980s.

The ideological stance in Zimbabwe - along, of course, with other factors such as recession and poor rates of profit - contributed to the loss of interest by foreign firms in the country after 1980, even though the government turned out in practice to be more pragmatic and more amenable to foreign enterprise (see Chapter 3 Part 3) than had been feared. Nevertheless, the government did appear to remain - in theory at any rate - firmer in its goal of Zimbabweanising the economy than was the case in Kenya. Thus, as late as 1989, in 'The Promotion of Investment: Policy and Regulations' (1989 p.4) it is stated, "..the Government prefers majority Zimbabwean participation in new foreign investment projects.... Whilst the Government is prepared to allow majority foreign ownership in high priority projects, and in some cases 100% ownership, it will encourage arrangements to be negotiated for the eventual transfer of majority ownership to Zimbabwean entities; ideally these arrangements would be negotiated at the outset or after a stipulated period". And expectedly, a number of commercial disabilities were imposed on existing firms, such as rules on the repatriation of profits and insufficient foreign exchange for imports. Not surprisingly, there was little foreign investment in the country in the 1980s, and D.F.I.s accordingly had little opportunity for partnership ventures. Furthermore, as in Kenya, the main D.F.I. felt obliged to take over the assets of existing foreign firms that quit the country.

So far in this section the references to the power of the state and its ideological stance in Kenya and Zimbabwe have been associated with the implications for foreign investment. In general, however, the state in each country looked for an enhanced profile in industry by the deliberate buying into existing firms - largely, though not totally - through D.F.I.s which it owned and/or influenced (refer to above quote from Miller) and urging D.F.I.s into new promotions. Though, as mentioned earlier, the latter behaviour had something to do with substituting for a dearth of indigenous entrepreneurship, it also had to do with political opporunism and patronage. Also the revenue aspect must not be forgotten. For D.F.I.s to have holdings in profitable concerns would help to keep the D.F.I.s themselves viable and - ideally - to provide tax revenue and dividends for government. The result, as seen in earlier chapters, was to turn equity-holding D.F.I.s into quasi-holding companies, especially the Zimbabwean I.D.C., where official support for such a stance was made more or less explicit. Finally, a couple of blatant examples of political chicanery were mentioned earlier in the 'small business' section. In the small business divisions of both the I.C.D.C. and the (Rhodesian) I.D.C., a strong political aspect was evident in their operational behaviour (see Part 2, Chs. 5 and 7).

THE IMPLICATIONS FOR D.F.I.s OF THE SOFT STATE

(a) Introduction.

To summarise, there is a place for specialised D.F.I.s in developing countries as fillers of gaps in the financial systems, though since by definition mainstream intermediaries have avoided the work they take on, they need to display especial qualities of flair, local knowledge and integrity. Furthermore certain types of extension support, financed by government or other agencies, are appropriate in relation both to the D.F.I.s themselves and to their customers. To colour D.F.I.s' remits and business operations with ideological and sociological goals, at one time believed to be not only understandable but even laudable and promoting efficiency, has been shown by experience to be generally inefficient. Resources are misallocated and obstacles may be put in the way of business which, though viable, is not congruent with the state's normative stance. At the very least, exceptionally high degrees of honesty, dedication and commitment to hard work would be necessary to give development finance policies affected by ideological goals a chance of succeeding. Needless to say, these qualities have typically been absent.

Indeed, the whole process of development finance, whether through specialised intermediaries or not, has been damaged by the attributes of the 'soft' state, which not only bedevil the basic operational role of D.F.I.s, but also compound the normally detrimental effects of goals based on politico-ideological aspirations.

'Softness' in relation to the D.F.I.s of Kenya and Zimbabwe has already been given some space in earlier chapters: the paragraphs below constitute a fuller treatment. The procedure will be to use the attributes of 'softness' as discussed in Chapter 1 of Part 1 as pegs on which to hang the experiences of the different intermediaries.

(b) 'Social indiscipline and disobedience to public authority'.

This feature was described in Part 1 Chapter 1 as meaning the lack of compulsion and responsibility by those at various stages in the development finance process towards servicing loans and equity capital. This was seen (Chapter 5 Part 2) to be particularly serious in the case of the Kenyan I.C.D.C., where dividends and interest due from subsidiaries were rarely paid, though normally included in the accounts as though received. Furthermore, the Small Loans Scheme proved to be a particularly blatant example of unserviced finance. Not only did I.C.D.C.-linked firms fail to meet financial obligations, but, as seen, their record in supplying timely company information to the I.C.D.C. was abysmal, as the R.B.C. Report noted. The I.C.D.C. in its turn, continually failed to service government loans, which became de facto grants.

What were the reasons for this malaise? First is the fact that many firms were in such bad financial straits that they could not afford to meet financial obligations. This, however, was due partly to the poor management and the supply bottlenecks - again often a function of poor management - on which the RBC Report commented. Secondly was the failure of the I.C.D.C. to chase up companies, either to obtain dividends and interest due and/or to get sufficient information about their operations. And the option of putting companies into receivership was not pursued with much alacrity. Behind this situation lie second layer problems, such as an insufficiency of suitably qualified personnel in the I.C.D.C. itself, a dearth of sound receivers, political aspects of I.C.D.C.-company links - for example Africans taking over Asian businesses, and the favouring of Kikuyu borrowers (see Pt.2 Chapter 5) - and the determination of the I.C.D.C. to keep some industries, in particular loss-making textile concerns, extant. Thirdly was the fact that government, in its turn, did not seem to bother to chase up the I.C.D.C. The personal links between government and I.C.D.C. partly explain this.

The D.F.C.K. and I.D.B. scenario has been similar, with rather better accounts showing more starkly the lack of financial servicing by companies linked with them: similar reasons lie behind their poor record. Though these two D.F.I.s were not in theory meant to be so closely linked with the state as the I.C.D.C., in practice they have not managed to operate with much degree of independence, and so they have been subject to much the same shortcomings as the I.C.D.C.

The Zimbabwean I.D.C. experience in this aspect of the 'soft' state - 'disobedience to public authority', which is defined as lack of responsibility in relation to loan and equity servicing and inefficiency in providing information by companies - has not been so serious as in the case of the Kenyan I.C.D.C. But the reason lies in the fact that the Corporation has been shunted away from too heavy involvement with concerns that have problems, and has come to have more in common with an investment trust or holding company than with a truly 'development' organisation. Nevertheless, as a result of its former willingness to take over collapsed or abandoned companies, without having the expertise to vivify them, the I.D.C. is linked to a number of dormant or non-performing concerns that bring it in no returns. The Z.D.B. in its turn has become saddled with increasing interest arrears. Though its extension, monitoring and follow-up procedures have been presented in the literature as wide-ranging and extensive, they have been unable to ensure sound business.

(c) 'Overcentralised government, which undermines local initiatives'.

As discussed in Chapter 3 of Part 1, in developing countries, especially - as experience has shown - those in Africa, the apparatus of state power has tended to become monopolised by powerful family/tribal/political groupings, which avoid losing it by abolishing or managing democratic processes, and which justify their privileged statuses by appeal to various ideological principles. In Kenya there has been for many years a one-party system; in Zimbabwe there are opposition parties, but they are marginalised by the government-controlled media. Criticism has been much more open in Zimbabwe than in Kenya, as earlier quotes from domestic publications have shown, but in both countries the governments, via personnel links, dictate, and the fact that they are in a position to supply local finance, foreign exchange, privileges, and so on, have not shrunk from imposing their wills on organisations within their jurisdiction and influence.

In both Kenya and Zimbabwe, D.F.I.s, as noted in earlier chapters, have been obliged to go in for some new projects - and support ailing existing ones - often for prestige or sociological reasons. This would classify - in terms of the theory - as the D.F.I.s adopting a promotional or pure supply-leading role. In earlier discusion supply-leading was not rejected as a viable policy but it was recommended that considerable extension and entrepreneurial support would be necessary if such an approach was to be successful. Given the poor state of most Kenyan and Zimbabwean concerns brought into being on D.F.I. initiative, clearly the intermediaries have been unable properly to carry through a promotional role.

More blatant examples of government political chicanery were the small business division of the I.C.D.C., already mentioned above, and similar I.D.C. arrangements at the end of the Rhodesian U.D.I. period. Also to be recalled has been the habit of the I.D.C. with regard to 'poaching' projects as a consequence of its close government links and exploitation of insider knowledge. The one example of an institution which initially appeared - from points made to the writer at interviews - to have escaped government pressure was the Z.D.B.: further research, however, largely involving an analysis of the Bank's portfolio, showed this to be far from true. In Kenya the D.F.C.K. and I.D.B., though designed as conduits into the country for foreign money, have nevertheless had their business heavily influenced by government.

Possibly the suggestion in the title about overcentralised government 'undermining local initiatives' is not significant in the case of Kenyan and Zimbabwean D.F.I.s, which have been mainly brought into being - in their post-independence form - by government promotion, pressure or suggestion, and in which senior personnel are appointed by, or are the same as, government officials. In these instances state suzereignty might be expected. However what has been lacking has been the type of initiative and imagination on the part of government and the D.F.I.s under them to try and make government-inspired D.F.I. operational remits - however ill-conceived - work. What is essentially a commercial issue has been too often regarded just as a political and ideological matter, to be managed by politicians and administrators rather than businessmen. As noted in the previous subsection, the RBC Report on Kenyan D.F.I.s amply elaborated on business shortcomings. Small wonder that, in relation to the I.D.C., government policy opted, in the mid-1980s, for a more cautious quasi-investment trust role.

(d) 'Collusion of government officials and top civil servants with powerful individuals and groups whose conduct they are supposed to regulate'.

The relevance to D.F.I.s of this suggestion about the 'soft' state concerns, in particular, the interface between officials and foreign companies. As explained, in both Kenya and Zimbabwe, policy was to partner foreign companies with D.F.I.s and/or other domestic interests. Some foreign companies - until the 1980s, when new foreign private investment dried up - went along with, or welcomed this arrangement; others were turned off by it. Though the conspiratorial neo-colonialist-type link postulated in Chapter 3 of Part 1 hardly seems to have been present in Kenya or Zimbabwe, certain advantages were afforded these companies, if only because they tended to be the profitable concerns, capable of generating income for the D.F.I.s with which they were associated. Thus they could expect protection both against competing imports, and, more sinisterly, against the establishment of new competing domestic firms. However, the 'softness' of both countries is seen in the inconsistency of government policy towards these foreign business interests. While on the one hand usually - though not always in Kenya - affording them monopolistic status, they were in both countries hampered by curbs on local borrowing, limitations on profit and capital repatriation with parallel parsimonious regulations on the use of blocked funds, generally insufficient foreign exchange allowances for essential imports, no attempt - in Kenya - to address the effect of depreciation on the repayment of foreign exchange loans, and stipulations about personnel indigenisation. Even protection against competing imports was not certain, if the appropriate officials could be bribed by foreign exporters (see Chapter 5 for Kenyan evidence).

Companies in which D.F.I.s had majority holdings were classified as parastatals, and, especially if the other holders were domestic, could be subject to considerable government influence. Earlier chapters have referred to the normally disastrous financial state of parastatals in both Kenya and Zimbabwe. Though generally afforded more indulgences than potentially viable foreign-linked firms, they were frequently seen as providers of employment for miscellaneous people connected with powerful officials. Hence they became overstaffed loss-makers, helping to damage the financial viability of D.F.I.s with which some of them were associated.

(e) 'Endemic corruption....'

The quote in Chapter 1, Part 1 goes on to suggest that endemic corruption 'hinders innovation', 'prevents change', and 'inhibits eradication of corrupt behaviour'. Much of the discussion in the sub-sections above have implicitly hinted at these points, and it remains only to tie up the loose ends.

A number of personnel link-ups between D.F.I.s, governments and companies have been identified in both Kenya and Zimbabwe. This can mean the creation of jobs for family and friends, the placing of people in responsible positions for political or nepotistic reasons, and the favouring of particular individuals or groups with capital and loans. This type of corruption adversely affects an institution's finances, and, as has been indicated above, brings about stagnation, since there is little incentive for new ideas and new methods in a company weighed down by unqualified or too many staff.

Other examples of corruption noted by the writer were the Willowvale scandal in Zimbabwe, the poaching of projects by the I.D.C., the bribery of officials concerned with importing goods in Kenya, and - also in Kenya - the favouring of Kikuyu people with loans. Furthermore anecdotal evidence had it that in both countries that the examples noted by the writer could be multiplied. Clearly none of this is likely to engender the level of business confidence that leads to expansion and innovation in industry.

Finally, as has been implied above, once government officials are integrated into the corruption scenario, it is difficult to eradicate it. Even in the relatively more open society of Zimbabwe, where the Willowvale scandal was forced into the law courts, the progress of the case appeared to be dogged by procedural obstacles, suggesting that effort was being expended to protect the alleged culprits.

D.F.I.s AS DETRIMENTAL TO DEVELOPMENT

(a) Introduction.

The above section has sought to show that, though there was a place for D.F.I.s in Kenya and Zimbabwe, even though their likely viability had a good chance of being compromised by ideological compulsions, the appurtenances of the 'soft' state damaged their performance. To some extent the Zimbabwean I.D.C. salvaged its viability, not by efficient development-orientated behaviour, but by moving into a different sort of role. The Z.D.B. appeared, however, to be on the road to insolvency, and the Kenyan D.F.I.s were already there. More importantly, there is little ground for identifying economic development in both countries as due to the existence of the D.F.I.s. Propping up collapsing concerns has meant misallocation of resources, and successful companies have been so despite their D.F.I. links, except in so far as the links have led to government help and protection, and this in itself is damaging to macroeconomic efficiency.

To go further, did the behaviour of the D.F.I.s actually inhibit development? A case supporting this may indeed be made.

(b) Aspects of D.F.I. operational behaviour.

1. D,F.I.s as a 'demonstration vehicle' (RBC Report Component 3 Vol 1 1989 p.iv)
The fundamental rationale for D.F.I.s is that they should fill gaps in a country's financial markets and so provide loan and equity finance in contexts mainstream intermediaries avoid. If D.F.I.s can make a success of what they do, others will try and emulate them. In both Kenya and Zimbabwe the D.F.I.s failed to provide this sort of example, so mainstream financial institutions have either not moved into more adventurous forms of business - unless pushed into it by government - or have done so with scant understanding of the implications of what they were doing (11).

2. Resource allocation.

In most developing countries real resources available for economic growth fall short of government aspirations. In both Kenya and Zimbabwe resources have been directed by D.F.I.s into ill-conceived projects and to bolstering concerns that would be best left to die. Not only has this meant the denial of funds to projects that might have done better, but it has blunted the willingness of agencies, both domestic and foreign, to provide more money. Furthermore, the fact of tying up capital indefinitely in sound companies for the sake of profits, or in unsound companies where there is no way of getting the money back, has meant that existing funds do not constantly revolve into the nurture of new projects.

3. Conduct.

As suggested above, the D.F.I.s in Kenya and Zimbabwe have been poor examples of successful providers of new sorts of finance, but also, by their slapdash behaviour, they have helped to inculcate a culture of inefficiency and dubious conduct in business in general. Such are personnel overlapping, employment creation, the implications of government/D.F.I. association, high administrative expenses, and frequent D.F.I. inability to properly monitor the concerns under them. Clearly the poor management state of so many Kenyan companies connected with D.F.I.s - as discussed in the RBC Report - is witness to the spread of the malaise.

4. Financial development.

Earlier in this chapter it was explained that successful D.F.I.s will, in a sense, work themselves out of a job. As well as constituting examples for others, D.F.I.s concerned with equity finance have a role maturing the stock market by active participation in it. In neither Kenya or Zimbabwe has this happened. By a deliberate policy of buying into sound companies and rarely disposing of their holdings, D.F.I.s, potentially influential players in the markets, have failed to provide a useful impetus to securities trading. Indeed, had such shares been left with their former owners, some - from time to time - might have come on the stock market, so helping to develop mechanisms that in the event and partly due to the D.F.I. operational behaviour described, atrophied. It has been noted that in both countries the number of firms listed on the stock exchanges and the volume of trading has declined since independence.

(c) Government influence.

1. Introduction.

The case that is being made out for the D.F.I.s as inhibitors of economic development cannot ignore government influence. Indeed it would be wrong to do so. To some extent the above behaviour - or non-behaviour - is due to government dictate, pressure or example, and there is no way of knowing what the D.F.I.s in Kenya and Zimbabwe would have been like, how they would have operated, and how effective they would have been, with different types of state apparatus, or with governments having more of a laissez-faire attitude.

2. The nature of government influence.

Government influence may be said to operate on three levels, (i) the broad political philosophy that defines the approach to policy, (ii) the policies themselves, which in practice usually owe a lot to pragmatism, and (iii) the consistency, efficiency and integrity with which the policies are applied and which help to set a standard for dealings in society in general.

In developing countries broad political philosophies were fashionably centralist in the middle decades of the century, and Kenya and Zimbabwe were no exceptions to this. More recently, this approach has been found wanting, and is widely blamed for the economic malaise in which many developing countries find themselves. Whether, of course the philosophies themselves should be blamed rather than the consistency of the application of them in practice is a complex issue beyond the scope of this study. However the fact that they tend to modify the discipline of market forces in favour of broad normative goals does not bode well for efficient resource allocation.

In Kenya and Zimbabwe actual policies, despite the rhetorical allegiance of the states to defined politico-ideological philosophies, were heavily weighted by opportunism. Thus, as noted, although nationalist and/or socialist predilections were theoretically prejudicial towards foreign business involvement in the economies, in practice foreign business interests - normally in partnership with D.F.I.s - were often given quasi-monopolistic status to try and ensure profitability. Also of course many purely domestic firms above the small business level were generally monopolies.

Finally, as noted, the application of policy was inconsistent and short on integrity. Foreign businesses, for example, may often have been indulged with monopolistic advantages, but at the same time were hampered in other ways. D.F.I.s, as part of the operational structure presiding over this disorder, helped fashion an environment where new foreign business was discouraged from setting up in the two countries, and where the creeping complacency of monopolistic status often led to company losses, and so further inhibited new investment, whether purely domestic, or foreign.

## RECOMMENDATIONS

(a) Introduction.

The purpose of this study has been to delineate how features associated with the concept of the 'soft' state damaged the performance of D.F.I.s in Kenya and Zimbabwe, and rendered those intermediaries disabling rather than proactive in relation to economic development. It has not always been possible - nor would it have been very meaningful - to disentangle 'soft' state effects from ideological and other influences, and hence the investigation has needed to embrace these latter issues in order not to leave loose ends and to give a rounded picture. Furthermore it is clear from a cursory study of other African countries and their D.F.I.s that the experiences of Kenya and Zimbabwe are by no means untypical. (See Appendix 3).

The paragraphs below make recommendations as to how D.F.I.s should operate in order that their performance may be improved, both in terms of their own internal viability, and in relation to economic development in the territories in which they are situated. Furthermore, because of the - normally - close association between governments in developing countries and D.F.I.s it is appropriate to make recommendations to governments also, in the context of development finance.

(b) Governments in relation to D.F.I.s

As stated above, modern developing country governments and D.F.I.s are usually closely associated. Would it be better for domestic D.F.I.s to be totally divorced from this involvement? In reality this is not easy to achieve, for even when an institution is owned 100% by non-government bodies, whether local or foreign, government may exert pressure to get the institution to do business in the way it wants. Only a government with a dedicated laissez-faire attitude might leave a D.F.I. totally alone, and even now, when governments are being urged to be less interventionist than formerly, it is unrealistic to postulate that they would be as disinterested as that. Even so, other issues arise if government opts out. Firstly, a D.F.I. owned and also under the control of private sector industry is likely - in the interests of viability - to be very cautious, and/or to confine its business to directing capital funds wholly or mostly to its owners. This latter was true of the Industrial Promotion Corporation of Rhodesia and Nyasaland. Secondly, if international and/or foreign non-private sector agencies are in control of a D.F.I., then indeed they may have the resources to go in for more adventurous business, possibly separating the finance of some extension support work - as has been recommended - from the central capital-provision function. However, it is very unlikely that any government would be prepared to have nothing to do with a development finance programme that was being conducted on its territory. Furthermore, the operators of such a programme would regard it as fair for a government to be involved if money was being spent on measures to support the programme.

Therefore, government association with the work of development finance institutions must be almost inevitable. It is not whether government is involved that matters, but what it does. Broadly, the role of government should be as follows. Firstly, it should fashion a macro-economic environment conducive to economic development. This point, made by Cameron, was mentioned earlier (Pt. 1 Chapter 2). Secondly, apart from in some circumstances providing capital funds itself for D.F.I.s, it should be prepared to support and perhaps lead D.F.I.s in seeking financial and other assistance from appropriate domestic, foreign and international agencies. Thirdly, it must establish proper supervisory arrangements for D.F.I.s. Fourthly, it should lay down the broad parameters of development strategy, subject, of course, to good sense, integrity and economic realities. Fifthly, it should be prepared, in a disinterested fashion, to finance some aspects of extension work. This is all, except of course that some of the recommendations below directed specifically at D.F.I.s cannot be totally separated from D.F.I. cooperation with government.

(c) D.F.I. recommendations.

Following on from the above, what may may be recommended for D.F.I.s so that they have a chance of being (i) internally viable and (ii) effective 'development' institutions? (12).

Firstly, D.F.I.s should identify specific financial needs that are not adequately met by the mainstream financial markets, and aim to fill them. All the remits of the D.F.I.s in this study were couched in broad terms, which denied them focus and permitted such non-developmental practices as buying into successful foreign firms, and holding on to the shares evermore.

Secondly, the staffs of D.F.I.s should be sufficiently stocked with qualified local people familiar with local customs and traditions and able to operate efficiently in the areas of extension and monitoring. Foreign experts should be employed in at least an advisory, and at most a vetoing capacity.

Thirdly, a non-open-ended arrangement should be negotiated with government or other appropriate agency for the finance of some supporting services, particularly those that may be classified as 'education'.

Fourthly, though promotional or - what was defined earlier as - 'pure' supply-leading behaviour by D.F.I.s is not to be ruled out, it should be undertaken with great circumspection, after exhaustive project assessment. Furthermore, there needs to be sufficient and suitably qualified staff available to carry out this function.

Fifthly, equity-holding D.F.I.s should generally aim in due course to sell off holdings This keeps capital revolving, and lubricates the stock market. Clearly sales must be subject to an appropriate financial criterion. An earlier suggestion - clarified in Appendix 2 - was that returns from new projects due to come to fruition over a span of time in the near future should on average be expected to at least equal the average returns that over a given past period of years have accrued from the equity holding(s) intended to be sold off. This ensures that when they revolve capital, D.F.I.s do not get themselves into a financial position inferior to what has gone before.

Sixthly, loans and interest due should never be capitalised or allowed to remain indefinitely in arrears. After sufficient leeway to address whatever problems are affecting debtors' finances, the indebted concerns ought without more ado to be put into receivership.

Seventhly, D.F.I.s must require as a matter of course timely and adequate accounting and other information from companies connected with them.

Eighthly, dormant firms under D.F.I. auspices, given that experienced consultants can produce no viable rehabilitation plans, should be wound up.

Ninthly, D.F.I.s rehabilitation loans should be conditional on firm programmes for turning round the companies in question. Frequently, as this study has shown, such money has come to mean little more than subsidisation.

Tenthly, a D.F.I. should not, in the interests of financial viability mutate into an intermediary that is not development orientated. Financial viability must be a result of sound business that has a 'development' character, and not follow from an institution being effectively no longer a D.F.I. The only proviso to this relates to the situation where a D.F.I. has been so successful that it has worked itself out of a job; in other words, its lending and investment activities have been emulated by other intermediaries. In these circumstances it may legitimately consider forging for itself a new role.

Finally, a D.F.I. with problems of financial viability - even if disguised by opaque accounts - should not be permitted just to soldier on. The issue of addressing the problems of a sick D.F.I. are large and complex, and beyond the scope of this study. However, it is better the matter is faced, even if it means winding up the organisation, rather than that the D.F.I. should get itself into ever deeper trouble.

(d) The 'soft' state.

The recommendations for government vis-a-vis D.F.I.s and for D.F.I.s themselves cannot be effective if soft state features persist.

In Anglophone African countries true democracy in the West European sense is rare. Continuing governments without a long tradition of sound and honest rule are prone to complacency, inefficiency, arbitrariness and growing corruption as powerful alliances and officials develop networks of power and aggrandisement. D.F.I.s tend to become part of this system via example, influence or equation with official interests. Therefore renovation of government practices is a necessary prerequisite for D.F.I. success, something recognised by the I.M.F. and the World Bank in a much wider context during the 80s, when they established the Structural Adjustment loan arrangements. As is observed in 'Sub-Saharan Africa: from Crisis to Sustainable Growth' (1989 p.6), "Ultimately, better governance requires political renewal. This means a concerted attack on corruption from the highest to the lowest levels. This can be done by setting a good example, by strengthening accountability, but encouraging public debate, and by nurturing a free press". And also, it might be said, by replacing controls with markets.

## FURTHER RESEARCH

A study of this nature, while succeeding if it aptly identifies certain reasons behind the relative failure of so many developing world D.F.I.s, must suggest certain lines for further research. These follow below.

Firstly, of course, there are large areas of D.F.I. work not fully addressed in the earlier chapters. Small business finance received some space, but the tourism and mining D.F.I.s in both Kenya and Zimbabwe have - apart from some limited treatment in Appendix 3 - been ignored. In fact, despite supporting the exploitation of home-grown products, the tourism and mining D.F.I.s in these countries have been financial failures (13). A comprehensive application of the 'soft state' concept to the operational behaviour of these organisations would be an instructive exercise.

Secondly, a structured investigation of the criteria for providing finance, and the nature of the follow-up procedures of foreign, international and supranational finance-providing agencies is overdue. The approaches of the various organisations towards providing money lack consistency, as also is their control over the funds, once handed over. The establishment of a firm set of principles in these matters would help to discipline the behaviour of those in developing countries who dispose of the finance on offer.

Thirdly, so far anecdotal evidence exists as to the attitude of multi-national companies to D.F.I.s. Under what circumstances would they accept partnership with D.F.I.s, and could the formula of partnership ever be so fashioned as to attract foreign firms back into Africa?

## ENVOI

It is not suggested that the recommendations in the penultimate section are newly-minted. Much of what has been said is well understood, but for too long vacillating concern with sociological and political considerations, plus of course the features of the soft state have, in so many D.F.I.s, fudged and clouded their importance. The D.F.I. of the future has a place in the developing economy, but if it is to be effective and viable, it should combine adventurousness and vision with caution and intelligence. Above all, like the government under whose auspices it operates, it must display integrity.

## NOTES PART 3

1. This of course relates to Patrick's demand-following hypothesis. However - as mentioned in Chapter 5 of Part 1 - mainstream intermediaries fail to expand long

term financing facilities, not because there is no demand, but because the quality of the demand is with difficulty assessed.

2. As noted before, in the U.K. a good example of an intermediary that was formed to make loans that others avoided, and then, by being a success, became a model for others, was 3i.

3. Admittedly a large subject is being dismissed perfunctorily here, and the reality was not as simplistic as the few words above suggest.

4. It is too early to consider further the D.F.C.K. small business 'window'.

5. The following information was gleaned from various interviews.

6. The writer did have a couple of extensive interviews at the Zimbabwean SEDCO in 1990, but failed to get entry to the Kenyan KIE and SEFCO.

7. Several European countries placed great emphasis on textile production as a leading sector in the early days of their industrialisation. Rather in the same vein, but without the same success, Kenya has seen fit to lay down - and subsequently prop up - a textile industry. In the 1988/89 I.C.D.C. Annual Report (p.12) it is asserted - via a bar chart - that the value of equity investments and medium/long loans in textiles exceeds all other loans and investments put together.

8. Small business credit is excluded from the discussion.

9. Interview at Barclays in Nairobi, April 1990.

10. Structural adjustment also addressed the consequences of overspending and centralisation by developing country governments.

11. The post-independence crop of new financial intermediaries in Kenya, most of which came to grief, is an example of this.

12. As elsewhere, the discussion is focussed on general D.F.I.s for secondary and tertiary industries, and avoids those that are specialised on specific types of production or on small business finance.

13. The writer had a number of interviews with officials of Kenyan and Zimbabwean mining and tourism D.F.I.s. (See Appendix 3).

# APPENDIX 1

## RESTRICTIONS AND SURPLUSES

## INTRODUCTION

Unlike the situation in most advanced countries, where monopolistic behaviour is curbed by legislation, governments in developing countries have frequently favoured monopolies, and have been willing to endow firms with monopolistic advantages. On the other hand, and in contrast to this, governments have also been prone to impose disabilities on enterprises, which nullify or cut away at the effects of monopoly status. It is suggested that this habit of operating what are clearly contradictory policies at one and the same time is an example of the 'soft' state.

Additionally, even the hoped-for 'favourable' effects of monopolistic behaviour on economic variables such as employment, production and investment can be reduced or destroyed by interference in the crucial area of profit maximisation. Consideration of this issue follows directly below.

## MONOPOLY AND SURPLUSES IN THEORY AND PRACTICE

A monopoly has its own exclusive market, and thus, as any basic text-book will illustrate, has the opportunity to generate high profits (synonymous with artificially induced rents of scarcity). Bagchi (1982 p.128), focussing on multinationals, observes, "The production of consumer durables proved ideal..., since governments in the third world could easily be persuaded to impose stiff tariff and quota restrictions on the import of luxury consumer goods. The multinationals wanted to protect their markets in the third world, and the easiest method of doing that was to set up production facilities in those countries behind tariff walls. The willing collaboration of native capitalists in the host country afforded them the necessary political protection".

Apropos of Bagchi's emphasis on multinationals, monopoly status can be (and is) afforded to any legal type of concern, including 100% owned indigenous companies, and parastatals. Also it is not necessarily a question of concerns wanting to hang on to their markets in the face of competing imports, as not having to compete with any other producer, including other domestic ones. Potential new domestic firms may therefore be directly prohibited from becoming established, or they may be inhibited by, for example, not being eligible to apply for import licences in order to buy vital foreign equipment. The hope is that, by the supposed certainty of profits derived from exclusive markets, businessmen and civil servants (in state-run concerns) running monopolies will be encouraged to invest further. Also employment is protected, and all the other economic fruits of thriving industry will in due time benefit the countries concerned. It is also suggested that in a small market for a product, a monopoly is inevitable, since a multiplicity of firms in the industry would make it impossible for scale economies to be obtained. Harvey, though, is not happy with this apologia (see p.74 in main text).

Despite the theoretical deduction that monopolies derive large profits from protected markets, in practice these notional surpluses do not necessarily accrue to or stay with the firms themselves. Devices exist whereby governments and others may commandeer these surpluses, the most obvious one, of course, being taxation. Now it is hardly to be expected that a government will not tax profits, but the level of taxation probably matters, and from a 'supply-side' point of view too high a level will inhibit further investment, or indeed will discourage the initial investment in the first place. Another standard means of surplus extraction is having to pay out for various licences that are made obligatory in connection with selected activities.

Other, less salubrious methods by which surpluses are eroded away are via bribes and suchlike payments. Krueger (1974) assumes that firms might be willing - under some circumstances - to bribe officials in order to obtain monopoly status, with the officials themselves having competed to obtain the positions they hold in the expectation of such income. Posner (1975 p.812) neatly distils Krueger's discussion into the following lines and also shows that there are other costs to society consequent on practices of this sort. He observes, "It might seem that where monopoly is obtained by bribery of government officials, the additional loss of monopoly with which this paper is concerned" - that is, the social costs of monopoly - "would be eliminated, since a bribe is a pure transfer. In fact, however, bribery merely shifts the monopoly profits from the monopoly to the officials receiving the bribe and draws real resources into the activity of becoming an official who is in a position to receive these bribes".

Krueger links bribery with the matter, mentioned above, of having to obtain licences. She refers (op.cit. p.292) to "... means of influencing the expected allocation (of licences) .... including bribery, hiring relatives of officials or employing the officials themselves upon retirement...".

The above paragraphs on the extraction of monopoly surpluses are principally relevant to multinational firms with establishments in developing countries. The treatment of indigenous firms and/or of parastatals - and indeed even of multinationals if in partnership with domestic agencies such as D.F.I.s - may be less harsh than that experienced by totally independent foreign firms, but this is by no means certain. However the methods of surplus extraction may be somewhat different. For example, officials in parastatals are in a convenient position to extract surpluses directly themselves by large expense accounts and non-monetary benefits and/or to create unnecessary jobs for their friends and relatives.

## THE UNDERMINING OF MONOPOLY ADVANTAGES

(a) General.

As well as being affected by the above factors which directly erode monopoly profits, firms, as indicated in the 'Introduction', may also be hit by regulations which mar their operations, and prevent them generating the surpluses which, in the absence of these factors, would be notionally possible (1). In the forthcoming discussion, there is sometimes overlap with the arguments in the last section, for it can be a matter of opinion whether an imposition or restriction is to be considered as eroding monopoly profits or as increasing fixed costs: the immediate financial effect on the firm is the same in each case. If there is a distinction, it is largely to do with intention. Policies that aim to cash in on monopoly profits are technically distinguishable from general economic and social directions that adversely impinge on firms' operations. As far as possible, this section introduces the latter type of measure, but the delineation can never be perfect.

(b) Inadequate foreign exchange allocation.

Typically firms have to buy materials, components and financial services from abroad in order to carry on production. However, even where a firm has been established with government approval as a monopoly, an inadequate foreign exchange allocation may preclude it importing what it needs in order to achieve a level of output that maximises profits. Figure 1 illustrates the situation.

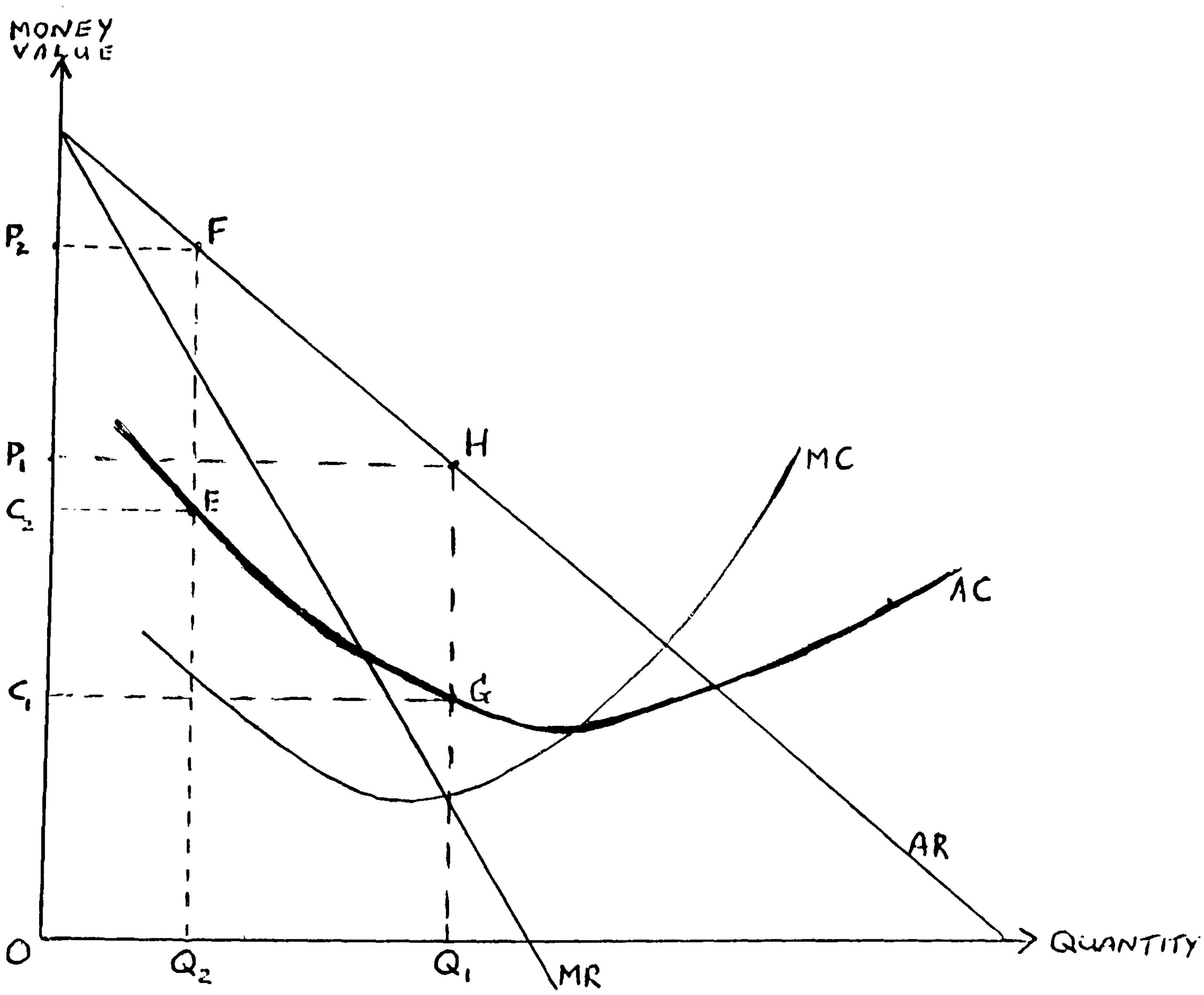


FIGURE 1

For profit maximisation the firm would wish to produce, of the good in question, quantity OQ1, which is where marginal cost equals marginal revenue. Monopoly profit would be C1P1HG. However, unable to buy sufficient vital imports, the firm can only produce OQ2. This reduces monopoly profits to C2P2FE. And from society's point of view (i) the higher price of OP2 redistributes income from buyers of the good to the sellers, (ii) there is loss of FHP1P2 consumers' surplus and (iii) the good, at the higher average cost of OC2, is produced more inefficiently.

One reaction of a firm in such a situation would be to devote resources to trying to obtain more foreign exchange (2). This is possible if officials allocating foreign exchange are subject to persuasion by reasoned argument or emoluments, or if financial intermediaries exist from whom, at a price, exchange may be obtained (3). Such activity, however, raises costs. Clearly the optimum solution for the firm is to spend money on trying to secure more foreign exchange until the marginal increment of such expenditure equals the marginal accrual of profit. Nevertheless, the maximum profit obtained from the firm's operations will inevitably be smaller than if there was no foreign exchange constraint.

In the longer term the lack of foreign exchange can prevent a firm re-equipping. This will result in lower profits, higher prices and lower output, as working with increasingly obsolete and worn-out machinery puts up variable costs, and hence both average and marginal costs. Once again it may be possible to secure foreign exchange by spending money. If this money comes from accumulated profits, the firm ever after loses the revenue these profits could have generated. If it is borrowed, future average costs are increased by the interest charged. In both cases future monopoly profits are reduced.

(c) Domestic suppliers of inputs.

Another context when restrictions are put on firms' desire to buy imports is when domestic producers of the inputs in question are established. If these suppliers can sell goods of no lower quality and at no higher prices than similar imported products, then the buyers will be put at no cost disadvantage if they are obliged to buy from them. However this is typically not the case, and the firms in question expect in their turn monopoly status and protection against lower priced foreign products. This causes buyers' average costs to be higher than they need have been, so increasing the prices they charge, lowering their outputs and reducing monopoly profits. It may be possible for buyers to 'persuade' officials to allow them to obtain from abroad some or all the supplies they need, but the extra eventual profits have to be set against the costs of the exercise. Also, of course, the resources devoted to the setting up of local suppliers will have been wasted (4).

A further problem sometimes faced by buyers who are obliged to obtain supplies of inputs locally is the erratic arrival of purchases. Supplying firms may themselves be faced with foreign exchange restrictions, so cutting their outputs. Furthermore, as has been noted in the main text about Kenyan and Zimbabwean companies, there may be management problems which disable the production process. Transport of goods also may be unreliable. The effect of these eventualities is to hold back production in the buyer companies, as shown in Figure 1, so reducing profits (5).

(d) Employment.

A further imposition that may be placed on firms is a set of regulations with regard to employment. This can cover a number of possibilities such as (i) a straightforward requirement to hire more people generally so as to help reduce unemployment, (ii) pressure to go in for labour intensive methods of production (6), (iii) the necessity to phase out expatriate staff plus increasingly stringent rules about bringing in new such people coupled with exhortation to take on more indigenous people in 'staff' positions. (i) will certainly put up a firm's costs, and the chances are that (ii) will as well. (iii) need not, if expatriates are replaced by genuinely qualified and experienced local people. However, if expatriates give way to the less experienced, inefficiency creeps in and/or staff numbers increase as the expatriates are kept in 'advisory' positions. In conclusion, with variable costs increasing, then, as in the other circumstances so far discussed, monopoly profits fall.

Increases in employment in parastatals have already been referred to in an earlier section. In these institutions it is almost an inevitability, as officials who have the power to create jobs for their kin take it that government will step in with subsidies if losses take the place of profits (7).

(e) Financial impositions.

1. Local bank borrowing.

Frequently foreign firms are not eligible to borrow from domestic commercial banks, or the amount to be borrowed might be limited in some way. 'Foreign' firms are classed in terms of the proportion of the shareholding in a company in foreign hands.

This provides an incentive for firms to go into partnership with local agencies who hold the requisite proportions. On the other hand, though, they may be inhibited from coming at all. The 'solution', bringing more money in from abroad, meets the resistence of bankers, who, since the onset of the international debt crisis, have not been eagar to put money into developing countries. Inevitably, if firms can obtain working capital from abroad, interest rates are subject to risk premiums, and the exchange rate uncertainty must be paid for. All this increases costs, so reducing monopoly profits.

2. Repatriation of profits and capital.

Other impositions on foreign firms may be concerned with the transfer abroad of profits from operations, whether to foreign shareholders or to remain undistributed. Frequently such money has to remain in low interest government stock until such time as it is allowed to be moved. Clearly this type of imposition does not affect the money value of such profits as a firm may be able to earn. However, in net present value terms the worth of the blocked profits is less than this money value, since they are earning less than their international opportunity cost. Even if the locally-earned interest rate earned by the blocked funds is not an imposed low rate, the real net present value of the profits is lower than the money value. For in an environment where eventual transfer abroad is surrounded by uncertainty, where exchange rate depreciation might reduce their foreign value, and where political change might result in the alteration of current arrangements, a high risk premium would be required to ensure that the actual money profits equalled their certainty equivalent.

Effectively, therefore, monopoly profits are reduced by these controls. Also, of course, as in other circumstances discussed, foreign business will be discouraged from coming to the country concerned in the first place.

Similar effects follow from the transfer of capital abroad. If a foreign firm wishes to dispose of assets, it may only be permitted to do so at a substantial discount, and/or be obliged to put the proceeds temporarily into blocked assets. This reduces the value of the capital owned by the firm, in the first instance directly, and in the second instance because what is left is not earning its opportunity cost.

With regard to having to sell at a discount, it might be suggested that if past profits had been disproportionately large, they could have compensated for the losses sustained. However, further consideration reveals that this could not happen, since the market value of an asset is related to the profit level: if profits had been inordinately large, so would notional market value, and therefore so also would be the money loss when selling at an artificially imposed low price. Hence, no matter how high the money value of a firm's monopoly profits may have been, their real value is much less, since they cannot make up for the capital value losses consequent on a government-imposed low price.

COMMENT

The purported situation whereby firms manage to remain in (or achieve) protected monopoly niches in ex-colonial territories and then generate large profits for themselves is, as noted earlier, designated 'neo-colonialism', and used to be much believed in and warned against by political leaders in developing countries and by some writers on development issues. Bagchi has been quoted earlier and in the main text, and Woddis (1967 p.56) quoted in Leys (1976 p.26) explains, "... neo-colonialism generally represents a new alliance, one between external imperialism, and sections of the local bourgeoisie and petty-bourgeoisie". Though the theory of neo-colonialism is plausible, the practice is much less in evidence. Indeed, if neo-colonialism - as a label for foreign firms extracting large profits from the territories they were established in - was ever likely to take off, it was soon nipped in the bud by politicians and other officials in developing countries, who seem to have acted not so much out of ideological disapproval, as from a naive belief that the fruits of foreign business activities in their countries could be sequestered with impunity.

The discussion in previous sections noted the basic aspect of economic theory about monopolies, which is that - technically - they are in a position to make large profits. It also looked into a number of ways in which governments (and others) in developing countries have undermined and nullified the financial and economic consequences of monopoly behaviour. Indeed, not only have firms in general been disappointed in the profits they have made, they have also been discouraged from making new investments. The proverb 'killing the goose that lays the golden eggs' was never more apt (8). Furthermore it is important to note that this scenario is relevant not only to foreign firms, but to domestic ones as well, including parastatals.

Logical government behaviour would not persist in unreconcilable attitudes and policies, whereby ritual gestures against 'neo-colonialism' are paralleled by an acceptance that new businesses - even from abroad - must be encouraged, since they produce goods and employ a workforce, while at the same time profits are extracted from them and restrictions imposed on them. That this confusion occurs must be explained again by the existence of the 'soft' state.

NOTES APPENDIX 1

1. Of course, the regulations considered are normally not only applied to businesses classed as or regarded as monopolies. However, the Appendix focuses on monopolies, and it is in this specialised sense that the discussion is to be understood.

2. As was noted in the main text, Berkshire International in Zimbabwe employed somebody full time in order to try and secure more foreign exchange.

3. Again as noted in the main text, the Zimbabwe Development Bank made loans to firms who didn't really need to borrow but were in great need of foreign exchange.

4. Hoechst (Kenya) was apparently hit in this way, though the initiative to circumvent importing restrictions seems mainly to have come from foreign sellers (see main text).

5. The writer was told in the premises of Berkshire International (Zimbabwe) that they had a convenient foreign source of low-priced new machinery - which they desperately needed - but they were not allowed to buy it due to the existence of a local government-sponsored company that should in theory supply them. However

this local company was showing itself quite unable to, literally, 'deliver the goods'.

6. This occurred in Botswana as a result of a temporary subsidy on unskilled wages.

7. See the main text about parastatals in Kenya and Zimbabwe.

8. Admittedly the discussion in the Appendix is largely theoretical, but numerous practical illustrations are found in the main text about Kenya and Zimbabwe.

# APPENDIX 2

# D.F.I.s, THE THEORY OF THE FIRM AND CAPITAL BUDGETING

## INTRODUCTION

The main text asserts that a financial intermediary truly committed to a philosophy of 'development' should revolve capital. This means that funds committed to the fostering of capital projects should not intentionally be kept tied up in those projects indefinitely, but in due course should be realised and hence become available for new investment. If a D.F.I. does not do this it cuts down on the funds available for developmemt finance, having to rely on profits and new accretions of outside money, and comes to look more like an investment trust or holding company than a 'development' institution. Also the build-up and maturing of appropriate expertise atrophy when a D.F.I. can remain solvent by just collecting income from successful investments without having to address the matter of realising and re-using the funds invested. Obviously money passed to beneficiaries as loans should automatically return to the lender in accordance with the arrangements negotiated, but deliberate decisions have to be made to liquidate shareholdings, and it is this latter issue with which the appendix is principally concerned.

## THE MECHANISMS FOR SELLING SHARES

A difficulty with regard to the sale of shares may be the lack of a mechanism for disposing of them. If there is a stock exchange, of course, the difficulty is that much less, and the main text recommended that by trading stock, a D.F.I. had the opportunity of assisting in the maturing of a stock exchange. Otherwise, it is normally possible to trade in a more ad hoc fashion via banks and other 'mainstream' financial institutions, and when this sort of business increases, it eventually prompts the establishment of embryonic stock exchange facilities.

Of course, many 'ordinary' people will be bypassed by arrangements of these types, due to (i) perceived risk of buying a few shares in perhaps just one specific company and (ii) the sophistication and logistical problems of coping with stock market facilities almost inevitably located in a country's capital city. Established ways round this are the creation of investment trusts, and unit trusts. Investment trusts still imply the use of stock exchange facilities, whereas unit trusts do not, and indeed units in particular may be made available over the counters of post offices and bank branches to small savers living far from the capital of a territory. A D.F.I. may set up an investment trust or a unit trust as a subsidiary (1), and there is no logical necessity for such an institution to confine itself to equities originating from its parent. Alternatively a trust may exist quite independently, and this may be preferable, for it can less easily be subject to D.F.I. influence and pressure.

## D.F.I.s AND THE THEORY OF THE FIRM

The necessity for a D.F.I. to be a revolving capital organisation, and hence to be a seller of income-generating shares, suggests a conflict of goals. For whereas a D.F.I. should be financially viable (2), the sale of profitable investments would seem to jeopardise this requirement. How can these two conflicting recommendations be reconciled?

Clearly a D.F.I. should not, as a matter of policy, be a profit-maximising organisation in a neo-classical sense. This would probably mean the perpetual holding on to shares in the most prosperous companies, which, as has been pointed out, compromises the 'development' philosophy. True, a successful profit maximisation policy would maximise the funds available for further investment, but tactics would require that these funds be not necessarily re-invested in line with development-orientated criteria (3).

The theory that seems more applicable to D.F.I.s is that of 'satisficing behaviour', a set of ideas popularised by Simon (1964). Formulated with private enterprise companies in mind, the theory postulates that an organisation has a number of goals in its line of vision, typically related to 'production', 'inventory', 'sales', 'share-of-the-market' and 'profit', and since it is unrealistic to expect to 'maximise' in all of them, the organisation aims to 'satisfice', that is, to achieve a satisfactory level of multiple goal performance. As Koutsoyiannis (1979 p.388) explains, "The profit goal is set by the top management so as to satisfy the demands of shareholders and the expectations of bankers and other finance institutions; and also to create funds with which they can accomplish their own goals and projects, or satisfy the other goals of the firm".

In relation to D.F.I.s, a satisfactory level of profit is certainly necessary in order to be able to pay dividends to shareholders and service loans from financial institutions (4). The other goals mentioned above are not so obviously applicable, but a number of development finance goals exist, of which - in line with the thrust of this appendix - a recommended one is the liquidation of equity holdings in order to raise money for new investment. 'Satisficing' in this context would imply disposal in accordance with a defined criterion that did not aim to maximise anything but produced a satisfactory though sound result in terms both of the D.F.I. itself and the pursuance of economic growth (5).

The only difference between D.F.I. satisficing and commercial company satisficing is that for a D.F.I. satisficing should be a deliberate policy aim, whereas for a commercial company it is more a second best solution in a situation where it is not practicable to maximise profits. However this is a philosophic matter which need not be pursued further.

A CRITERION FOR THE DISPOSAL OF SHARES(6)

Clearly there is little to be gained by selling off income-generating equities in a context where there are no opportunities for further apt and judicious investment. However such a situation should not normally pertain over long periods in an economy where there there is a prospect of economic growth and the higher living standards that people expect to go with it. Indeed, if a D.F.I. is not becoming involved with the finance of development there is little point in it having been established in the first place.

An active D.F.I. in an economy where government presides over or has attempted to fashion economic conditions that are not inimicable to capital investment can expect over time and with varying degrees of urgency to be faced with a range of different types of demand for the finance it has available. Much of this demand will immediately be seen to be related to unviable projects, and can be rejected. Other ideas for using capital funds may hold out more promise, and perhaps can be developed into sound proposals with the aid of D.F.I. advice and assistance. To some extent the D.F.I. may usefully seek out uses for its funds, perhaps explaining to local firms how injections of equity could enable them to expand, and encouraging them to go ahead. Also there may be applications for partnership arrangements from established multinational firms: normally the potential viability of this type of proposal will not need so much investigation.

Money is allocated as either equity or debt: at this point in the discussion, the analysis focuses on equity. Later there are some remarks on debt. In line with standard business finance procedures the various possibilities for investment can be listed in order in relation to their expected internal rates of return. These rates of return will be computed from the expected values of the investments, which are derived from the probabilities of different outcomes, taking into account macroeconomic circumstances, local conditions, and so on. In order for some new investments to be undertaken with money obtained from a realised shareholding, the average IRR, weighted in accordance with the amount of funds put into each investment, should be expected to be at least as high as the yield from the old investment. Alternatively the sum of the net present values of the new investments, discounted at the old investment yield rate, should be, at the very worst, zero. These procedures allow for the fact that, in a developing context, where indigenous people are to be encouraged to build up successful firms, a good-looking project that appears to have promise should not necessarily have to earn the going rate, as long as returns from other new investments cross-subsidize it.

Given the conditions outlined above, a D.F.I. may go ahead and sell off a profitable investment, in the plausible expectation that it will not as a consequence lose out. There is no need to labour the point, amply dealt with in the text, as to why a D.F.I. is necessary as an investment vehicle for certain varieties of new project. It has been postulated that the peculiar circumstances of development finance justify supporting assistance from agencies separate from the D.F.I., so nurturing the viability of projects with financial help and perhaps also expertise the D.F.I. does not provide itself. 'Mainstream' financial intermediaries would not have these advantages (7).

Also, as noted above, D.F.I. would not normally aim to be a profit maximiser.

The concept of 'risk', or - more correctly - 'uncertainty' (Knight 1921), since the estimate of probabilities for outcomes of new investments cannot be objectively calculated, has not been brought into the above discussion. However, plausibly the average level of uncertainty can be postulated as higher in ventures financed by D.F.I.s as opposed to ventures financed by 'mainstream' intermediaries. Graphically this would show in a 'flattish' normal distribution for the probability-determined expected pay-offs from a project, and a high coefficient of variation. A standard reply to the anxieties that such a situation would generate in the minds of financiers would be to argue that projects where returns were at the left corner of the normal distribution should be balanced by projects where returns were at the right-hand corner. However, more positively, the purpose of the extension and other help - referred to above - applied to the business of development finance, is principally so to hone, tailor and buttress a new venture that the uncertainty of outcome is reduced. In other words, the normal distribution graph is made 'tighter'.

In general, the above has been written with equity finance in mind, since the purpose of the appendix is to discuss the appropriate context for liquidating profitable equity holdings. In contrast, there is little problem over a rule for debt financing. Obviously money available from a maturing loan or, given a change of policy, from the sale of shares will - if applied as credit - be allocated only to borrowers expected to be able to pay the relevant rate of interest, and to meet capital repayments at the due times. Supporting assistance should, as with equity finance, be employed to identify and assist ventures that have hold out promise of success.

Finally, a word of caution. Financing decisions by development finance institutions must be a matter not only of applying mathematically-based criteria, but also of using judgement, as long, of course, as 'judgement' does not become a convenient excuse for partiality and sloppiness. For example, in some contexts a D.F.I. would do better to put all its funds in government stock: this, however, would destroy the raison d'etre for the organisation's establishment, so would not be a tenable policy, however safe from a financial angle. However, there is no reason why residual funds available from the sale of equity or from loan repayments for which a timely investment destination is not available should not temporarily be lodged in safe securities. Another issue concerns the recommendation that funds from the sale of shares and put into new equity investments should earn an average return that is not inferior to that on the liquidated holding, rather than that each separate new investment should yield this return. Now this could suggest that money might legitimately be put into projects with abysmal prospects, as long as projects with good prognoses, and financed at the same time, were expected to compensate. Clearly such a policy is not what the recommendation means to validate. Any project that is to be financed by D.F.I. funds should have promise, even though in some instances the expected return is relatively low.

Though the above criterion is suggested as a way of ensuring D.F.I. viability, it has to be admitted that - given the economic circumstances and investment conditions in many developing country contexts - it may lead to stagnation. D.F.I.s have an excuse for keeping funds in safe investments, and may only go in for new investments when sound foreign partnership arrangements become available. Something of this kind seems to have happened in Malawi. (See Appendix 3).

## CONCLUSION

In the context of the overall study, a very apt criticism of the discussion in the sections above is that - in so far as it prescribes how persons involved in the process of development finance should behave - it assumes integrity and disinterested logical consistency. Unfortunately, of course, this has typically not been the case. Ideologically-motivated policy, merging into soft state features, have so often weakened the ability of the D.F.I. as an objective concept to operate even in the precariously viable way suggested. Part 2 of the main text amply demonstrates the reality rather than the ideal.

## TECHNICAL NOTE

The following lines case in mathematical terms the conditions - explained above -

under which a D.F.I. may appropriately sell off shares in a performing company and invest in new equity.

New investment may be made if:

1. current NPV of investment to be liquidated $\geqslant$ 0 and
2. sum of alternative investments have an expected NPV $\geqslant$ current NPV.

Where (i) $k^*$ is the capital realised from selling existing investment(s)

(ii) P is the amount of money invested in each new project

(iii) c is the yield from each new investment

$$\text{Max. } k = \sum_{i=1}^{n} c_i P_i$$

$$\text{subject to} \quad \sum_{i=1}^{n} P_i \leqslant k^*$$

$$P \geqslant 0$$

NOTES APPENDIX 2

1. In Kenya, the I.C.D.C. set up an investment trust (See Pt. 2 Chapter 5), as did also the Botswana Development Corporation.

2. In all D.F.I. remits that the writer has seen, the requirement to be financially viable is stated as a matter of course.

3. In the long term, a successful D.F.I. might be regarded as a total social benefit maximiser, but such complex considerations are outside the scope of the present study.

4. Satisficing behaviour appears to be applicable to the policies of a D.F.I. established to lend to African-owned businesses in KwaZulu. Harvey explained to the writer that the aim was for the institution to remain solvent and make a low return on capital.

5. A theory which seems - perhaps unfortunately - to apply quite frequently to D.F.I.s in developing countries is Williamson's model of managerial discretion (Williamson 1963). As Koutsoyiannis (op.cit p.171) states, "Williamson argues that

managers have discretion in pursuing policies which maximise their own utility rather than attempting the maximisation of profits which maximises the utility of owner-shareholders. Profit acts as a constraint to this managerial behaviour..". She later lists as variables in the managerial utility function accoutrements such as "salary, security, power, status, prestige and professional excellence". With many developing country D.F.I.s, profit has often not been a constraint on managerial utility, since governments have too readily covered losses and not insisted on loan servicing. So the opportunities for gathering advantages and perks have been that much greater. Burgeoning administrative costs, and the oft-noted multiplication of staff in parastatals - which include many D.F.I.s - testify to what has been happening.

It may fairly be concluded that the soft state is well suited to breeding a high degree of managerial utility in organisations, particularly those in the public sector.

6. R.L. Kitchen in 'Finance for the Developing Countries' (Wiley 1986) writes extensively about capital market theory and risk in Chapter 2. However this material does not dwell specifically on D.F.I.s. The present writer's much more limited treatment aims to focus just on one aspect of D.F.I. capital budgeting, and does not elaborate into the effects of inflation and changing interest rates.

7. There is no contradiction here. If a 'mainstream' institution was enabled to branch out into development finance by being afforded extraneous extension help, it would be classed as a D.F.I.

# APPENDIX 3

## SOME COMMENT ON OTHER D.F.I.s IN KENYA, ZIMBABWE AND ELSEWHERE

## INTRODUCTION

Chapters in the main text investigated the major 'general' D.F.I.s in Kenya and Zimbabwe. Other D.F.I.s in those countries were omitted, as also by definition were the numerous parallel institutions elsewhere in Anglophone Africa. The following paragraphs briefly review a number of these other organisations - and also one from the Far East - so as to intimate that the experiences of the I.C.D.C., the D.F.C.K. and the I.D.B. in Kenya, and the I.D.C. and Z.D.B. in Zimbabwe, are not untypical. Furthermore, though specialised small business financing intermediaries were not discussed in the main text, this is not the case in the sections that follow, and certain examples of this type of institution are reviewed.

In some instances the discussion is of events that took place up to a decade ago. However, as illustrations of the variety of D.F.I. experience that have contributed to the post-independence history of developing countries, it is believed that the investigations are valuable and instructive.

## KENYA

(a) Kenya Industrial Estates.

K.I.E., a small business organisation, was originally linked to I.C.D.C., but became a separate organisation in 1976. Despite the rather unusual name, indicative of the remit of the organisation to manage and construct industrial estates, rural development centres and industrial promotion areas, it has been active in lending and providing technical assistance to small entrepreneurs.

J. Levitsky (1986) looked into the institution on behalf of the World Bank 1986, and painted a fairly dismal picture. He noted (p.31) that in 1981 81% of loan repayments were in arrears, and he expected that 55% of loans made would never be repaid. There had been some improvement by 1984. Of 692 loans on K.I.E. books, 58 borrowers had failed completely, and 151 were having serious problems with their businesses. The rest had no or only 'minor' problems (p.48). Though this information is from some years back, anecdotal evidence available to the writer in 1990 suggested that K.I.E. had continued to fail to become a financially viable organisation.

A brief glance at an organisation's experience cannot expect to account for its difficulties. However it is plausible that the type of company problems identified by the RBC Report for the I.C.D.C., the D.F.C.K. and the I.D.B. would equally be true of K.I.E. Administrative costs of the organisation were also reputed to be excessively high relative to income, perhaps understandable in the light of the technical help - without government financial support - given to small businessmen.

(b) The Kenya Tourist Development Corporation.

This organisation, set up in 1965, and 100% owned by government, aimed to provide equity and loans to enable Kenyans to get into the potentially lucrative tourist business. And in subsequent years the Corporation took on more of an entrepreneurial role itself by buying majority holdings in formerly European-owned hotels.

As with the I.C.D.C. there is some obscurity in the accounts, and it is not clear how much 'dividend receivable' and 'interest receivable' - as the annual accounts would have it - are synonymous with the actual receipt of money. The Auditor in the 1987/8 Annual Report (p.12) implicitly looks into this when he remarks on the growing amount of - mainly interest - indebtedness to the Government. He observes, "The Corporation's indebtedness to Government continues to rise and I have still not received satisfactory explanations as to why the Corporation has not remitted these funds to Government. The Corporation has only explained that it failed to remit the funds to Government because the Corporation's loanees had defaulted in their loan repayments to it".

And there are other ways in which the figures in the Accounts may have been massaged to give a more favourable overall impression. As the Auditor remarks (Ibid. p.12) "...the estimated loans not fully recoverable as at 30th June, 1988, amounted to KSh.1488m. The Corporation, however, only made a provision for bad debts in these accounts of KShs.813678400". Had full provision been made, of course, the so-called surplus for the year would have been turned into a loss.

Analysis of the accounts from earlier years reveals malaise similar to the above situation, and it is safe to conclude that the K.T.D.C. is not properly a financially viable organisation. And the cause is fairly clear. A substantial number of tourist facilities in which the Corporation holds equity and/or to which it has made loans are loss-makers. Management problems identified by the RBC Report no doubt have much to do with this state of affairs, plus also the clear ineffectiveness of the Corporation in chasing up bad debts.

Back in 1975 (p.132) Leys was writing, "The extent of the K.T.D.C.'s investments were not known, its administration having fallen on evil days". It is a moot point whether, by the end of the 1980s decade, things were much better.

ZIMBABWE

(a) Small Enterprises Development Corporation.

1. Structure, remit and finance

S.E.D.CO. came into operation in 1984 to assist small business in all areas, except for agriculture, with finance and various varieties of 'extension' help. A small enterprise was one defined as "having fixed assets not exceeding Z$500000 and/or a permanent labour force not exceeding 50 persons" (S.E.D.CO. circa 1989). All legal types of business were to be helped, though, with some ritualistic obeisance to Zimbabwe's early socialist aspirations, S.E.D.CO. "gives priority and preference to cooperatives" (Ibid). However, with reference to this aim, the writer was informed that financing cooperatives did not happen much, because they were subject to management problems and internal squabbles (1). And indeed, the 'ownership profile of approved loans' in the S.E.D.CO. Annual Report 1989 (p.21) is given as 1.5% of the total for cooperatives, as opposed to 75.3% for sole proprietorships.

The bulk of the funds for disbursement by S.E.D.CO. have come from government as a 'capital grant'. There was also, at the end of the 1980s a loan facility from the World Bank via the Zimbabwe Government. Virtually all S.E.D.CO. financing has been in the form of loans, and in 1990 16% interest for rural projects and 18% for urban and peri-urban projects were charged. There is clearly an element of cross-subsidy here, as rural loans would normally be more costly to manage than urban loans. However, of more significance was their relationship with the commercial bank base lending rate on commercial and industrial loans, which during the same period was 14.75%. Given the especial difficulties associated with small business finance, and the volume of extension work S.E.D.CO. purported to be undertaking, the extra income from a 16% rate or an 18% rate as compared with 14.75% would - even if paid on the nail - hardly seem adequate to meet the likely extra expenses. S.E.D.CO.'s big advantage in relation to mainstream commercial banks was, of course, that most of its funds for disposal - except for the 9.75% World Bank money - were, in practice, 'free' of servicing. Hence S.E.D.CO. has been in a position to conduct highly concessionary lending operations, while still having a large margin over borrowing costs.

2. Experience.

Despite a certain professionalism intimated by the writer when looking into the operations of S.E.D.CO., and a financial record which appears to be sounder than that of many other small business agencies, there are severe problems recognised not just by disinterested observers but by the staff of the organisation.

Investigation of the accounts reveals that they would never have been able to deliver a financial surplus from operations had there not been a regular government grant to cover administrative expenses. This grant covered the cost of a number of short courses for S.E.D.CO. clients, so technically was for extension work as well as pure administration. The arrangement had been negotiated at S.E.D.CO.'s inception, and was due to end in 1990 when S.E.D.CO. was supposed to be 'on its feet'. However it was accepted in 1989 that S.E.D.CO. would not in practice be able imminently to dispense with the subsidy, largely because - as it was put to the writer - government had failed to supply the Corporation with anything like the amount of capital funds initially promised. Now this explanation is plausible if it is assumed that (i) viable but unsatisfied lending opportunities existed, and (ii) administration was subject to scale economies, and would not absorb the income from more loans. There seems some truth in (i), for though 70% of all project applications were, in the late 80s, rejected, not all the remaining 30% could be funded. With regard to (ii) although the cost of some categories of pure administration might experience scale economies, other expenses in the areas of extension, education, and monitoring might well go up more than proportionately, for at the margin loan management costs probably increase.

And staff problems could only exacerbate the rise in costs as higher salaries would need to be paid to attract more qualified people. As the Chairman pointed out in the 1989 Annual Report (p.7), "..as long as a situation exists where highly trained and expert staff are on a salary structure which is below that of the private sector and other parastatals there is no way that they can be retained in the long term....Presently the staff complement is only 48% of actual requirement".

It was felt at S.E.D.CO. that government should continue to help out with administrative expenses. If a division - albeit imperfect - can be made between pure administration and extension costs - there is a case - argued in the main text - for a government taking on the finance of extension in areas of problematic lending, and this would seem to apply in the case of S.E.D.CO. All intermediaries have to face administrative costs, but small business lending in particular needs substantial supporting services.

In the year ended 30th June 1989 government grants stood at Z$1.66m, and the net surplus at Z$0.12m (Ibid. p.25). Had government only been financing extension and not general administration as well, it is likely, therefore that the accounts would have been in the red. So even if the government relents, and in subsequent years only reduces, but does not abolish its grant, the viability of S.E.D.CO. is in question. However the situation will be much less serious than if government cuts off funds completely.

A further basis for anxiety over the finances concerns the fact that - as with some Kenyan institutions it is not clear to what extent - in the Balance Sheet of the annual accounts - 'interest receivable' and 'current loan maturities' identifies money actually received. And disquiet was expressed to the writer that repayment arrears in 1990 were running at 15.8% of disbursements: the proportion had been up to 28%. Anything above 10% was thought unacceptable. The remark in the 1988 Annual Report (p.8), "During the year, plans were drawn up to strengthen the Debt Recovery Unit", may be indicative of increasing worry over arrears.

3. Conclusion.

Small business finance is a difficult area to exploit, but, in comparison with many schemes, such as the arrangements run by the I.D.C. in Zimbabwe and the I.C.D.C. in Kenya, which were virtually destroyed by mountains of bad debt and the factors that led to it, S.E.D.CO. has been fairly successful. Loans have been made, businesses have been established, and repayments have come in. However, it has been operating on quite a small scale, and is questionably viable. Tricky problems have to be addressed if it is to prosper.

(b) The Zimbabwe Mining Development Corporation.

The Z.M.D.C. was founded in 1982 to invest in the mining industry as it stood and to adopt a promotional role towards exploration and the establishment of new ventures. Assets acquired in the early years involved the take-over or acquisition of majority holdings in going concerns such as Mhangura Copper Mines Ltd. and Sabi Consolidated Gold Mines, or unviable undertakings - often where the owners wished to leave the country. As the Annual Economic Review 1986 (p.51) observes, ".. the Government has often offered direct assistance to mines faced with closure, in some instances this has entailed take-over of such companies to safeguard employment".

The performance of the Z.M.D.C. has been unsatisfactory, partly a reflection of and perhaps also partly a cause of the relative stagnation in the mining industry. For example, from 1980 to early 1989, the volume of most minerals mined was on a downward trend. Only coal, and to a lesser extent gold went up (Quarterly Digest March 1989 p.45)(2). Funds for use by the Corporation have been obtained fairly painlessly via a series of 'capital grants' from Government and unsecured interest-free Government loans. And - very indulgently on the part of the Government -, "The repayment of these loans is still subject to negotiation with the Government of

Zimbabwe and is dependent on the viability of the projects being developed" (Z.M.D.C. Annual Report 1989 p.23).

Even so, the Z.M.D.C. has found it difficult to be financially viable. Though, "The Corporation eliminated a loss of Z$1.34m the previous year and made a profit of Z$1.78m"(Ibid. p.4) - that is from June 30th 1988 to June 30th 1989 - this was largely due to "a substantial grant from government of Z$1.35m" (Ibid. p.7). To the extent that indifferent Z.M.D.C. performance can be attributed to the condition of its subsidiaries, the Z.M.D.C. Chairman speaks of "equipment breakdowns and poor availability of LHD machines" (Ibid. p.4), "undercapitalisation of the Corporation and its subsidiary companies coupled with antiquated plant and machinery" (Ibid. p.6). In the Corporation itself, as with S.E.D.CO., there was the problem of "recruitment and retention of qualified personnel ... due mainly to uncompetitive salaries and benefits" (Ibid. p.6).

From the above cursory survey of the Z.M.D.C. it seems it has been unable to nurture Zimbabwean mining into a vigorously growing industry, but, kept afloat by subsidies, it has presided over a steady decline.

(c) The Zimbabwe Tourist Development Corporation.

This organisation dates from 1984 when it took over the assets of the Zimbabwe Tourist Board. The Z.M.D.C. is qualitatively different from the other corporations surveyed in that it was not conceived as primarily an asset-holding institution. A major part of its business has been tourist promotion and publicity, and the physical facilities acquired have been more to do with government-inspired social necessity than commercial planning. As is stated in the 1986 Annual Economic Review (p.57), "Since Z.T.D.C.'s inception, it has been involved in the acquisition of hotels threatened with closure and those that are seen as ultimately leading to sound financial contribution to the parastatal itself. By 1986, a total of 4 hotels were under the Corporation's control".

The Corporation's funds have come from substantial capital grants from Government, and besides the hotel purchases it has made a number of 'development' loans in the tourist industry. Reputedly the repayment record has been poor. The production of annual reports has been spasmodic, so making it difficult to properly judge Z.T.D.C. performance. Indeed, in the first Annual Report (1984/5 p.12) the auditors were complaining of "absence of details" and "inadequate controls...over recoverable expenditure". So, "Because of the significance of the above we are unable to express an opinion on the financial statements at 30 June 1985 or the loss for the year then ended".

There are few grounds for believing that the Z.T.D.C. is free of the shortcomings typical of many other development corporations.

BOTSWANA - THE NATIONAL DEVELOPMENT BANK

(a) Structure, remit and allocations.

This organisation dates from 1966. The capital structure is rather unconventional, in that the Bank has operated from a foundation of 'unrecallable capital', which consists predominantly of funds from the Botswana Government - validating the fact that nearly all directors are government appointees - but which also includes donations from non-Botswana agencies, such as Oxfam and the U.K. Freedom from Hunger Campaign. The unusual status of the capital obviates the necessity for regarding it as a collection of shares properly requiring dividend returns, and smooths the passage of government subsidies into the organisation. For example, in the Annual Report for 1986/7 (p.22) it is stated, "The Government has further invested 4.0m Pula in the capital of the Bank raising the total unrecallable capital from 9.2m Pula to 13.2m Pula during the year". Additionally, the Bank has borrowed money, again the great bulk coming from the Government. Smaller loans from external sources have often been on highly concessional terms (3).

Nearly all N.D.B. disbursements have been as credit rather than equity finance. Also the Bank has had a bias towards the finance of agriculture and activities supporting agriculture, and in proportional terms the emphasis on these categories of beneficiaries has tended to increase over the years. However its remit authorises it to allocate money to secondary and tertiary industry, and hence qualifies it for inclusion in a study where the investigation of agricultural finance is, in the main, avoided. In terms of average size of loan, and in line with definitions of D.F.I.s in other countries, the N.D.B. has operated as a small business intermediary.

The table below illustrates these features.

**TABLE 1**

LOANS APPROVED BY SECTORS (AMOUNTS IN 1000 PULA)

| | **1980** | | **1982** | | **1984/5** | | **1986/7** | |
|---|---|---|---|---|---|---|---|---|
| | NO. | AM. | NO. | AM. | NO. | AM. | NO. | AM. |
| AGRIC. | 2583 | 5173 | 3860 | 8378 | 2725 | 7125 | 1019 | 9694 |
| COM/IND | 218 | 4143 | 325 | 3925 | 381 | 2673 | 273 | 4359 |

SOURCE: National Development Bank Annual Report 1986/7 Table 2

At the official exchange rate in 1986 of 1.9 pula per U.S. dollar (African Economic and Financial Data 1989 p.24), the average approved agricultural loan at that time was circa $18000, and the average approved commercial or industrial loan circa $30000. Furthermore the agricultural figure, even taking inflation into account, was a big increase on previous years' experience. Despite the relative average smallness of these loans, in 1986/7 a subsidiary division was established to assist persons who wanted loans of not more than 10000 pula (or $19000).

(b) Financial outturn.

The accounts of the N.D.B. make for fairly depressing reading.

To consider first the 'income and expenditure account', for the year ended 31st March 1984 there was a deficit of 0.3m Pula, following on a supposed surplus of 0.2m Pula for the 15 month period preceding that (N.D.B. Annual Report 1983/4 p.27). However these figures emerge from calculations based on 'interest earned' -

as opposed to 'received' - of 3.75m Pula for 1983/4 and 3.5m Pula for the earlier period. Furthermore the amount of 'bad debts written off', at 6.25m. Pula for the first 15 months and zero for the following year seem optimistically trivial.

The general situation appears to have deteriorated further a few years later, for the deficits in 1986 and 1987 respectively were nearly 2m Pula and 3/4m Pula respectively (N.D.B. Annual Report for 1986/87 p.25). Again, there was considerable 'interest earned' in the calculations, and no money allowed for writing off bad debts.

The 'balance sheet' records as assets 'repayments of advances due within one year', but there is no indication as to how much money actually accrued. Though the figures in question are arrived at after some provision for 'doubtful' debts, the provision is sufficiently optimistic as to prompt comment from the auditors. In the 1983/4 Report Deloitte, Haskins and Sells observe (p.25), "The bank has made a provision for doubtful debts of 5% of the total outstanding advances.... We are unable to establish whether the provision ....is adequate or not and accordingly are unable to express an opinion thereon". And indeed, in the 1986/7 Annual Report it is stated (p.19), "Since the beginning of the now six years lasting drought situation, the arrears on outstanding loans have grown at a very alarming rate". Over the years the very substantial 'loans' from government plus increases in the unrecallable capital (both referred to above) are what appear to have enabled the N.D.B. to survive.

(c) Assessment.

Like that of so many D.F.I.s, the record of the N.D.B. has been poor. It is not possible to comment on the reasons for this too authoritatively without depth research, but certain clear factors emerge from the annual reports.

Firstly, of course, as was made abundantly clear in the main text, viable lending on a small scale basis is notoriously difficult to achieve. And agricultural lending subsumes further problems not followed up in the main text. However in earlier pages monitoring, extension and other support have been emphasized as of overwhelming importance if a D.F.I. undertaking problematic lending is to have a chance of being viable, and this is especially true of small business finance. Although it may be assumed that the N.D.B. - from the designation of various managers - involves itself with work of these kinds, there is no description or elaboration in the annual reports of what is done. Though it cannot fairly be intimated from this that the N.D.B. is necessarily weak on support services, it is true that those D.F.I.s which regard them as important tend to write a lot about them. And it is certainly apparent that no extraneous agency such as the Government pays for or independently provides relevant assistance to the central financing function.

Secondly, the N.D.B. has fallen into the McKinnon-designated trap (see Part 1 Chapter 2) of operating an interest rate structure that is out of touch with commercial reality. A paragraph, quoted in full, from the 1983/4 Annual Report (p. 11) makes this embarrassingly clear.

"The Bank's approach to financing of commercial and industrial sectors corresponds with the Government's strategies and policies i.e. to promote employment creation undertakings, accelerate rural development, diversify economy's industrial base and encourage local ownership and management of the business sector. To support these policies the Bank placed emphasis on locally-owned and rurally based projects through its interest rate structure, by charging relatively lower rates to the projects that met these criteria. Productive enterprises in the industrial sector were also charged the minimum interest rate instead of the higher rates charged to trading enterprises. Loan appraisal techniques continued to emphasise labour intensive techniques in order to maximise employment creation".

As an almost text-book illustration of financial repression, these lines are without parallel in all the D.F.I. annual reports consulted in connection with the study. Such a political and social role for interest rates - plus the accompanying 'social' aspirations - are well fitted to deny money to the efficient and nurture high cost enterprise. Although adjustments were made to interest rate tactics later in the 1980s (4), the N.D.B. was weighed down at this time by an albatross that could hardly fail to prejudice its solvency.

TANZANIA AND ZAMBIA

(a) Introduction.

In the absence of up-to-date and sufficient information, the lines that follow do not attempt for Tanzanian and Zambian D.F.I.s even the limited survey that has been effected in relation to other D.F.I.s in this Appendix. Rather, the aim is to make a few comments which illustrate the - typically - chequered careers of developing country D.F.I.s, so as to support the conclusions that were arrived at from the depth D.F.I. analyses in the main text.

(b) The Tanzania Investment Bank (T.I.B.).

The Tanzania Investment Bank was set up in 1970 to make loans and equity investments - though in practice nearly all its allocations came to be loans - in the whole spectrum of productive activities. The entire share capital was subscribed by the Tanzania Government, and Tanzanian financial parastatals, though the Bank subsequently obtained some loans from agencies such as the African Development Bank and the International Development Association.

What is apparent from the Annual Reports of the T.I.B. is a great dearth of information, so rendering it impossible to to make an adequate assessment of the organisation's experience; however there are clues enough to breed suspicion. (Perhaps if independent auditors had been authorised to check the accounts rather than the Tanzania Audit Corporation, a public body, greater openness would have been encouraged). Thus, although, for the year ended 30th June 1984, there was purportedly a profit (T.I.B. Annual Report 1983/4 p.13), so enabling the organisation to pay a 10% dividend on the 100m Tanzanian shillings capital of its shareholders, the integrity of this 'profit' is much in doubt. For example, as in so many D.F.I. annual reports investigated, the substantial 'current loan maturities' in the balance sheet (Ibid. p.12) does not carry with it any indication as to whether the money was actually received, and if in fact much was not, the quite modest expense 'provision for bad and doubtful loans and investments' (Ibid. p.13) to be set against income is far too optimistic. However there is no independent discussion as to the extent of bad debts. Similarly the question as to whether the very large income figure 'interest and commitment fees on portfolio loans' (p.13) actually accrued is left obscure. A charitable inclination to give the T.I.B. the benefit of the doubt in these matters is, though, pulled up short by an item 'grants' which appears in the 'consolidation of assets and liabilities' table. No comment is afforded to 'grants' which in value are six times the paid-up share capital, and in 1984 equal to more than three-quarters the size of all loans from outside agencies. It is to the existence of these 'grants' - presumably from Government - that the emergence of 'profit' can almost certainly be attributed.

(c) The Tanganyika Development Finance Company (T.D.F.C.).

The Tanganyika Development Finance Company dates from 1962, with share capital owned by the government, and British, Dutch and German development agencies. Though mainly participating in companies' equity, it also put money into loans and income notes. The influence of the foreign participants, who supplied many of the directors, may have helped to make the accounts more transparent than those of the T.I.B., for the minimal profit in 1980 appeared to be genuine. However, the T.D.F.C. has received some government indulgences. For example (T.D.F.C. Annual Report and Accounts 1980 p.28), "The Tanzania Government ... exempted the company from the dividend provisions of the Companies Act 1972", and "Payment of dividends to non-resident shareholders is subject to exchange control approval and the allocation of foreign exchange". Also, the level of administrative expenses must have given some cause for concern. In 1980 they used up nearly a third of the Corporation's net income (Ibid. p.20).

(d) The Development Bank of Zambia.

This was established in 1974. The overwhelming majority of shares were subscribed by the Zambian Government and Zambian parastatals, with a minority of 'Class B' shares divided amongst a numerous cohort of extra-Zambian development agencies and banks. Thus, with a very minimal stake in the organisation, each foreign shareholding body is unlikely to have had the same influence and interest in the organisation as it would have if heavily committed. And indeed, in general, all or nearly all directors appear to be Zambian. A number of loans have been negotiated with domestic and extra-Zambian agencies, and most D.B.Z. allocations have been in the form of loans, though it may make equity investments.

The main feature of the annual accounts of the D.B.Z. is, like those of the T.I.B., a chronic lack of information. With regard to capital disbursements, though the broad overall industrial allocation of funds is charted, and new approvals described as, for example, 'Installation of an Ice-Making Plant' (Development Bank of Zambia Annual Report 1984 p.10), there is no indication of the legal status and associated ownership of the concerns with which the Bank is involved. Furthermore though - at least in the earlier 1980s - 'profits' were presented as having been made, there are grounds for scepticism. First of all 'income' - from which profit after expenses is a residual - included 'interest receivable', (Ibid. p.17) but as with so many other D.F.I.s, it is not clear that the interest was actually 'received'. Secondly, in the 'charges' (this seems to be a synonym for 'expenses') no provision at all is made for bad debts. And it seems unlikely that Zambian business has been so credit-worthy that all debt servicing liabilities are met in due time in totality. Furthermore, elsewhere in the accounts, there is no mention of loan repayments, either receivable, late or received. Since there is no 'consolidation of assets and liabilities' table, as there is with the T.I.B., the issue cannot be pursued further.

In conclusion, there is little justification for believing in the financial viability of the D.B.Z. from the accounts as presented.

## AN INDONESIAN EXAMPLE OF SMALL BUSINESS LENDING

To confirm the fact that problems related to the finance of small business are not confined to Anglophone Africa, there follow now some remarks on a scheme for providing concessional credit to small scale enterprise in Indonesia.

KIK/KMKP (Small Investment Credit/Small Permanent Working Capital Credit) was introduced in 1973 and aimed to provide medium term credit for investment and working capital in virtually all sectors of the economy, with regulations favouring indigenous borrowers. A rule making people in certain sectors of the civil service ineligible as applicants for loans was presumably designed to prevent officials with influence commandeering funds.

Bolnick (1982) usefully reviews the operation of the scheme, but his fairly up-beat assessment is not fully supported by the facts. From his reporting it seems clear that the scheme saddled itself at the outset with the type of constraint often fitted to lead to problems. Thus (p.67), "The interest charges, maturity limits, collatoral requirements and self-finance shares are set to provide highly preferential treatment for S.S.E." i.e. small-scale enterprise "customers. Furthermore, the regulations specify that applications are to be approved in terms of 'feasibility' rather than by traditional commercial criteria". It is not made clear, however, what are the criteria for 'feasibility'. Also, in order to cushion the commercial banks operating the scheme, "the burden of financing these preferential loan terms is shifted away from the handling banks to Bank Indonesia via a system of liquidity credits and risk coverage..". (Ibid. p.67-8) Thus although the standard anxieties facing financiers about to lend on a small-scale basis were expected to be present in relation to the Indonesian scheme, the operators of it were conveniently able to shrug them off by tapping the resources of the central bank. Such an arrangement is hardly designed to enhance informed responsibility on the part of the lenders.

In due course it is stated, "...by far the majority of ... credit goes to existing business...This is to be expected, given the fact that most businesses are existing businesses, and that neophytes are difficult to appraise until after they have proved their entrepreneurial abilities". (Ibid. p.76). The scheme's policy here is understandable, though clearly new businessmen were not meant to be ruled out, as there was no statutory lower limit to the size of loan disbursed. But even so, "Bank Rukyat Indonesia, which handles just under 50% of KIK credit, has a repayment rate of only about 50%..". (Ibid. p.76). This is rather weakly excused in the following manner, "...many Indonesian SSE" i.e. small-scale entrepreneurs, "are not accustomed to meeting rigid payment deadlines, so a lot of brief arrears may exist without implying any problem with the loan". (Ibid. p.76). Further comment by Bolnick on the difficulties of collecting and interpreting data may identify true obstacles to properly assessing the scheme's performance, but from the limited evidence it seems that the sceme has not been immune to the problems faced by analogous arrangements elsewhere.

MALAWI - A SUCCESS STORY?

(a) Introduction.

So far in this appendix, the D.F.I.s considered have shown up indifferently. Like the Kenyan and Zimbabwean D.F.I.s investigated fully in the main text, success and financial viability have eluded them, or have at best been ambiguous. However, although this type of record is typical of developing countries, it is not inevitable. Certain D.F.I.s in Malawi do appear to have fared well, though it must be accepted that the cursory glance a few paragraphs in an appendix afford can hardly analyse in depth what has been going on.

(b) The Investment and Development Bank of Malawi (Indebank).

Indebank was established in 1972 "to make a contribution to the advancement of productive business enterprises which in turn contribute to economic and social progress in accordance with the developmental goals set and pursued by the Government" (Indebank Annual Report and Accounts 1987 p.4). Indebank may allocate its funds to beneficiaries in equity or loan form, and has taken equity stakes in half its 80 or so (in 1991) company interests. The destination of funds covers the whole range of industry from agriculture to services.

McKendry (1991 p.7) states, "The Investment and Development Bank of Malawi ('Indebank') has had a particularly strong trading record in recent years. Its profit before tax trebled in real terms between the years 1987 and 1989, reaching Kwacha ('K') 4.9m in the year ending December 1989; dividend income (K3.1m in 1989) made a significant contribution to the profit. This performance represented a pre-tax return on capital employed of 22% which suggests that Indebank has a reasonably sound portfolio".

This refreshingly bullish assessment demands explanation. Certainly much of the business into which Indebank loans have gone comprises productive activities that would seem appropriate in a developing country context, such as basic manufacturing based on local raw materials, for example tea processing. Also Malawi still has some way to go in the import substitution of fairly straightforward products, such as plastic containers. However, for such ventures to be viable also demands efficient management, something that the RBC Dominion Securities Report found not to be true of Kenyan companies, to the subsequent detriment of the D.F.I.s that supported them. Conceivably a sentence in the aforementioned Annual Report (p.4) throws a very illuminating ray of light on the situation in relation to Indebank. "Indebank achieves its objectives by obtaining overseas resources to supplement local resources for investments made preferably but not entirely in limited liability companies and corporations". In other words, the Bank likes to put money into established going concerns that are actively investing. And having foreign currency to allocate it is an attractive source of funds for companies that may find it difficult to obtain sufficient foreign exchange through other channels.

Though Indebank, by pursuing such a policy, could be accused of 'playing safe', nevertheless the consistent and successful operation of the policy over a period of years requires efficient and intelligent Indebank management, and a management, moreover, not swayed by the pressures and bad example of partial politicians and their cronies. Though it is rather naive to be too dogmatic about the Bank's efficiency and integrity without depth research, McKendry (op.cit. p.4) is complementary. He states, "Research has confirmed that both organisations" - that is, including the Malawi Development Corporation - "are professionally managed", many of the investment officers having been "educated at Western business schools and universities".

Also seemingly of very great significance are the ownership circumstances of Indebank. Most of the capital is in the hands of four foreign and supranational agencies, the C.D.C., the Dutch F.M.O., the Germam D.E.G., and the I.F.C., and these appoint the great majority of the directors. Certain of these agencies also provide lines of credit, as does the I.B.R.D., and against the influence of these powerful bodies, it is plausible that the predilections of local officials for self-aggrandisement and the furtherance of pet schemes would not, in a country that has largely escaped the disadvantages of xenophobic ideological pressures, get very far.

(c) The Malawi Development Corporation.

This was set up soon after the achievement of independence in 1964 for investment in the whole range of productive activities, and unlike Indebank is owned 100% by the Malawi government. As well as the K20m capital, the M.D.C. has obtained further funds by borrowing, but since the bulk of this debt is due to the Malawi Government and the Import and Export Company of Malawi, in which the M.D.C. has an overwhelming majority interest, it may be assumed that timeous repayment need not be a problem. For, since all M.D.C. investments are equity, loan repayment could require the liquidation of assets. And though, "The financial strategy of M.D.C. includes such measures as revolving funds realised from the sale of equity ..". (M.D.C. Annual Report 1987 p.7), this does not seem to have happened much.

McKendry (op.cit. p.7) observes, "The performance of the Malawi Development Corporation ('M.D.C.') is not quite so strong;" - that is, as Indebank - "... but their performance is still much healthier than that of many other D.F.I.s". Indeed, there have been years when the M.D.C. has made operating losses, for example 1983 and 1984, but these outturns did not develop into a trend, and McKendry's latter remark remains starkly true. How may M.D.C. experience be explained?

McKendry's remarks about good management are meant to apply to the M.D.C. as well as Indebank, and good management is partly the basis of the policies that evidence shows the Corporation to have pursued. For most M.D.C. investments are majority or minority holdings in active firms with foreign company partners. Hardly any companies held by the corporation are dormant, suggesting that hostile ideological rhetoric in Malawi less readily frightened expatriate entrepreneurs away from the country, so prompting take-over of the businesses they left behind.

Furthermore, investment has always been careful - and indeed, according to commentators, perhaps too cautious. For example, in 1987, 23 years after the Corporation's inception, it had holdings in only 19 companies (M.D.C. op.cit. p.36-39). As a corollary of this policy, it has avoided more adventurous types of investment, such as bringing on more Malawian businessmen. The following quote (Ibid. p.7) seems more a ritualistic gesture in this direction rather than an operational policy. "M.D.C. will step up its support for capable local entrepreneurs and every effort will be made to stimulate and develop local entrepreneurial and managerial skills".

Nevertheless, M.D.C. investments have not been immune from the type of shortcoming apparent in many Kenyan companies. In consequence, the M.D.C. 1987 Report (p.6) referred to the "...manifold measures undertaken in 1984 to improve management performance, especially in subsidiary companies". Gratifyingly, the 'manifold measures' appear to have worked, for company profits and dividends to the M.D.C. went up thereafter.

## CONCLUSION

The above paragraphs have reviewed, with varying degrees of depth, some of the experiences of twelve development finance institutions (or arrangements). Except for the two Malawian organisations, the financial viability of all is (or was) in doubt. The apparent solvency of the Indebank and the M.D.C. appear to be at least partly due to a shrewd determination to restrict business to alliances with successful foreign companies rather than supporting and nurturing domestic entrepreneurship. Though this type of policy means there is a good chance of profits, some would argue that important aspects of national 'development' were being ignored. On the other hand it testifies to a government willing to create an economic backdrop where foreign capital is prepared (or perhaps has been prepared) to come to the country.

In a study which has as its principal aim the distillation of the effects of the 'soft state' on the structures and operations of D.F.I.s, and through them on economic growth, the limited treatments in this appendix obviously do scant justice to the issue.

However certain points do emerge. In particular there is the frequent vague and dubious presentation of financial data in the accounts, and also at times the convenient omission of information. Also evident is the occasional concern about the standard of management in the businesses of financial beneficiaries, and even in the D.F.I.s themselves. The bad loan repayment record is more frequently referred to, with the implication that this shortcoming is not easily followed up. Finally there are the biassed regulations for allocating funds, with the possibility - not of course stated - that the bias might merge with politically-motivated and personal favouritism. As a consequence, there must be some doubt as to whether economic development has been much helped by D.F.I. activity in the various countries considered.

The broad conclusion from the discussion in this appendix is that the malaise identified as affecting the main 'general' D.F.I.s in Kenya and Zimbabwe exists also in other developing countries.

NOTES APPENDIX 3

1. Interview in 1990 with a senior official of S.E.D.CO.

2. With a base year of 1980, the volume indices in Jan 1989 were as in Table 2.

**TABLE 2**

MINERAL PRODUCTION IN ZIMBABWE

| | | | |
|---|---|---|---|
| Asbestos | 67.8 | Iron ore | 73.0 |
| Gold | 118.5 | Silver | 38.2 |
| Chrome ore | 104.0 | Cobalt | 62.6 |
| Coal | 146.1 | Tin metal | 84.8 |
| Copper | 52.7 | Other | 82.9 |
| Nickel | 81.8 | All minerals | 94.5 |

SOURCE: (Zimbabwe) Quarterly Digest of Statistics March 1989

3. Some 25 year U.K. Exchequer low cost housing loans have been at 6.1/8% (N.D.B. Annual Report for 1986/7 p.27).

4. The 1986/7 Annual Report observes (p.9), "..all new loans up to 10000 Pula would be charged 10% interest and become part of the (new) Small Business Fund". At this time the Botswana discount rate was 9%, so 10% on small business loans was wildly concessionary.

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