

FINANCIAL INTERMEDIATION AND ECONOMIC DEVELOPMENT:  
THE CASE OF THE DEVELOPMENT BANK OF ZAMBIA: 1974 - 1981

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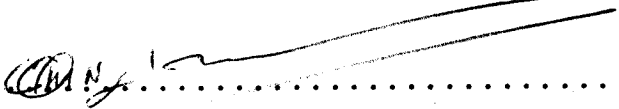
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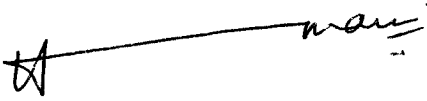
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August, 1982

APPROVAL PAGE

This dissertation of Moses Khonje is approved as fulfilling part of the requirements for the award of Master of Arts (Economics) of the University of Zambia.

Signed  ..... Date 30/1/84 .....

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DECLARATION

The work of this thesis was carried out in the school of Humanities and Social Sciences, The University of Zambia, and has not been submitted for any other degree or diploma in any University. This is the original work of the author, except where otherwise acknowledged in the text.

A handwritten signature in dark ink, appearing to read 'M. Khonje' with a stylized flourish at the end.

MOSES KHONJE

Dedicated to my Father, the Late  
Pearson Yesaya Mkheto Khonje

and my Mother,  
Violet Mafuleka Khonje

without whose parental love and  
guidance, my academic struggles  
would have been doomed to failure

Since independence in 1964, there has been an urgent need for economic development in Zambia, which led to the establishment of the Development Bank of Zambia (DBZ) as a source of long-term finance for development.

This thesis examines the role of DBZ in the development of the country, particularly through its investment policies and appraisal methods. It also looks at how the portfolio management decision has been arrived at in the Development Bank of Zambia in order to meet national criteria and requirement. In doing so, it considers how projects financed by DBZ have been important instruments with respect to the following:

- (1) Contribution to national output,
- (2) Generation of employment,
- (3) Effecting linkages with other sectors of the economy,
- (4) Contribution to reduction in the imbalances between rural and urban development.

It was observed that the Bank had developed appraisal techniques of internationally accepted standards. In its appraisal work, emphasis is placed on adequate appraisal and scrutiny of all aspects of the projects such as the managerial, technical, financial, commercial and economic aspects. Notwithstanding this fact, the choice criteria of selecting projects is tailored to the needs and requirements of the country.

It was also observed that the Bank had made a significant contribution to the economic development of the country through the provision of medium-term and long-term finance to both private and parastatal enterprise for development purposes. The bulk of the loans sanctioned by the Bank were mostly for new

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of existing projects and expansion ones, which were mostly extended to agro-based industries. However, the Bank has failed to make an impact on the rural sector of the economy. A Province-wise analysis of the distribution of loans sanctioned by the Bank indicates that by 1979, 89 percent of the loans went to five provinces, namely, Central, Copperbelt, Eastern, Lusaka and Southern, while the remaining four provinces viz, Luapula, Northern, North-Western and Western accounted for 7 percent with the remaining 4 percent being unallocatable.

It was also observed that the Bank continued lending to financially big business, to the neglect of small scale enterprises which are not yet covered by the DBZ Act. Indeed, by 31st March, 1981, the average loan amount stood at K577,000 per project which is by far in excess of the minimum loan amount of K25,000 stipulated in the DBZ Act.

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## CHAPTER 1

### INTRODUCTION

Since independence in 1964, there has been a growing recognition in Zambia of the urgent need for economic development. The Government has given considerable weight to the following objectives: growth of per capita income, employment generation, equitable income distribution and control over economic resources. Three National Development Plans have so far given primacy to these objectives.<sup>1</sup>

It is however recognised that even though these objectives may be conceived, they may not be accomplished without properly coordinated and efficient financial system. It is generally observed that there is an important link between financial resources and real capital expenditure which is forged when financial institutions lend out the funds placed with them. Hence finance is the life blood of every economic system.

In underdeveloped countries, in which the level of savings and capital formation is very low, financial intermediaries play an important role in economic development. They help in gathering small sums of capital into larger pools required by nascent modern enterprises. Hence the mobilization of small units of capital into packages for transfer to productive investments is the prime role of financial intermediaries. This role is what is known as financial intermediation.

It should however be borne in mind that there are different types of financial intermediaries in an economy each of which performs specialised functions. For the purpose of this thesis, a distinction needs to be made between the roles played by the various intermediaries. Taking an example of one

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<sup>1</sup> These plans are the First National Development Plan (FNDP) which ran from 1966 to 1970; the Second is the Second National Development Plan (SNDP), which ran from 1972 to 1976; and the third is the Third National Development Plan (TNDP) which is expected to run from 1979 to 1983.

financial intermediary, Commercial Banks, on the one hand and another type, Development Banks, on the other, one finds that their roles are different. Commercial Banks usually provide a collecting point of savings of a relatively small average amount from a large number of individual sources. Furthermore, they have shown a tendency of utilising their savings safely and profitably by lending to projects which are technically and financially viable. Development Banks on the other hand are not only concerned with the project's viability but also with the impact of the project on the economy. That is, in addition to the technical and financial viability of a project, the project should also be economically viable. For instance, though the project may be financially and technically viable, if it does not generate employment, and continues to drain foreign exchange by utilising imported raw materials, to the neglect of local ones, it will not be accepted from the Developmental perspective. Thus, the creation of development banks can make a contribution to the solution of the problem of allocating development finance, by ensuring that scarce supplies of capital are distributed in accordance with the best interest of the development of the economy as a whole.

It should be emphasized that in order to make funds available for development, a developing country must devote its effort to mobilizing funds from both domestic and external sources. However, in the final analysis, the country must step up savings within the domestic economy due to the danger of too large an indebtedness to foreign countries. Foreign funds not only tend to be small but also extremely sensitive to the politico-economic atmosphere in the recipient country.

## Definition of the Problem

Even though the government objectives listed above were conceived, until 1974 there was no institution in the country providing long-term finance for economic development. Although the existing institutions had some resources for lending, long-term finance was merely a secondary aspect of their activities. There was therefore a need for an institution to fulfil the functions of mobilizing resources, promoting and financing viable industrial projects in addition to appraising investment proposals and to determine their technical, economic and commercial viability. The Development Bank of Zambia (DBZ) was therefore instituted in December 1972 and became operational in January 1974, to undertake these objectives.

This study looks at the role of the Development Bank of Zambia in the economic development of the country. In particular, it evaluates the investment policies and appraisal methods of the DBZ and its impact on the development needs of the country.

There is one school of thought that maintains that what matters for development is simply more investments, the kind of investment being of little importance. This study, being concerned with investment policies, evaluates how the Development Bank of Zambia applies itself to this argument.

Very little research has been done on the Development Bank of Zambia and its contribution to the economic development of the country. We are yet to ascertain who the main beneficiaries are of the investment policies of the Development Bank of Zambia. It has generally been observed that financial intermediation in underdeveloped countries ensures a flow of credit to only those entrepreneurs who have security to offer regardless of productivity; and that credit flows to large-scale industries rather than to small-scale ones;

to expatriates and migrants rather than to local entrepreneurs; to urban rather than to rural areas and so forth.<sup>2/</sup> Though this study had the aim of looking at these issues as well, it received a set back due to the non-cooperation of the bank.

### Scope of Study

The period of study is January, 1974 to March 1981. The beginning of the period marks the year in which the Development Bank of Zambia became operational. The end of the study is determined primarily by the availability of reliable data.

In order to present a comprehensive analysis of the role DBZ plays in national development, a number of issues have been examined. These issues include source and method of finance (capital structure), lending and investment policies, appraisal methods, investment activities and others.

### Method of Study

The study is mainly theoretical, descriptive and analytical, and uses such statistical analyses as are necessary. The descriptive work is mainly based on data compiled from the DBZ's annual reports, bank manuals and also from personal discussions with bank officials.

### Preview of Chapters

The study comprises of six chapters including the introduction. Chapter I looks at the review of literature. Chapter III looks at the Financial Structure

<sup>2/</sup> Rattan J. Bhatia and Deena R. Khatkhate, "Financial Intermediation, Savings Mobilization, and Entrepreneurial Development: The African Experience", IMF Staff papers, Volume XXII, No. 1, March 1978 p. 137

of Zambia. It also looks at the history of the Development Bank of Zambia. Chapter IV looks at the Development Bank of Zambia. This chapter looks at the structure of the Bank and also reviews its policies. Chapter V looks at the project appraisal and investment activities of the Bank. Finally, Chapter VI. concludes the findings and includes recommendations.

CHAPTER 2  
REVIEW OF LITERATURE

There is extensive literature on the role of financial intermediation in economic development. Although there is numerous literature on financial intermediation in general, very little has been written on Zambia. This review combines both the theoretical and practical aspects of financial intermediation on economic growth. Initially, it looks at financial intermediation in general and then in the course of discussion zero-in on development banking in general and later on Development Bank of Zambia.

Most of the previous studies on financial intermediation have concluded that there is an observable link between financial resources and real capital expenditure which is forged when financial institutions lend out the funds placed with them. It has generally been observed that three main issues exist regarding the influence of financial intermediaries on economic growth, and these are, first their impact on the growth of savings especially the household sector; second their role in the financialization of these savings; and third their ability to ensure the most efficient transformation of mobilized funds into real capital.<sup>1/</sup>

The recognition of the importance of financial intermediation in economic development, is not essentially a twentieth century phenomenon. Rather it stretches to the time when most of the present industrialised countries began to industrialise. In one study, a Chinese entrepreneur named Sheng Hsuan-Huai, who promoted the Imperial Bank of China in 1896, was reported to have defined the function of a financial intermediary when he said, "if we wish to begin carefully in order to get results, we must accumulate small funds to make a big fund".<sup>2/</sup> He was referring to China's need for more financial intermediaries to gather small sums of capital into larger pools required by nascent modern enterp

<sup>1/</sup> Rattan J. Bhatia and Deena R. Khatkhate, "Financial Intermediation, Savings Mobilization and Entrepreneurial Development: The African Experience" IMF staff Papers, Volume XXII, No. 1 March 1978, p. 133

<sup>2/</sup> Phillips Perera. Development Finance, Fredirick A. Praeger, Publishers, New York, 1968, p. 137.

In another study, Polakoff and Durkin (1981) analysed among other issues, the emergence of financial intermediaries and financial markets in the United States of America. They showed the historical/and evolutions of these institutions from colonial times until the mid 1970s. They observed that capital markets as they were known today, did not exist in the period before 1850 when there was neither a need nor a desire for them. They noted that in those days, investors were very often their own savers: For instance, most people worked for themselves as farmers, shopkeepers, artisans and small manufacturers, and they expanded their enterprises by ploughing back some of their earnings or by investing their own labour. However, as years passed by, the American economy began to develop rapidly. These were the years when the U.S.A. became an urban country. Towards the end of the 1800s, the westward movement reached its peak. It was an age of more than ordinary technological process, the age of the rail roads, of steel and so on. Large scale industrial firms began to appear with greater frequency. This was reflected in the rise of the national income and dollar volume of savings. They further observed that vigorous and salubrious developments that were taking place in the economic and business world had profound ramification for the capital market and the growth of financial intermediaries. External financing was resorted to either through direct sale of primary securities in the capital market or through intermediaries. It was further observed that for the financial system, five developments in the fifty or sixty years after 1850 were especially significant and these were:

First of all, the assets of financial intermediaries grew at a much faster rate than they did in the first half of the century. Second, most of the increased saving that fed the intermediaries flowed through commercial banks, savings banks, and life insurance companies. Third, the investment banker emerged as an independent and vital force in the capital market. Fourth, during the final years of the period, industrial securities became increasingly important in the equities market. Finally, and closely related to the others, the latter half of the nineteenth century witnessed the integration of local and regional financial markets along national lines. (Polakoff and Durkin (1981),



Polakoff and Durkin further noted that until the 1920s, financial institutions competed against one another only in the broad sense that they were outlets for the savings of those who did not consume and invest all of their income. Each financial intermediary was highly specialised, performing distinctive functions that rarely overlapped. For instance, commercial banks in big cities were not interested in time deposits or in long-term loans; savings banks did not make short-term loans; Building and loan associations did not accept funds for deposit; Life insurance companies insured lives and granted annuities, but they did not describe themselves in any way as savings institutions; Investment bankers monopolised the flotation of new securities; Country banks welcomed time deposits and made some long-term loans; and private bankers accepted some accounts that might otherwise have gone to commercial banks, but there was no aggressive competition. However, circumstances were altered in the 1920s. Financial intermediaries became more diversified and competition among them increased. Polakoff and Durkin point out that the World War 1 had something to do with this trend for it affected financial institutions as it did everything else.

In their final analysis, Polakoff and Durkin noted that since World War 2, The Federal Government has played a highly influential and indeed expanding role in the economic life. Before the war, the Government had played a relatively passive and unimportant role in the economy. This changing role has resulted in an increase in Government capital formation and composition in total debt. It was also observed that one other notable change since World War 2, were the substantial changes that had occurred in the form of savings. This resulted in the continued growth of indirect finance - that is transference of saving into investment through financial intermediation. For instance, the contribution of financial intermediaries to external financing rose from less than 50 percent in the periods 1901 - 1912 to more than two thirds in the immediate post-war years. By the late 1960s financial intermediaries were supplying 85 percent of the

funds raised in the credit market compared to about 75 percent in the 1950s. By the late 1970s, nearly 90 percent of all funds raised was acquired through financial intermediaries. The analysis by Polakoff and Durkin seems to suggest that financial intermediation has been one of the key factors in the economic development of the U.S.A.

A study by Adams and Hoshii (1972) found that banks had played a very important role in the industrial and commercial development of Japan and that they still continued to occupy a central position in the economy. The Japanese financial history dates as far back as 1872, but the present financial structure was fixed only after the Second World War.

Adams and Hoshii noted that one significant feature of the present Japanese entire financial system is the large part played by the Government and Governmental institutions in the field of money, credit and investment. Government's influence extends far beyond the formulation of monetary policy or the determination of interest rates, to the extension of credit to individual firms or the financing of particular projects. The Japanese financial structure consists of the following institutions: Bank of Japan; Commercial banks; Financial institutions for small businesses; Financial Institutions for agriculture, forestry and fisheries; Government financial institutions (comprising a great variety of banks and so called finance corporations (koko, kinko) set up for special purposes or a special clientele); Securities finance institutions, insurance companies and Trust fund Bureau-Post Office. However, besides these institutions, the most important institution in the field of banking and credit, is the Ministry of Finance which shapes fiscal and monetary policies, supervises not only all credit institutions but also the behaviour of all corporations, collects taxes and custom duties, controls foreign exchange, and has a decisive voice in the approval of foreign investment in Japan and Japanese investment overseas.

Unlike the U.S.A., in which there is some degree of private sector autonomy in the field of finance and investment, most of the financial activities in Japan are controlled by the Government. The reasons cited by the Ministry of Finance assert, negatively, that the neutrality of the Central Bank would permit a monetary policy unrelated or even opposed to the economic and fiscal policies of the Government and, positively, that the efficiency of economic policy requires the coordination of all sectors of the economy and their integrated and comprehensive direction by the Government. This argument in a way seems to suggest that the Government is competent for everything in the life of the nation and that everything can and should be regulated by the government.

Though such a policy has succeeded in Japan, it may not necessarily be the case in most underdeveloped countries. It has generally been observed that the role played by most governments in less developed countries 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.<sup>3/</sup> Take for instance, the widespread practice of regulating interest rates which credit institutions may pay for their deposit liabilities, which has resulted in very low rates being paid in the official markets.<sup>4/</sup> This has generally led to:

- (i) a widening of the existing gap between the demand for and the supply of funds, thereby contributing to open or repressed inflation, and
- (ii) the perception of an unofficial non institutionalised financial markets, itself a symbol of the segmentation of the market.<sup>5/</sup>

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3/ See for instance Galbis Vicente, "Financial Intermediation and Economic growth in Less Developed countries: A Theoretical approach, The Journal of Development Studies, Vol. 13, No. 2, January 1977, p. 59.

4/ Ibid

5/ Ibid

However, in the Zambian development context, this type of market segmentation is relatively unimportant.

Most relevant to this study from the two literatures cited above, is the need to have specialised financial institutions in the economy and also the seriousness of the need to tailor the operations of these institutions to the development needs of the country. This requirement in itself stresses the importance of the government in controlling the operations of the financial institutions if they are to play an important role in the economic development of the country. However, the authorities should create an environment which is conducive to growth both of the real economy and of the financial system. This policy has worked well in Japan and has resulted in the growth in financial intermediation being reflected in real Gross Domestic Product.

Bhatia and Khatkhate (1975) in a study conducted in eleven selected African countries to determine how far financial intermediation had progressed with economic growth over the period 1960-70, however found that there was no definitive relationship discernible between financial intermediation and growth in some of the countries studied. Though a suitable measure of the relative importance of financial intermediation in any country is given by the proportion of financial assets of all kinds - currency, bank deposits, shares, government securities, and even trade credits - to Gross National Product (GNP), they however observed that for many of the African countries studied, there was no data on financial assets other than currency, demand deposits, and time and saving deposits (i.e. quasi-money). They therefore took the ratio of currency, demand deposits and quasi money to GNP as an indicator of financial intermediation. Moreso, in an attempt at uniformity, they used figures for the Gross Domestic Product (GDP) rather than

for GNP, since the latter were not available for some of the countries considered. The indicators used in their study seem reasonable considering that in many of the countries studied, the significance of financial institutions rather than banks and post-office is negligible and also the need to have uniform data to render comparisons meaningful. However, in this study, we do not adopt these indicators. This is due to the fact that the importance of a single financial institution in financial intermediation may be misleading if measured by these indicators. This is because other financial institutions not studied, may have played a major role in the change that may be reflected in the GNP. Thus for the purpose of this study, financial intermediation will be measured by how successful DBZ has been in mobilising funds for development purposes.

Bhatia and Khatkhate observed that at one end were countries such as Ivory Coast, Kenya and Zambia where they found that the increase in financial intermediation appeared to have been coterminus with the growth of per capita GDP. At the other end were countries such as Ghana, Mauritius and Sierra Leone, in which they found that despite the growing level of per capita GDP, financial intermediation had not increased perceptibly or had even declined. In between these two extremities were countries such as Morocco, Nigeria, Malagasy, Malawi and Tunisia where financial intermediation was sometimes positively and sometime negatively correlated with the level of per capital GDP. They attributed the lack of definitive relationship partly due to limited extent of financial intermediation in the countries where the hypothesis was tested. In contrast to this Beatty (1974) in a study of some Southern African Countries observed that there was no lack of money for development finance. He observed that while there was no actual shortage of money for development, the shortage was in talented promoters of integrity, entrepreneurs, organisers and managers.

One other characteristic studied was the effect of innovations in financial markets on the economic development of the country. Ness (1974) found that innovations in financial markets introduced in Brazil by the Military Government in 1964, were responsible for the rapid rates of economic growth attained during the period 1968-72. The financial market reforms initiated by the Government were designed to meet several specific needs of the then relatively inconsequential Brazilian financial markets:

(1) making yields on financial instruments sufficiently attractive to raise new savings and divert savings from the alternatives of real estate investment and capital flight; (2) creating medium and long-term debt markets to finance government, business, and housing; (3) providing access to new equity funds by corporations and to ownership of equity by the general public; (4) ensuring that investment in socially desirable sectors and regions would receive financing and (5) assuring that business was not constrained by inflation in internally generating funds for use in expansion i.e. by modifying income taxation in a manner that substantially increased the capacity of business to re-invest internally generated funds. (Ness (1974), p. 455)

As a result of these measures, Brazil recorded one of the most rapid economic growth rates in the world at that time, averaging a 10 percent per annum growth of real GDP. This growth was made possible by the development of voluntary non monetary financial savings which resulted in maintenance of high productivity of investment through sophisticated financial institutions and instruments.

So far Ness' conclusion seems to lend support to the already established hypothesis associated with Goldsmith (1969), Gurley and Shaw (1955), Patrick (1966), and Porter (1966), that improvements in the financial intermediation process are a precondition of economic growth, and hence the generally accepted belief that financial intermediation is the principal propelling force in the growth process of a country. Though this argument sounds plausible, it has

certain limitations in that the Brazilian experience may not necessarily apply to most developing countries. For instance, whilst it was possible for the development of voluntary non-monetary financial savings e.g. in Brazil, in most underdeveloped countries, it is achieved through compulsory provident and pension fund schemes, and also through insurances. Such schemes have proved attractive in several countries such as India, Malagasy, Turkey and Zambia.

On the analysis of financial intermediation in general, Benston and Smith (1976) contended that a proper framework was yet to be developed for the analysis of financial intermediation. They pointed out that the traditional economic analysis viewed financial intermediaries as passive conduits through which monetary policy was affected and that even when a micro view was taken, the analyses were often restricted to studying the effect of the rate of change, allocation of money, and credit ratios. Benston and Smith further observed that since some writers viewed financial intermediaries as firms, they should be analysed with the micro-economic tools that have been employed to analyse other industries. However, they noted that in methodology, considerable divergence was to be found. For example, "while Pesek (1970) and Towey (1974) described one financial intermediary, banks as producing money by employing loans as inputs, Hayman (1972) and Melitz and Pardue (1973) described them as producing credit with deposits as inputs".

Essentially Benston and Smith viewed the role of the financial intermediary as creating specialised financial commodities. These commodities, they said were created whenever an intermediary found that it could sell them for prices which were expected to cover all costs of their production, both direct and opportunity costs. These commodities, they said, could be used to effect consumer's inter-

temporal, intra-temporal and state determined consumption decisions. Therefore, in order to effect these consumption decisions, a financial intermediary ought to charge prices which were expected to cover the transactions costs associated with the financial commodities produced. Included in the price of these financial commodities are amounts that compensate the financial institution for the costs of processing the paper work required to record the transactions, to determine the likelihood that the borrower will repay his debt, to monitor his repayment of the debt and to acquire the funds borrowed. Also included are amounts (interest) that compensate other consumers for deferring present consumption. Benston and Smith hence believed that a more complete analysis would show the relationship between specific types of transaction costs and the type of financial intermediary and financial commodity that should arise to reduce costs.

Most relevant to this thesis from the previous literature just cited, is the need to understand the cost associated with a specific financial institution and how the cost affects its financing decision, if the financial institution is to remain a going concern.

Moving into the sphere of development banking, Diamond (1957), was the pioneer writer on the subject. In his study, he outlined the history, ownership and structure of some of the early development banks. It should be noted that though development banks are essentially a post World War 2 creation, their origin would be traced back to the mid-nineteenth century in Europe during the Industrial revolution.

When looking at the history of development banking, Diamond noted that the mode of financing of the process of industrialisation in Europe differed



from that of Great Britain in that whereas most investment funds were acquired through self-finance in Great Britain, they were acquired through external finance in Europe. When explaining this point, Diamond writes:

The situation of the European countries that followed Great Britain in industrialising was different. The mere fact of following while providing the opportunity for imitation, also created difficulties. For once the urge to develop emerged, there was a keen desire to do so quickly, to "catch up" with the leader. This was an expensive task, partly because of the high capital outlay required to take over the latest techniques of production and implant them in an economy relatively primitive, partly because of the need to lay down quickly the costly base of overhead facilities (especially transport) essential to rapid growth, and partly because of the conviction that investment in many fields simultaneously was essential to quick development. Sudden increases in the scale of production and investment were necessary in countries seeking to transform their economies rapidly, which had not been necessary in Britain earlier. (Diamond (1957) p. 21)

Hence in order to satisfy some of these needs in Belgium, the Societe Generale pour Favouriser L'Industrie Nationale was formed in Brussels in 1822, as a joint-stock bank designed to sell shares and bonds to help finance commercial and industrial ventures. It became the main promoter and supporter of Belgium industry in the 1830s.

Similarly, in the mid 1850s the French entrepreneur was typically a small businessman whose enterprise was a matter of family and friends. The banks shared these characteristics as well with the merchants and industrialists. The well established businessman with a need for new funds which his business or friends could not supply, could turn only to his long-established commercial banking connection. The new customer thus found it difficult to raise funds from the banking system.

Diamond points out that it was against this background that led to the establishment of two institutions in France, namely, the Credit Foncier and Credit

Mobilier in 1852. These institutions like the Societe Generale were formed to concentrate on long-term financing and derived their resources from the issuance of bonds and promisory notes. Of the two institutions, the Credit Mobilier played a significant role in French industrialisation. It was associated with ideas of national development and this gave impetus to its success in France and everywhere. It is significant too, that although the Credit Mobilier was a purely private enterprise concerned above all with its profits, it had close ties to government policy.

The Credit Mobilier notwithstanding the fact that it had a stormy and not altogether praiseworthy career of about 15 years, became a model for similar investment banks in many other European Countries like Germany, Austria, Belgium, Netherlands, Italy, Switzerland and Spain. On the importance of these institutions, Perera (1968) writes:

These institutions could lend at medium-and long-term, subscribe to shares, underwrite, guarantee, and provide both professional and technical advice. As multi-purpose institutions they were invaluable in the conversion of many smaller enterprises to more efficient operating scales and in the encouragement of entrepreneurship. The Societe Generale operates today as a financial giant. (Perera (1968) p. 152)

It is important to note that over the years, there has been a marked contrast in the operations of these institutions. For instance, in the nineteenth century, they concentrated their resources to a greater extent on large scale enterprises. In the 20th century, there has been a growing recognition not only for the special needs of large enterprises, but also of the needs of small and medium industrial enterprises and of other sectors. Diamond writes:

This recognition often has come in the train of a specific wide-spread economic problem, such as wartime destruction, the need for rationalising industry, the effects of depression or social needs and pressures, particularly in depressed areas or in the lagging regions of a country. (Diamond (1957) p. 29).

During World War 1, new institutions were created to deal with these special demands. In the mid forties, more new institutions were established to deal with post world war 2 reconstruction. All these institutions were required to provide medium and long-term finance. These institutions have tended to specialise mostly in one particular activity. One other significant feature of these institutions is that they have had increasing large participation of the Government. For instance, most of these institution have been sponsored by the government and some have generally had government aid in the form of share capital or low interest-free loans or guaranteed bond issues, and have often been under government regulations or have had government representation on their policy making bodies.

Diamond (1957) further pointed out that every country in Europe had seen the creation of these specialised institutions. He writes:

Thus in 1919, the Belgian Banque Nationale provided the capital (in which the Government, private banks and public later joined) for a societe Nationale de Credit l'industrie, to provide long-term credit to industry. In the same year, the principal banks of France and certain large industrial enterprises set up the Credit Nationale pour Faciliter la Reparation des Dommages Causes par la Guerre, in which the Government has since become an important shareholder. The Industrial Mortgage Bank of Finland was created by a group of banks and industries with the blessing of the Bank of Finland in order to borrow abroad with a government guarantee funds which they could not otherwise obtain .... In Italy, the Government set up the Istituto Mobiliare Italiano in 1931 and the Istituto per la Ricostruzione Industriale in 1933 to provide industrial finance. The latter is now a gigantic holding company as well as banker, controlling and financing a large segment of the Italian economy (Diamond (1957) p. 30).

It should however be borne in mind that the creation of industrial finance institutions was not restricted to Europe and America alone. Thus Perera (1968) writes:

The employment of development banks in what are now called the emerging nations, dates back to the 1930s with the establishment of several government-controlled institutions in Latin American countries: Corporation de Fomento de la Produccion (CORFO) in Chile and National Financiera in Mexico. Others that followed were Colombia's Instituto de Fomento Industrial in 1940, Argentina's Banco Industrial de la Republica Argentina in 1943, and Venezuela's Corporacion Venezolana de Fomento in 1946. These institutions were encouraging industrialization. They were established to provide entrepreneurship to the industrial sector and to finance publicly owned, mixed, and privately owned ventures. (Perera (1968) p. 152).

Diamond (1957), Boskey (1959) and Perera (1968) noted that development finance institutions gained prominence after the early 1950s. Numerous of these institutions have since been established in the emerging world to provide medium and long-term funds to industrial, agricultural and infrastructural projects that private capital could not otherwise provide.

Mistry (1980) traces the thrust of contemporary development financing to the early 1950s when the World Bank made loans to two institutions in Ethiopia and Turkey. He writes:

By the late 1950s, the World Bank had become an enthusiastic proponent of the private development institutions (DFI). It saw the potential for promoting growth of new enterprises in the industrial sector and to a lesser extent, in the transport, tourism and mining sectors of developing economies. It also saw DFIs as catalysts for capital market development in the third world.

During the First Development Decade in the 1960s, a large number of private DFIs were established and supported in Asia, Europe, Latin America and Middle East.

By the end of the 1960s, it was realised that it would be limiting to channel resource transfers only through DFIs. They alone would not be able to meet the long-term funding needs of an increasing segment of eligible and deserving borrowers in the developing countries.....

the investment by the bank in the equity of a borrower, the guaranteeing of a loan by a third party to a borrower, the underwriting of attempts by a borrower to raise equity or debt and the service of providing broad financial contracts both within and outside of the developing country.<sup>6/</sup> Houk however further points out that a financial institution which restricts its activities only to the banking functions mentioned above, should not be classified as a development bank. He says, a development bank must, in addition to its banking function, attempt to/certain problems of, or bottlenecks to, development, the magnitude and importance of which may vary from country to country.<sup>7/</sup> Houk further points out that one of the principal benefits of a development bank is that it continually reminds practitioners of development that finance, unaccompanied by technical assistance and unrelated to development objectives is likely to be sterile.<sup>8/</sup>

On the need for development banks in general, Diamond (1957) noted that they were expected to provide not only long-term finance but also play a catalytic promotional role - a development role. He further observed that development banks hand tailored to fit circumstances that brought them forth,, were needed in relieving some deficiencies of the private sector such as finance and more importantly enterprise and managerial and technical skills. However, in spite of this early recognition, it is now surprising to read Diamond and Gulhati (1973) revising some earlier assumptions made in Diamond (1957). They observed that despite the fact that the growth of development banks was significant since the end of the Second World War, experience showed that development banks had become passive bankers, supporting financially well known and well-entrenched business houses

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6/ Houk, J.T. Dock, Financing and problems of Development Banking, Frederick A. Praeger, Publishers, New York, 1967. p. 6.

7/ Ibid

8/ Ibid

rather than as development banks. In the same paper, a number of serious issues were raised and these are:

Firstly, taking the strong financial showing of most Development Finance Companies (DFCs), one major weakness could be identified and that is: most DFCs had remained heavily dependent on official funds, both national and international. It was also observed that Governments had extended numerous incentives to DFCs, such as contribution to share capital, tax holiday or exemption and interest subsidies. Perhaps the most important incentive is the acquisition of loans at well below the market price of capital. Perera (1968:153) also made an observation that many privately controlled financial institutions that had emerged in the last 15 years had been created by commercial banks as "captive" affiliates to provide higher risk capital-not necessarily development finance - at rates of interest often far exceeding those permitted the bank in its commercial lending. Citing Peru as an example, he observed that the maximum interest that commercial banks could charge in February, 1966 was 12 percent plus a 1 percent commission. On the other hand, loans made by a Financiera or Finance Company affiliate generally carried an effective rate of 20-30 percent and were extended for terms far larger than the one-year maximum permitted commercial banks. While profitability could be a good measure of performance of DFCs, it could be a misleading index in terms of DFCs' general development role.

Secondly, the financial success of DFC clients is no assurance that these enterprises had yielded adequate development benefits. This is due to the fact that most projects financed by DFCs in some developing countries usually had the benefits of incentives extended to them. These incentives took the form of subsidies and a well guaranteed protection against outside competitors through policies of import substitution. These incentives often have the effect of alter-

ing the cost-price relationship. It is also evident that DFCs may be supporting projects which are financially attractive but which contribute to wasteful import substitution. Diamond and Gulhati further contended that even projects which were export oriented were not immune to the criticism. Though a high financial return of the project may be an indicator of good performance, it is possible suffice it to say that it may be achieved by masking inefficiencies in production through the incentives extended to them. It should be noted that DFCs can hardly be expected to support economically attractive projects but which are financially untenable. Bhatt (1977) contends that the choice criteria of a development bank must indeed have a direct relationship with the development objectives of a country such that it can not judge the soundness of a project merely on the basis of its ability to service a debt. Undoubtedly, a project should be financially sound in this sense for without that, the development bank itself would not remain a viable institution.

Thirdly, the question can be raised as to whether DFC investments have enhanced, or at least counteracted the skewed income distribution generally prevailing in developing countries. However it has been observed that most DFCs have tended to support the already well-entrenched businesses at the expense of new ones, projects in relatively developed areas of the economy at the expense of backward ones, and large scale projects at the expense of small ones. This in a way has tended to exacerbate the skewed income distribution generally prevailing in developing countries. The causes of this trend could probably be attributed to the following: "Firstly, DFCs may not be adequately equipped to grapple directly with the problems of the rural poor or the destitute in urban areas; Secondly, a good number of DFCs do not lend for amounts smaller than the stated minimum. Very often, this amount/generally be much larger than is relevant to small scale industries; and thirdly, DFCs may have responded

/may

favourably to loan applications which in the main came from well established business houses in big industrial centres rather than from the ranks of potential entrepreneurs or small-scale industrialists or sponsors in backward regions.<sup>9/</sup>

Mnamba (1980) made some similar observation to those of Diamond and Gulhati when he looked at the activities of the Tanzania Investment Bank. He noted that despite the fact that the Bank had been able to identify itself in the economy by increasing its portfolio from five loans at the time of commencement in 1970, to one hundred and seventy three loans by 1979, 77 percent of these loans were concentrated in four of the country's regions, namely, Dar-es-Salaam, Arusha, Morogoro, and Mbeya. He attributed this factor to the fact that the Bank may not have made itself known to the majority of regions, or possibly due to most prospective loan applicants from the rest of the regions failing to meet the Bank's standards. Perhaps the premise to this lies in the fact that most development banks are risk averse in that they could hardly be expected to commit a large part of their portfolio loans to risky projects. This is particularly true in cases where there is pressure from some lending sources that impose conditions on a borrowing development bank.

The general observations made by Diamond and Gulhati (1973) and those of Mnamba (1980) are reinforced by those of Chirwa and Chimbwayinga (1981) in their study of the Development Bank of Zambia (DBZ). They observed that though DBZ performed tremendously well as per the act of its establishment, it failed to register an impact on the population due to its policies which were biased against

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9/ William Diamond and Ravi Gulhati, "World Bank's Experience with Development Finance Companies", Economic and Political Review of Management Weekly, Volume VIII, No. 23, June 1973, P. M-53



small scale enterprises. For instance, the bank does not lend for amounts less than the stated minimum of K25,000 per project. They also observed that the bulk of loans and equities sanctioned by the Bank were concentrated in five provinces of the country, namely Lusaka, Copperbelt, Southern, Eastern and Central. By 1979, these provinces accounted for 89% of the total amount sanctioned by the Bank, while the remaining four provinces viz, Luapula, Northern, Western and North-Western accounted for only 7% of the loans sanctioned and the remaining 4% being unallocatable. They attributed this skewed distribution to the following reasons: (a) DBZ's dependence on client sponsored projects, (b) DBZ's orthodox operating policies and (c) lack of promotional campaigns in rural areas. Furthermore, as regard the sectorial distribution of loans, they noted that in the first year of the Bank's operations (1974/75), agriculture took the largest share of the loans sanctioned by the Bank. Since then manufacturing has taken the lead. They noted that this trend may have had adverse implication on the following: Balance of payment problems due to the continued importation of raw materials for industry; food shortages, due to stagnation of agriculture; and urban unemployment. In conclusion on this matter, Bhatt (1976) attributed the failure of development banks to lack of appreciation by their managements of their specific tasks in the development context.

However, despite the numerous literature written on development banks in general, there isn't much literature written on the Development Bank of Zambia (DBZ) apart from the unpublished report of Chirwa and Chimbwayinga (1981) just cited above. Their work was general and looked at the structure, function and performance of the Development Bank of Zambia. It could be viewed as a basic study written on the Development Bank of Zambia. However, it tended to look at all aspects of the Development Bank of Zambia and because of that, it didn't give adequate treatment to most aspects. The point of departure in this thesis is the

need to critically examine the investment policies and appraisal methods of DBZ in its effort to generate and administer the development funds for development. This approach does not dispense with the earlier work by Chirwa and Chimbwayinga. Rather it builds on it and hopes to provide a deeper understanding of the nature of project appraisal work undertaken in the Bank.

The main significance of previous literature to my study is that it provides us with useful information on development banks as to their evolution, types, characteristics and activities. It also makes it easier for us to isolate certain factors that may help us understand a given development bank i.e. Development Bank of Zambia within the general perspective outlined in the literature. Despite their weaknesses, development banks could be used as useful tools in administering funds for development. It is generally observed that it is easier to raise outside funds when you have a development bank. This is because a development bank may be well placed to advise its clients on the appropriateness of new technology due to the expertise it usually possesses.

The main conclusion from all the previous literature significant to this thesis, is the role of financial intermediaries in creating specialised financial commodities and the importance of tailoring the investment policies and criteria of appraising and selecting projects of a development bank to the needs and requirements of the nation. This thesis is modelled on the study presented in Bhatt (1977)'s article. This study points to the fact that a development bank needs to have an optimum portfolio selection of investments. This approach tends to serve the needs of the bank and above all it also contributes to meeting the nation's objectives and requirement. However, this approach has some shortcomings in that it raises questions as to what extent the "profit making" investments are to subsidise those which lose money from the narrow perspective of financial liquidity.

### CHAPTER 3

#### FINANCIAL STRUCTURE IN ZAMBIA

The attainment of independence in 1964, not only brought about an increase in national income but also a rapid increase in financial assets. This in turn necessitated more financial institutions. Notwithstanding this fact, it is important to note that immediately after independence, the financial system was ill-adapted to the development needs of the economy with most of the banking facilities concentrated in urban areas and only a few in rural areas. Hence in order to foster economic development through monetary policy, a host of policies have had to be formulated. This in turn resulted in the composition of the Zambian structure changing from time to time according to the dictates of the economic condition of the country. However, it is not the purpose of this chapter to discuss in detail the evolution of the financial structure. Rather it briefly looks at the history of the existing financial institutions and their role in the mobilization of domestic savings during the period under review.

The Zambian financial structure comprises of the following financial institutions:<sup>1/</sup> Bank of Zambia, Commercial Banks and Non-Bank Institutions.

#### Bank of Zambia (BOZ)

The Bank of Zambia acts as the central bank of the country. Monetary authority is vested in this institution and has the responsibilities of issuing government money, control of legal reserve requirements for commercial banks, and lender of last resort. It also has direct control of commercial bank lending to non-Zambian business, control of expatriate owned bank's dealings with their parent companies, direct control of imports and control of repatriation of profits

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1. The basic source of data on financial institutions are Chiselebwe Ng'andwe "Inflation in Zambia: 1964-1976 Ph.D thesis, University of Connecticut, 1980; Bank of Zambia Annual Reports and Quarterly Statistical Reviews; Bank of Zambia "The role of Banks and Non-Bank Financial Institutions in the mobilization of Domestic savings in Zambia. Paper presented at an international seminar on Central Banks. Douala - Cameroun, 1982.

and wages of, respectively, expatriate firms and employees.

During the period under review, the Bank of Zambia has been able to exert its influence on the financial sector of the economy. This has been reflected in the significant growth of its assets and liabilities. Figures on BOZ's assets for period 1965 to 1 March 1981 are given below.

TABLE III (1). TOTAL ASSETS/LIABILITIES OF BANK OF ZAMBIA (K'000)

End of Period	TOTAL	End of Period	TOTAL	End of Period	TOTAL
Dec., 1965	64,230	Dec., 1971	215,716	Dec., 1977	496,168
" 1966	72,866	" 1972	172,456	" 1978	1,103,549
" 1967	80,902	" 1973	245,558	" 1979	1,046,557
" 1968	102,365	" 1974	237,516	" 1980	1,117,529
" 1969	172,173	" 1975	414,253	March 1981	1,059,515
" 1970	286,427	" 1976	460,944		

SOURCE: Bank of Zambia, Quarterly financial and statistical Review, several copies.

The BOZ experienced a significant increase in its assets in 1978. This was due to substantial increase in the bank's holding of Treasury Bills of K541.2 million. This was on account of a requirement under the stabilization programme agreed with the International Monetary Fund (IMF). Under this programme, it was required that a 100 percent special deposit be placed by commercial banks at the Bank of Zambia against all requests for foreign exchange cover which were in the pipeline.

On the other hand, fiscal policy is directed by the Cabinet through the Ministry of Finance. Under the constitution, all fiscal measures must be approved by the National Assembly (the legislative arm of government). However Ng'andwe (1980) noted that in reality, the National Assembly is a rubber stamp for decisions taken by the executive branch. He further observed that the President and his Cabinet had substantial scope for harmonising fiscal policy with monetary policy.

### Commercial Banks

There were four commercial banks operating in the country with a branch system at the end of March, 1981. These are the Barclays Bank (Zambia) Ltd, Grindlays Bank (Zambia) Ltd., Standard Bank (Zambia) Ltd., and Zambia National Commercial Bank. The fifth commercial bank, namely, the Bank of Credit and Commerce (Zambia) Ltd opened its business in September 1981.

#### Barclays Bank (Zambia) Ltd

The Barclays Bank started operations in 1918, under the name of Barclays Bank D.C.O., a company incorporated in the United Kingdom. The Bank, however, became locally incorporated in November, 1971 under its present name. However, it still remains a subsidiary of an international banking system - The Barclays Bank International. By 1974, the Bank operated twenty eight branches and six agencies. By 1981, it was operating twenty six branches and four agencies of which the great majority were concentrated in urban areas.

#### Grindlays Bank (Zambia) Ltd

This Bank started operations in Zambia, in 1965 under the name of National and Grindlays Bank. It still operates as a foreign owned bank. By 1974, the

Bank operated eleven branches mostly along the line of rail. However, by 1981, the number of branches went down to only seven. Six of these were situated in large urban areas and only one in rural areas. The recent policy of the Bank is to cater for corporate clients almost exclusively.

#### Standard Bank (Zambia) Ltd

This Bank started business in Zambia in 1906 under the name of Standard Bank of South Africa Ltd. The Bank became locally incorporated in 1974 under its present name. Like the Barclays Bank, it also remains a subsidiary of an international banking system - The Standard Chartered Bank Ltd. By 1974, the Standard Bank (Zambia) Ltd, operated twenty one branches and eighteen agencies. By 1981, it was operating twenty four branches and twelve agencies.

#### Zambia National Commercial Bank (ZNCB) Ltd

This Bank originated from the dictates of the 1968 Economic Reforms which the Government promulgated in order to put the economic destiny of the country increasingly in the hands of Zambians. It was observed that by that time, the four commercial banks operating in the country, viz, Barclays Bank, Commercial Bank, Grindlays Bank and Standard Bank, operated with restricted branch network. Thus, it was held that they did not cater for the entire needs of a fast growing economy like Zambia.

The ZNCB was incorporated on the 21st of August 1969, under the name of National Commercial Bank Ltd. It however opened its doors for business on the 15th of October, 1969, with members of staff drawn most from the Bank of Zambia. Its authorized share capital in 1969, amounted to K5 million made up of 500,000 shares of K10 each. Out of this, K2 million was issued and fully paid up. Over 99 percent of the paid up capital was subscribed by the Bank of Zambia on behalf

of the Government of the Republic of Zambia. These shares were however transferred to the Finance and Development Corporation (FINDECO) when FINDECO was formed.

Meanwhile, in 1971, the Government acquired a controlling interest in the Commercial Bank (Zambia) Ltd., by taking over 60 percent of the Bank's share capital. In 1975, the takeover was finally completed and then, the Commercial Bank was amalgamated with the National Commercial Bank. In March 1978, the name of the Bank changed from National Bank to Zambia National Commercial Bank.

Bank of Credit and Commerce (Zambia) Ltd.<sup>2/</sup>

This opened its business to the public sometime in September, 1981. It is a wholly foreign owned Bank. In general, the Bank of Credit and Commerce group is a young bank. It started operations in 1972 with branches in Abu Dhabi, Luxembourg and London. Since then the Bank has grown at an enviable pace and now operates in 56 countries.

The Bank is establishing itself in the third world countries like Zambia, with a view of serving local business interests, providing international banking services and establishing full range branch network offering intercountry trade. At the time of writing this thesis, the bank had only one branch situate in Lusaka. However, it is the bank's intention to open branches in most populace areas of the country in the near future.

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2/ The basic source of data is the Financial Review of Zambia, Volume 1, No. 3, September 1981.

### Savings Mobilization by Commercial Banks

The Commercial Banks as a group, have made a considerable contribution to the mobilization of domestic savings. For instance, between December 1965 and March 1981, deposits of commercial banks rose by 729%. During the same period, the commercial banks' total assets/liabilities rose by 1524%. Table III (2) gives details about resource mobilization by commercial banks.

It is important to note that commercial banks have been more successful in mobilizing deposits in the urban than in the rural areas. This success has been due to the concentration of banking facilities in the major towns of the country. For instance, by the end of 1980, the number of branches and agencies in the urban areas stood at 66 compared with 35 in the rural areas. Needless to say, within the rural areas themselves, about 22 out of 44 districts remained unserved.

The argument often advanced by the commercial banks for neglecting the rural areas is that the generally low level of savings prevalent amongst the rural populace cannot enable them to operate profitably. This is on account of the constraints under which they would have to operate such as poor communication and transport facilities.

There are three forms of savings which the commercial banks provide to savers, namely, current Accounts or Demand Deposits, Savings Accounts and Time Deposits.

By far the most important form of savings is the current account. This account enables customers to withdraw cash on demand, issue cheques and make



TABLE III (2). RESOURCE MOBILIZATION BY COMMERCIAL BANKS (K'000)

End of period	DEPOSITS					Other Liabilities (b)	Total Assets/ Liabilities
	Demand	Savings	Time	Other (a)	Total		
Dec. 1965	57,930	14,789	16,265	6,190	95,174	5,559	100,733
" 1966	76,885	19,544	20,514	8,190	125,133	11,470	136,603
" 1967	86,791	22,707	24,812	12,455	146,765	18,407	165,172
" 1968	120,406	28,359	29,647	12,008	190,420	21,888	212,308
" 1969	140,784	27,117	53,104	11,380	232,385	30,692	263,077
" 1970	143,110	29,096	74,431	18,097	264,734	27,893	292,627
" 1971	140,309	32,347	87,596	22,896	283,148	58,544	341,692
" 1972	139,991	29,493	110,250	27,583	307,317	60,002	367,319
" 1973	173,493	34,394	116,167	44,040	368,094	106,106	474,200
" 1974	186,031	40,637	134,340	49,119	410,127	194,200	604,327
" 1975	219,732	51,178	111,987	47,488	430,385	265,518	695,903
" 1976	255,645	63,924	159,131	42,143	520,843	361,682	882,525
" 1977	268,033	78,870	227,025	60,266	634,194	527,018	1,161,212
" 1978	260,823	82,777	159,787	63,394	567,277	683,724	1,251,001
" 1979	387,122	89,694	225,836	62,753	765,405	679,222	1,444,627
" 1980	358,342	105,215	282,900	63,866	810,323	738,630	1,548,953
March 1981	371,608	109,879	249,743	58,309	789,539	846,661	1,636,200

SOURCE: Bank of Zambia, Report and statement of Accounts, several copies and Bank of Zambia, Quarterly Financial

and statistical Review, several copies.

(a) includes deposits of Government and non-residents

(b) includes amount owing to Bank of Zambia, Banks abroad and Zambian banks; Bills payable and other liabilities.

use of the bank's other money transmission services. No interest is paid to the customer and instead customers pay ledger fees. Certain advantages have favoured the widespread use of current accounts as a means of payment. Primarily, the choice of this account by customers implies a preference for liquidity in that there are no limitations to the number of withdrawals one can make; they operate either in credit or by prior arrangement in debit; and lastly, they involve less risk of loss or theft than do other forms of money. However, there are also some disadvantages associated with current accounts in that cheques may not always be accepted when given in payment especially to a person who does not know the drawer of the cheque. In Zambia, only business cheques work. These accounts are maintained by personal and business customers. By the end of March 1981, current accounts formed 47.06% of total deposits of commercial banks.

Time deposits are next to current accounts in their share of total deposits. There are two types of time deposits: Fixed and notice deposits. A fixed deposit entails depositing of a fixed amount of money for a fixed period of time (minimum 6 months at current rate of 7 percent with a maximum period of 36 months at 9 percent rate of interest). However funds may be left on the account for a period in excess of 36 months at the discretion of the customer but only attracting a minimum rate of interest of 9 percent. A notice deposit entails a deposit of a sum of money (not less than K500) at 4.5 percent interest and a maximum period of 6 months at 6.0 percent rate of interest. Withdrawals from notice deposits are subject to giving the required notice. Partial withdrawals are allowed with notice deposits whereas no partial withdrawals are allowed with fixed deposits. By the end of March 1981, time deposits formed 31.63% of total deposits.

Savings accounts are most popular among small traders and salaried customers. These accounts attract a 7 percent rate of interest per year. They are techni-

cally subject to seven days' notice. Minimum balance requirements are usually demanded by the commercial banks. However, these vary from bank to bank ie from K20 with the Zambia National Commercial Bank, K40 with Barclays Bank, K50 with Standard Bank to K100 with Grindlays Bank. It should be noted that the imposition of high minimum balances as it is especially with the Grindlays Bank, does constitute an obstacle to attracting deposits especially from persons of moderate incomes. By the end of March 1981, these deposits formed 13.9% of total deposits of commercial bank.

It is of interest to note how monetary policies affect deposits mobilized by various commercial banks in the country. In Zambia, interest rates are fixed by the monetary authorities and hence individual banks do not use them to compete for deposits. In this case, the chief determinants of level of deposits seem to be the minimum balance required and quality of service offered by various banks.

In recent years, the real rates of interests on deposits (after taking account of inflation) have been negative. A Bank of Zambia seminar paper asserts that the main reason for keeping interest rate low, is the need to keep the costs of funds to the Government and parastatal sector low, and also to allow minimum costs of credit for the agricultural sector, especially the subsistence sector.<sup>3/</sup> This is reinforced by the view held by the monetary authorities that savings and investment seem to respond much more to the prevailing economic climate than to the level of interest rates. However, the keeping of interest rates low enough on account of these reasons has suffered severe criticisms. Firstly, it has not resulted in the rationing or allocation of the scarce capital resources more

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3/ Bank of Zambia "The role of Banks and Non-Bank Financial Institutions in the mobilization of Domestic Savings in Zambia. Paper presented at an international seminar on Central Banks. Doula-Cameroun, 1982 p. 13.

efficiently. The Bank of Zambia paper contends that in the face of cheap money from the banking system, the Government and especially the parastatals have felt no pressure to restrain their budgetary expenditures.<sup>4/</sup> Secondly, the subsistence sector has not benefited much from such a policy due to lack of collateral securities which are a requisite for commercial bank loans. Although interest rates play a secondary role in determining whether one should borrow or not, they are not an effective determinant in a country like Zambia where they are deliberately kept low.

The bulk of resources mobilized by commercial banks are channelled to the Government to finance the deficit, and to statutory and parastatal bodies. (see Table III (3)).

TABLE III (3) MAJOR APPLICATION OF FUNDS BY COMMERCIAL BANKS (K' 000s)

End of period	Loans and advances to public and statutory bodies	Government Securities	Treasury Bills
December 1965	32,229	9,582	11,270
" 1966	37,764	9,902	12,240
" 1967	66,420	8,658	5,230
" 1968	70,816	11,023	29,970
" 1969	79,219	17,255	37,120
" 1970	97,497	29,083	21,090
" 1971	141,081	27,729	11,400
" 1972	155,885	29,823	52,590
" 1973	160,689	42,728	78,540
" 1974	270,550	37,804	2,390
" 1975	328,395	36,121	99,530
" 1976	316,322	45,406	236,670
" 1977	317,515	65,898	466,973
" 1978	297,173	56,412	85,748
" 1979	386,325	49,688	231,610
" 1980	431,212	24,225	232,868

Source: Bank of Zambia, Report and Statement of accounts for the years ending December 31st 1976 and 1980.

Between 1965 and 1980, loans and advances to public and statutory bodies rose by 1238 percent. The BOZ paper asserts that much of the commercial banks' lending to these institutions, has been in response to official directives. During the same period, treasury bills increased by 1966 percent. The main factor responsible for the significant increase in treasury bills is the government deficit. Needless to say, there are some advantages derived by commercial banks from lending to these institutions especially the Government. Much of their lending is risk free and are of a short term nature. On the other hand, the private sector whose savings make the most important part of the bank's resources, has been starved of funds due to the banks' insistence on collateral securities instead of genuine needs for investments. The other short coming of commercial banks has been their inability to provide medium-term/loans to their customers owing to a policy of conservatism.

#### Non-Bank Financial Institutions

The non-bank financial institutions in Zambia are in three broad categories. The first is that of organisations supplying social security benefits to members out of accrued past contributions. This comprises such institutions as Zambia National Provident Fund (ZNPF), and the life branch of the Zambia State Insurance Corporation (ZSIC). The second category comprises savings and credit organisations. This includes the Zambia National Building Society (ZNBS) and the National Savings and Credit Bank (NSCB). The third category comprises purely credit organisations with funds directly or indirectly supplied by the Government. This includes the Development Bank of Zambia (DBZ) and others such as Industrial Finance Company (IFC) and Agricultural Finance Company (AFC).

#### Zambia National Provident Fund (ZNPF)

This institution was established in 1965 by an act of Parliament. However,

the need to introduce a pension scheme for all races was first raised in the colonial Government in 1958. Due to political and pressing problems, no major steps were taken towards this idea. It was only in the early 60s when the question of providing social security for workers became a pressing one, that a small working party was appointed. This party made several recommendations concerning the introduction of a social security scheme.

Before the ZNPF was established, the average African employee, except the mine workers, did not have any scheme for retirement benefits. The establishment of the ZNPF led to the subsequent closure of all private pension schemes. The ZNPF caters for all non-government employees. Membership to this scheme is legally mandatory for all workers in the private and parastatal sectors. Hence the establishment of the ZNPF has led to a substantial increase in forced savings.

During the seventeen years of its existence, the Fund has diversified the range of benefits offered to its members from old age and retirement benefits and disability, to survivors, emigration, home ownership, savings, maternity and funeral grants, supplementary, and retirement and gratuity benefits. However, the bulk of savings is meant for old age and retirement purposes. It is, however, sad to note that the ZNPF has been extremely inefficient in dealing with claims for pension benefits.

The revenue of the ZNPF comprises mostly statutory contribution and special contributions and a minor income from interest on its investment. Figures for statutory contributions for the period 1967 to 1980 are given in Table III (4). During the period under review, the Fund has been able to increase significantly its annual revenue from statutory contributions. This increase could be attributed to the substantial increase in the number of contributing members.

TABLE III (4) Z.N.P.F - STATUTORY CONTRIBUTIONS

End of period	Statutory Contributions	End of period	Statutory Contributions
June 1967	4,873,846	March 1973	17,310,000
March 1968	7,058,550	" 1974	20,191,792
" 1969	11,823,889	" 1975	23,331,138
" 1970	14,103,651	" 1976	27,050,363
" 1971	14,294,244	" 1977	28,426,229
" 1972	16,829,260	" 1978	30,136,258
		" 1979	28,952,831
		" 1980	32,223,315

Source: Zambia National Provident Fund Board, Annual Reports (several copies)

The investment policy for the fund is governed by the need to generate revenue for improved benefits for contributing members, and the need to maintain liquidity to meet claims from members at all times. Much of the Fund's investments portfolio consists of government stocks, direct loans to the Government and parastatal sector. The fund does also invest in real estate and subscribe to stock and shares of various parastatal organisations. Details about the fund's investment portfolio in 1980 are given in Table III (5).

TABLE III (5): EMPLOYMENT OF FUNDS AS AT 31ST MARCH, 1980

Detail	Amount	Proportion (%)
Government stock	51,376,658	19.05
Loans to Government	64,000,000	23.73
Building Society Deposits	9,140,000	3.39
Loans to local authorities	18,871,086	7.00
Loans to parastatal sector	62,833,637	23.30
Loans to private sector	1,398,588	0.52
Real Estate	31,096,579	11.53
Stock and shares	30,499,951	11.31
Home ownership loan scheme	452,661	0.17
	<u>269,669,160</u>	<u>100.00</u>

Source: Zambia National Provident Fund Board, Fourteenth Annual Report for

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Source: Zambia National Provident Fund Board, Fourteenth Annual Report for 1979/80. Government Printers, Lusaka, 1981.



From Table III (5), it is observed that the ZNPF's employment of funds is spread over several portfolios. However, the bulk of these portfolios are for funds to Government or Quasi-Government institutions such as parastatal and statutory bodies. This approach of selecting such portfolios reflects the fund's desire to maintain liquidity and more importantly to employ avenues of funds where the risk is nil or if anything, minimal.

#### Zambia State Insurance Corporation (ZSIC)

ZSIC was formed in 1967 and started operations as a wholly government-owned parastatal body in 1968. In November 1970, the private insurance firms (all of them foreign owned) were legally prevented from continuing operations in Zambia. In January 1972, the Zambia State Insurance Corporation became the sole insurance institution. The reason for this change was to channel the premium revenue (which stood at K16m for all firms in 1969) and profits into domestic investment, rather than in investment outside Zambia, which had been the practice of the private companies.<sup>5/</sup> The Zambia State Insurance Corporation, however, employs the services of some private brokers who act as agents on its behalf, in addition to its salesmen.

The business of ZSIC is carried on in two divisions, and these are: the Life insurance division and Non-life division.

The type of business carried on by the Life Insurance Division, is classified under two categories, namely Group Pension Scheme Insurance and Individual Life (ordinary life) Insurance.

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<sup>5/</sup> Chiselebwe Ng'andwe "Inflation in Zambia: 1964 - 1976" Ph.D thesis, University of Connecticut, 1980, p. 144.

The Group Pension Scheme Insurance is a voluntary pension scheme open to organisations. Organisations contribute to this scheme in form of premiums. The premium received under this scheme has increased considerably. For instance the premium received in 1972 amounted to K1,760,000 while that of 1980 amounted to K10,971,000. This represents an increase of 523 percent. Such a significant increase could be attributed to improved salaries in various organisations and also to many organisations opting for the scheme.

The Individual Life Insurance has nine policies from which would be savers can choose: Endowment policy, whole life policy, retirement annuity policy, mortgage cancellation policy, family income benefit, family protection benefit, temporary policy, child endowment policy and keyman assurance policy. This category also registered an increase in net premium received, rising from K6,154,000 received in 1972 to K8,365,000 received in 1980. Thus the total premium received by the life insurance division rose from K7,914,000 in 1973 to K19,336,000 in 1980. Table III (6) gives details about the net premium received by both the Life insurance and Non-life insurance divisions.

The Non-life Insurance Division consists of the following departments: Fire, Accidents, Contractors all risks, Marine and Aviation, and Motor departments. Each department offers various policies according to its speciality. Net premiums received by this division increased considerably, rising from K6,727,000 received in 1971 to K43,171,000 received in 1980.

Over the past years, this division has proved to be the corporation's main business. (See Table III (6)).

TABLE III (6): NET PREMIUM INCOME BY CLASS, NON-LIFE AND LIFE DIVISIONS  
(K'000)

YEAR	FIRE	ACCIDENT	MOTOR	MARINE AND AVIATION	CAR/ ENGINEERING	NONE-LIFE TOTAL	INDIVIDUAL LIFE	PENSIONS	LIFE TOTAL	CORPORATE TOTAL
1971	1,415	1,214	3,981	117	-	6,727	-	-	-	6,727
1972	3,153	3,184	5,840	580	-	12,757	6,154	1,760	7,914	20,671
1973	5,406	3,288	5,783	877	708	16,062	2,104	1,938	4,042	20,104
1974	5,596	4,210	6,998	2,080	616	19,500	2,808	2,550	5,358	24,858
1975	5,723	4,494	8,487	1,950	464	21,118	3,455	3,605	7,060	28,178
1976	7,873	5,427	8,284	3,109	1,035	25,728	4,367	5,664	10,031	35,759
1977	8,824	5,736	8,224	3,668	764	27,216	4,952	7,264	12,216	39,432
1978	10,290	6,598	8,348	4,060	771	30,067	6,459	8,454	14,913	44,980
1979	11,314	6,871	10,242	4,419	783	33,629	7,218	9,888	17,106	50,735
1980	13,338	8,233	13,687	6,699	1,214	43,171	8,365	10,971	19,336	62,507

SOURCE: ZSIC: Annual Report and Accounts, 1980

The corporation ensures that it channels funds into areas where its investments are highly secured. Investments in securities is restricted to government and government guaranteed debt. Direct loans to the parastatals are guaranteed by the Government. The corporation has chosen such avenues of funds in order to protect the interests of the insured persons. Table III (7) gives a detailed account of the corporation's employment of funds as at 31st December, 1980.

TABLE III (7): INVESTMENTS, LOANS AND MORTGAGES AS AT 31ST DECEMBER, 1980 (K'000)

	Non-Life	Life	Total for Corporation
Government of the Republic of Zambia	1,101	13,135	14,236
Loans to the Government of the Republic of Zambia	4,000	43,000	47,000
Mortgage on property	-	4,638	4,638
Other fixed interest securities and Loans	36,985	5,359	42,344
Leasehold property	13,458	17,778	31,236
Ordinary shares	783	910	1,693
Foreign Investments	575	-	575
Loans on policies	-	5,574	5,574
Staff house Mortgage Loans	-	426	426
Preference shares	-	1,144	1,144
	<u>56,902</u>	<u>91,964</u>	<u>148,866</u>

SOURCE: Zambia State Insurance Corporation Limited: Annual Report and Accounts 1980.

### National Savings and Credit Bank (NSCB)

The National Savings and Credit Bank was established in 1972 under an Act of Parliament - the National Savings and Credit Bank Act of 1972. However, its operations date to as far back as the pre-independence period. Prior to the 1972 Act of Parliament, the Bank was known as the Post Office Savings Bank. By that time, it was part and parcel of the Post Office. Since 1972, the Bank operates as a financially autonomous institution. However, it continues to work out of the Post Office.

The Bank has been very much concerned with promoting thrift among the working classes and among persons of moderate means. With several branches throughout the country, the bank offers the widest coverage of savings deposit facilities. By operating through Post Offices which are well spread all over the country, the bank has had an edge in mobilising savings in remote areas where the commercial banks have failed to penetrate.

The bank has shown satisfactory growth as regards the mobilisation of personal savings due to its liberal terms under which it carries out its operations. For instance, the bank requires a minimum balance of 50 ngwee to maintain an account which is in great contrast to those of commercial banks; deposits and withdrawals can be made at any Post Office in the country; and lastly, the bank is open to its customers both in the mornings and afternoons during the week, and mornings only on Saturdays. These services are an extension over the ones offered by commercial banks. In addition to these, the bank does grant loans to the public. The bank pays an interest rate of 4.25 percent on deposits. However, this rate does not compare favourably with those of commercial banks.

The NSCB has been able to increase deposits and number of customers during the period under review. For instance, at the end of June 1970, a total of K8,156,000 was standing to the credit of 223,000 accounts. However, by the end of June 1980, the corresponding figures for total deposits and customers had gone up to K26,311,000 and 629,000 respectively. This represents an increase in deposits of 141 percent in the seven years period. However, inspite of this significant increase in total deposits, the average balance due to each customer remained low during the period 1970-1980, fluctuating between K35 and K45.

Table III (8) gives more information on this trend.

TABLE III (8): DEPOSIT MOBILISATION BY NSCB ('000s)

End of period	Total Deposits (K)	Number of Depositors	Average balance (K)
June 1970	8,156	223	0.037
1971	8,661	246	0.035
1972	9,911	276	0.036
1973	10,933	295	0.037
1974	12,725	338	0.038
1975	14,421	374	0.039
1976	17,009	416	0.041
1977	19,688	461	0.043
1978	22,792	508	0.045
1979	24,670	555	0.044
1980	26,311	629	0.042

SOURCE: Central Statistical Office, Monthly digest of Statistics (several copies) and Bank of Zambia, the role of Banks and Non-Bank Financial institutions in the mobilisation of Domestic Savings in Zambia, paper presented at an International seminar of Central Banks. Doula-Cameroun. 26th April - 5 May, 1982.

## Zambia National Building Society (ZNBS)

The Zambia National Building Society was established on the 24th of December, 1970, under the Building Societies (Amendment) Act of 1970. Shortly thereafter, the ZNBS took over assets and liabilities of three former building societies carrying on business in Zambia. These were the First Permanent (1962) Building Society, the Security Building Society, and the Zambia Mutual Building Society.

The ZNBS offers a wide range of deposit facilities from which would-be savers can choose. Two main accounts are offered by the society, viz, share capital and Fixed deposits.

Share capital is a broad category and comprises four kinds of accounts, viz. Savings shares, Investment shares, Voluntary savings scheme and Fixed period shares. The savings shares yield an interest rate of 4 percent, and a minimum balance of K20 is required to maintain the account. Only one withdrawal in any one week is allowed on this account. Besides this condition, there is an upper limit of K200 that may be withdrawn in cash on demand on any such occasion; Investment shares yield a rate of interest of 6.25 percent and a minimum balance of K50 is required to maintain the account. A notice of withdrawal of at least one week is required for all withdrawals; The voluntary savings scheme is open mostly to the working class. Under this scheme, employees may request employers to have some money deducted from their month-end pay. The money so deducted is then sent to the ZNBS. The terms of conditions applicable to this scheme are more or less similar to those of the investment shares; The fixed period shares are mostly for the institutional or private investor who wishes to make lump-sum investments of not less than K500. These shares could be invested for various periods and earn varying rates of interest ranging from 8.25 percent for a period

ranging between 12 and 23 months to 9 percent for a period ranging between 48 and 59 months.

Fixed deposits can also be accepted for various periods at varying rates of interest ranging from 7.25 percent for a period of 12 to 23 months to 8.5 percent for a period of 48 to 59 months.

A general feeling is that savings shares, investment shares and voluntary savings scheme are most popular with salaried workers whereas fixed period share and fixed deposits are most popular with institutions.

During the period under review, the ZNBS has been able to increase its assets and liabilities from K54,531,000 at the end of 1968 to K126,220,000 at the end of March 1981. Share capital and fixed deposits comprise the bulk of the society's liabilities. For instance, at the end of 1968, they accounted for 94.5% of total liabilities, and at the end of March 1981, they accounted for 87%. Of the two main accounts, share capital contributes the most to total deposits of the society. For instance, of the total deposits of K109,325,000 standing to the credit of customers at the end of March, 1981, share capital accounted for 74 percent whilst fixed deposits accounted for the remainder 26 percent. Full details of savings mobilisation by the ZNBS are in Table III (9).



TABLE III (9): SAVINGS MOBILISATION AND MORTGAGE LOANS BY ZNBS ('000)

End of period	Share Capital	Deposits	Other Liabilities	Total Assets/ Liabilities	Mortgage Loans	Loans as Proportion of assets
Dec. 1968	32,622	18,916	2,993	54,531	40,047	73%
1969	33,100	22,322	3,245	58,667	42,722	73%
1970	42,660	21,877	3,942	68,487 (SIC)	40,045	58%
1971	47,610	21,575	4,900	74,085	54,163	73%
1972	48,410	21,767	7,030	77,207	53,110	69%
1973	55,670	21,848	5,592	83,110	61,625	74%
1974	54,951	26,745	6,479	88,175	65,828	75%
1975	51,849	33,502	7,731	93,082	74,467	80%
1976	49,622	34,467	12,485	96,574	79,181	82%
1977	48,543	39,774	19,738	108,055	88,946	82%
1978	50,670	41,402	21,894	113,966	92,447	81%
1979	67,234	32,513	19,941	119,688	97,419	81%
1980	75,022	28,887	15,983	119,892	97,530	81%
1981	81,280	28,045	16,895	126,220	102,597	81%

SOURCE: Central Statistical Office, Monthly Digest of Statistics, (several copies)

N.B. Prior to June 1971, figures relate to three Building Societies, viz, First Permanent Building Society, Security Building Society and the Zambia Mutual Building Society which were amalgamated to form Zambia National Building Society.

The bulk of the society's funds are invested in Zambia mainly in the form of first mortgages on residential properties for owner occupations. The table above shows the composition of mortgage loans in total assets. Besides mortgages, the society does invest in government stocks and also maintains deposits with commercial banks. This reflects the society's need for liquidity. However, of late, Government stocks have been declining steadily.

#### Industrial Finance Company (IFC)

IFC was established in 1969 initially as a wholly owned subsidiary of the

Industrial Development Corporation (INDECO). After the economic reforms of 1969, IFC was involved in the takeover of retail businesses from expatriates.

With the creation of the State Finance and Development Corporation (FINDECO) in 1970, it was transferred from Indeco to become a subsidiary of Findeco. It however continued with financing of small retail business (shops, bars, etc) and expanded its hire-purchase department for financing commercial vehicles, cars for members of ZIMCO staff, industrial plants and equipment and machinery. However, throughout the period of its operations, it was confounded with liquidity problems, and by 1978, it could continue no longer - it went into liquidation.

A report by the United Nations Industrial Development Organisation (UNIDO), cited the following reasons as having contributed to the failure of IFC:<sup>6/</sup>

1. The target population of borrowers was one which would not normally be accepted to prudent commercial houses.

2. IFC was undercapitalised i.e. it started with capital of K1 million which was later raised to K1.5 million. Since more than K5 million was lent, it meant that IFC had to obtain the difference from the commercial banks. Three million Kwacha was borrowed from the Zambia National Commercial Bank alone.

3. The interest rate charged was too low ( $8\frac{1}{2}$  to 10%) and made no provision for covering bad debts. When the original capital was exhausted, money had to be borrowed at  $9\frac{1}{2}$  - 10% rate of interest, leaving no margin to pay current expenses and operating costs. In some cases, money was borrowed at higher rates of interest.

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6/ United Nations Industrial Development Organisation, Republic of Zambia, Report on Small-scale industry, Report No. 12 Rev.1, May 1981, New York p. 35.

4. Many small businessmen went under in the recession. A major factor was their inability to obtain supplies due to transport problems which particularly affected rural areas. Very few cases were the direct result of misappropriation of funds.

5. In some cases, loans were approved because of political pressure and IFC management was overruled.

6. One reason was due to the inaccessibility of many rural areas. IFC's Head Office was in Lusaka and there was a branch in Mansa. This made it difficult for IFC to reach all the parts of the country in its effort to collect interest and later the principal amount.

7. Inadequate general management.

#### Agricultural Finance Company (AFC)

The AFC, a subsidiary of the Rural Development Corporation (RDC), effectively came into operations on the 1st of June 1970, to take over the functions of the Credit Organisation of Zambia (COZ). However, it was not a legal successor to that organisation. Most of its staff, in the main, were however drawn from the Credit Organisation of Zambia.

Since its establishment, the AFC has been a major source of credit for agriculture. The company provides three types of loans, viz. short-term (seasonal) loans, medium-term and long-term loans. Seasonal loans are largely used for purchase of seeds, fertilisers, wages and other requisites. The repayment period is generally one year and such loans carry an interest rate of 9 per cent. Medium-term loans are largely used for purchase of machinery, water pumps, oxen, etc. The repayment period stretches up to a maximum of five years at

9 percent interest. The Long-term loans stretch up to maximum of 30 years and are largely used for the purchase of land and development.

The objectives of the company are to provide credit to the farming community throughout the country while at the same time ensuring that as a limited company, the services are provided on a commercial basis. However, these two objectives are incompatible, and this has resulted in the poor level of loan recovery. Mostly, inadequate scrutiny of loan applicants to determine their reputation as potential borrowers and ability to repay loans has contributed to the poor level of loan recovery.

#### Development Bank of Zambia (DBZ)

The Development Bank of Zambia was established in December, 1972 by an Act of Parliament as a Statutory Finance Corporation. The principal objective underlying its establishment was to provide equity capital and medium and long-term financial assistance to development enterprises operating in Zambia through the mobilisation of both domestic and foreign resources.

The shares of the Bank are held by the Government of the Republic of Zambia, parastatal and private organisations. Originally, the Bank's authorised share capital was K10 million broken down into 600 class A shares and 400 class B shares. Class A shares were to be subscribed by government and parastatal organisations, while the Class B shares were to be distributed among local and overseas private institutional subscribers. However, in 1979, the Act was amended in order provide for Class C preference shares. Subsequently, the authorised share capital of the Bank was increased from K10,000,000 to K20,000,000 by the creation of K10,000,000 non-voting Class C preference shares during the

financial year 1979/80. In addition to its share capital, the Bank is empowered under the act to borrow from other financial institutions in order to supplement its resources.

### Historical Background

The establishment of the Bank was necessitated by the fact that there was no institution in the country providing long-term finance for economic development. Although the existing institutions had some resources for lending, this function was merely a secondary aspect of their activities. There was therefore a need for an institution to fulfil the functions of mobilising resources, and promoting and financing viable industrial projects in addition to appraising investment proposals to determine their technical, economic and commercial viability.

Consequently, the Government of the Republic of Zambia made a request to the World Bank to inquire into the possibility of setting up a development bank in Zambia, and to outline the basis on which it could be established. This led to a visit in November, 1971 of a World Bank mission, consisting of Mr. Mehta and Mr. Bernard Givin. Their report recommended the establishment of a development bank in the country. Their recommendations were in contrast to those of commercial banks who favoured the establishment of a capital market in place of a development bank. Later, in November 1972, another World Bank mission came to advise the Government on organisation, staffing and other matters relevant to the establishment of the proposed Development Bank of Zambia.

A comprehensive discussion on this institution is deferred to the next chapter.

## Conclusion

The non-bank financial institutions with the exception of the National Savings and Credit Bank are intended to provide the community with specialised services. Each institution has its own sources and uses of funds, and hence their functions do not necessarily overlap. Take the case of DBZ and the now liquidated Industrial Finance Corporation (IFC), though they both had facilities for medium-term and long-term lending their functions differed greatly. IFC concentrated on financing small scale enterprises. For instance, its loans ranged between K5,000 and K25,000 and moreso, it did not lend for productive investments. On the other hand, DBZ lends to productive sectors only and grants loans with a lower limit of K25,000. Moreso, emphasis on DBZ lending is placed on the soundness of the project for doubtless, without that, DBZ may not remain a going concern. The soundness of a project is determined by means of the Bank's project appraisal techniques.

DEVELOPMENT BANK OF ZAMBIA (DBZ)ESTABLISHMENT

The Development Bank of Zambia was established under the Development Bank of Zambia Act No. 35 of 1972 and commenced operations on January 11th, 1974. It is an autonomous institution whose shares are held by the Government of the Republic of Zambia, parastatals and private interests.

OBJECTIVES

As discussed in the previous chapter, DBZ was established largely as a consequence of the inability of the existing financial institutions to provide medium and long-term finance for economic development. Thus, its establishment marked a further step by the Government to influence economic development of the country. The business of the Bank as determined by the Act is inter alia:

- (a) to make available equity capital as well as long and medium-term loan funds to development enterprises engaged in the activities of
  - (i) manufacturing, assembling and processing goods whether of agricultural, forestry or ranching origin;
  - (ii) large-scale corporate agriculture and ranching;
  - (iii) engineering, construction, transport, power, tourist and mining industries.
- (b) to provide technical assistance and advisory services for the purpose of economic development
- (c) to assist in obtaining and placing foreign investment for the purpose of economic development
- (d) to administer on such terms and conditions as may be approved by the Board such special funds as may from time to time be placed at the disposal of the Bank;
- (e) to borrow funds in Zambia and elsewhere;
- (f) to buy and sell securities, including securities which the Bank has issued or guaranteed;

- (g) to study and promote investment opportunities; and
- (h) to do all other matters and things incidental to or connected to the foregoing.

The Act further specifies the following limitations on the activities of the Bank:

- (1) The Bank would not engage on its own account in the wholesale or retail trade, including the import or export trade, except as may be necessary in the course of satisfaction of debts to it and then only as may be necessary for that purpose.
- (2) The Bank would not seek to acquire a controlling interest and would not assume managerial responsibilities, in enterprises to which it may render assistance (whether financial or otherwise) except to the extent that the Board deems it necessary so to do in order to protect any investment therein of the Bank.
- (3) The Bank, may, subject to the other provisions of the Act, borrow money or other assets required by it for the purpose of meeting any of its obligations or discharging any of its functions under the Act: provided that the aggregate liabilities of the Bank outstanding at any one time, do not, without the written approval of the Minister, exceed seven times the amount of its paid-up share capital and free reserves.

### Capital Structure<sup>1</sup>

The capital structure of the Bank comprises share capital, loan capital and special funds. Share capital consists of ordinary shares and preference shares. In addition to share capital, the Bank maintains some reserves. Loan capital consists mostly of long-term loans, both secured and unsecured. Special funds consist mostly of grants and interest free loans.

1/ refers to the permanent long-term financing of the firm represented by long-term debt, preferred stock, and net worth (net worth consists of share capital and reserves)



## Share Capital<sup>2/</sup>

The Development Bank of Zambia Act (now amended) originally provided for an authorized share capital of the Bank of ten million Kwacha (K10,000,000), broken down into 600 class A ordinary shares, each having a par value of K10,000<sup>3/</sup>. However, the said Act was amended on the 12th of April, 1979, to provide for an increase in share capital from K10,000,000 to K20,000,000 by the creation of K10,000,000 class C preference shares.

Class A ordinary shares are allotted as follows:

(i) 450 shares with a nominal value of K4,500,000 to the Government of the Republic of Zambia.

(ii) 150 shares with a nominal value of K1,500,000 distributed among the following institutions in which the state has controlling interest, viz., the Bank of Zambia (50 shares), Zambia National Provident Fund (50 shares), Zambia National Commercial Bank Ltd., (20 shares), Zambia National Building Society (15 shares) and Zambia State Insurance Corporation (15 shares). By March 1974, all the 600 class A shares were duly subscribed<sup>4/</sup> and paid up.<sup>5/</sup>

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- 2/ Share capital is subdivided into smaller units called shares. A share has been defined in the case of *Boreland v. Steel* (1901) 1 CH 279 p. 288, as "the interest of the shareholder in the company measured by the sum money, for the purpose of liability in the first place, and on interest in the second, but also consisting of a series of mutual covenants entered into by all the shareholders interse."
- 3/ Authorized share capital is the maximum amount which a company is authorized to raise by issue of shares and upon which stamp duty and registration fee is paid. The amount of authorized capital is mentioned in the capital clause of the memorandum of the company along with the subdivision thereof into shares of a fixed amount. This is also known as the company's nominal or registered capital whose limits may not be exceeded, unless the authorized capital is increased.
- 4/ Subscribed capital refers to that part of the Company's capital which has been taken up or subscribed by the public (in this case the Government and Parastatal companies).
- 5/ Paid up capital is that part of capital which has been paid up by the shareholders, or which is credited as paid up on the shares.

In accordance with the Development Bank of Zambia Act, Class B ordinary shares are allotted to private financial institutions, both local and international. The Act provides for 400 class B ordinary shares with a nominal value of K4,000,000. In its effort to raise funds, the Bank has approached several foreign finance institutions in Europe and Asia and has encouraged them to subscribe to its equity stock.

However, by 31st March 1974, only 65 class B ordinary shares with a nominal value of K650,000 were subscribed and paid-up. These were mainly taken up by local commercial banks. During the following financial year (1974/75), five international financial institutions decided to participate in the Bank to the extent of K2,050,000. However, only K250,000 was paid up. In the subsequent financial year (1975/76), these shares had been subscribed to a total nominal value of K3,450,000 of which K2,900,000 was paid up. Furthermore, the Bank received commitments from other international organisations for the remaining shares which were not yet subscribed. During the 1976/77 financial year, all class B shares were duly subscribed though K550,000 remained unpaid thereon. During the 1977/78 financial year, the paid-up capital remained unchanged. However, in the subsequent financial year, all class B shares were fully paid.

As stated above, the capital base of the Bank was altered during the 1979/80 financial year with the creation of K10,000,000 non-voting class C preference shares. These shares are broken down into 2000 shares each having a par value of K5,000 and having dividend rights varying between 7 - 8½ percent per annum. During the same period, 1085 class C shares with a nominal value of K5,424,000 were issued to the Bank of Zambia and Zambia State Insurance Corporation Limited, in the amounts of K4,425,000 and K1,000,000 respectively. During the 1980/81 financial year, a further K2,000,000 was issued to the Zambia

National Provident Fund. Table IV(1) presents a list of shareholders as at March 31, 1981.

### Reserves

The Bank maintains the following reserve fund: Statutory Reserve, Special Reserve for currency fluctuations, and retained earnings.

In accordance with the Development Bank of Zambia Act (Part IV, Section 21, now amended), the Bank provides against any anticipated losses by establishing a statutory Reserve fund to which is allocated amounts at the end of each financial year. It is required that not less than 25 percent of the net income of the Bank for the year, must be transferred to this reserve, until the balance thereon equals the paid-up share capital. It is further required that this requirement is made good before any part of the net profit is allocated to other uses such as share-holders' dividend, etc.

The Bank also provides for a special Reserve Fund to meet any contingency which may arise in future. It is left to the Board of Directors' discretion to determine what part of the net profit is to be allocated to this fund. The Bank first provided for this fund during the 1974/1975 financial year.

During the 1978/79 financial year, the Bank started providing for a Reserve for currency fluctuations. This fund is designed to provide for currency fluctuations on the Bank's foreign loans.

After transferring funds to the reserves mentioned above and to share-holders' dividends (if any), the balance of that part of net profit that is

TABLE IV.(1) THE DEVELOPMENT BANK OF ZAMBIA: LIST OF SHAREHOLDERS  
AS AT 31ST MARCH 1981

Class A ordinary shareholders		Kwacha
1. Ministry of Finance		4,500,000
2. Bank of Zambia		500,000
3. Zambia National Provident Fund		500,000
4. Zambia National Commercial Bank Ltd.		200,000
5. Zambia National Building Society		150,000
6. Zambia State Insurance Corporation Ltd.		150,000
Sub-total		6,000,000
Class B ordinary shareholders		
1. German Development Company (DEG)		1,500,000
2. European Investment Bank (EIB)		550,000
3. Barclays Bank of Zambia Ltd		400,000
4. International Finance Corporation (IFC)		350,000
5. Standard Bank Zambia Ltd.		200,000
6. African Development Bank (ADB)		150,000
7. Bank of Tokyo		100,000
8. Grindlays Bank International (Zambia) Ltd.		100,000
9. Banca Nuzionale del Lavoro		100,000
10. Bankof America		60,000
11. Beogradska Banka		60,000
12. Jugobanka		50,000
13. Den Norske Creditbank		40,000
14. Zagrebacka Banka		40,000
15. Privredna Banka		40,000
16. Ljubljanska Banka		40,000
17. Rijecka Banka		20,000
18. Dai-ichi Kangyo Bank Ltd.		20,000
19. Mitsubishi Trust and Banking Corporation		20,000
20. Fuji Bank Ltd.		20,000
21. Mitsui Bank Ltd.		20,000
22. Mitsubishi Bank Ltd.		20,000
23. Investiciona Banka		20,000
Sub-total		4,000,000
Class C preference shareholders		
1. Bank of Zambia		4,425,000
2. Zambia National Provident Fund		2,000,000
3. Zambia State Insurance Corporation Ltd.		1,000,000
Sub-total		7,425,000
Total subscribed share capital		17,425,000

Source: The Development Bank of Zambia, Annual Report 1981.

TABLE IV. (2): ALLOCATION OF FUNDS TO RESERVES  
(KMWCHA)

End of period	Net Profit Before Distribution	Net Profit allocated to					Total Reserves for the Year	Cumulative Total Reserves
		Statutory Reserves	Special Reserves	Reserve for currency fluctuations	Retained Profits			
31st March, 1974	46,037	11,510	-	-	34,527	46,037	46,037	
" 1975	70,021	17,510	25,000	-	27,511	70,021	116,058	
" 1976	235,726	58,980	100,000	-	76,746	235,726	351,784	
" 1977	438,537	110,000	250,000	-	78,537	438,537	790,321	
" 1978	500,636	126,000	125,000	-	249,636	500,636	1290,957	
" 1979	618,208	155,000	-	120,535	342,673	618,208	1909,165	
" 1980	1,375,512	344,000	150,000	212,608	202,095	908,703 <sup>1</sup>	2817,868	
" 1981	2,130,605	533,000	-	458,702	218,982	1210,684 <sup>1</sup>	4028,552	
		1,356,000	650,000	791,845	1,230,707	4,028,552		

Source: Development Bank of Zambia Annual Reports

1/ The difference between total reserves for the year and the net profit before distribution is due to proposed dividends of K466,809 and K919,921 at the end of March, 1980 and March 1981 respectively.

left, known as the retained earnings, is also maintained by the Bank as a reserve fund.

Table IV (2) shows the growth of these reserves between 31st March, 1974 and 31st March, 1981.

#### Loan Capital (Resource mobilization)

In addition to its share capital, the Bank may incur unsurbordinated debts up to seven times the sum of its paid up share capital and free reserves. However, this ratio may be increased from time to time as the situation warrants. The Bank is empowered to mobilise such funds from both domestic and foreign sources. A detailed analysis of the Bank's borrowing activities during the period under review follows below.

At its inception, the Bank explored prospects for obtaining loans from international finance institutions, like the African Development Bank (ADB), International Bank for Reconstruction and Development (World Bank), and others. In this respect, the Bank had from its inception a line of credit of approximately K1.4 million with the African Development Bank and this was available for re-lending. This facility carries an interest rate of 6 percent per annum and is repayable over 12 years from 1st July, 1978. However, as at 31st March 1975, this facility remained unutilized. This was on account of some technical reasons and also due to refusal of some of the Bank's customers to assume foreign exchange risks inherent in such lines of credit. During the same period, the Bank also borrowed in local currency from the Zambia National Building Society. These loans bear an annual interest rate of 8½ percent and are repayable over a period of 15 years. They are secured by mortgages over

the freehold property valued at the cost of K113,184 as at 31st March 1974.

During the 1974/75 financial year, the Bank continued its negotiations with local and foreign financial institutions for additional funds for its lending operations. To this effect, the Bank received commitments of some K7 million from local sources. The Bank also applied for a line of credit of U.S. \$10.00 million from the International Bank for Reconstruction and Development (IBRD). To this effect, the IBRD sent a mission in February/March 1975 to appraise the Bank and make recommendations for possible assistance.

In the subsequent financial year (1975/76), the Bank acquired two unsecured loans from the Government of the Republic of Zambia and the National Commercial Bank in the amounts of K1,000,000 and K4,425,000 respectively. The loan from the Government bears an annual interest rate of 6½% and is repayable over a period of 13 years. On the other hand, the loan from the National Commercial Bank consists of promissory notes maturing eight years from the date of issue at an interest rate of 7% per annum. During the same period, a line of credit of US\$15 million (approximately K10 million) was established. This came as a result of the contact initiated with the IBRD in the previous period.

During the 1976/77 financial year, the Bank negotiated a line of credit of K2.2 million with the European Investment Bank repayable over 8 years from 28th February, 1983, with interest at  $5\frac{3}{4}\%$ . However, due to delays in legal formalities, it did not become fully operational in this period. It remained unutilized till the 1979/80 financial year. In this period, the Bank made the first withdrawal of K33,136. on the line of credit from the African Development Bank. The Bank also supplemented its local currency by acquiring two loans from the Zambia National Provident Fund. One loan of K800,000 bears an interest

rate of 8% per annum and is repayable over a period of 4 years from 31st December, 1979. The other loan of K1,000,000 bearing an interest rate of 7½% per annum is repayable over 12 years from 30th December 1980.

In the two subsequent financial years (1977/79), the Bank continued drawing on some of its existing lines of credit it already had. No new loans were acquired during this period.

During the 1979/80 financial year, the Bank initiated negotiations for other lines of credit from the African Development Bank, International Bank for Reconstruction and Development, and German Development Company (DEG), for UA 8,000,000, US\$15,000,000 and DM 6,000,000 respectively. The Bank also continued drawing on its existing lines of credit. During the same period, the bank borrowed in local currency by acquiring a long-term loan of K2,250,000 from the Zambia National Provident Fund. The loan is repayable over 20 years and bears an interest rate of 8.5% per annum, and is secured over the new Head Office premises. It is not for relending purposes but it is designed to provide finance for the Bank's new Head office presently under construction. It is also important to mention that at the beginning of the 1979/80 financial year, K4,425,000 was owed to the Zambia National Commercial Bank on a loan refinanced by the Bank of Zambia. However, on the first of November, 1979, with the agreement of the parties concerned, the loan was converted into class C shares and registered in the name of the Bank of Zambia.

Finally, during the 1980/81 financial year, the Bank continued drawing on its existing facilities. In addition to these resources, the Bank established three additional lines of credit equivalent to K23 million. The first agreement was concluded with the African Development Bank in June, 1980 for



UA 8,000,000 (approximately K7,850,000). This loan is repayable over 12 years starting from 1st July 1983 with an interest rate of 7.5% per annum. However, this facility was not utilized during this period. The second agreement was concluded in August 1980, with the German Development Company (DEG) for DM 6,000,000 (approximately K2,600,000). This loan is repayable over 8 years from 30th September, 1984, with interest at 8% per annum. During this period, the Bank made drawings of K1,306,190 on this facility. Finally, the third agreement was concluded with the International Bank for reconstruction and Development (IBRD) in January 1981. The IBRD agreed to place at the Banks' disposal a line of credit for US\$15,000,000 (approximately K12,600,000). However, this loan did not become effective until 1st May 1981. Furthermore, the Bank supplemented its local currency by borrowing from the commercial banks against promissory notes guaranteed by the Government. These promissory notes bearing interest at 7.25% per annum were issued to Standard Bank Zambia Ltd, Barclays Bank of Zambia Ltd., and Zambia National Commercial Bank Ltd., in the amounts of K1,000,000, K2,000,000, and K1,000,000 respectively. They will all mature in the 1983/84 financial year.

Table IV(3) shows the long-term indebtedness of the Bank as at 31st March, 1981.

### Special Funds

The Bank is empowered under section 12 of the Act to administer any special funds that may from time to time be placed at its disposal. Currently, there are two types of special funds that the Bank administers, viz, Special Fund for Rural Development and Special Fund for Technical Assistance.

TABLE IV(3): LONG-TERM INDEBTEDNESS AS AT

31ST MARCH, 1981

Year of acquisition	Lender	Balance of facility undrawn	Net Amount drawn (1)
<u>Secured</u>			
1973/74	Zambia National Building Society	-	47,541
1979/80	Zambia National Provident Fund	1,486,900	763,100
<u>Unsecured</u>			
1975/76	Government of the Republic of Zambia	-	884,800
1976/77	Zambia National Provident Fund	-	528,976
1976/77	Zambia National Provident Fund	-	1,000,000
1980/81	Standard Bank Zambia Ltd.	-	1,000,000
1980/81	Barclays Bank of Zambia Ltd.	-	1,000,000
1980/81	Barclays Bank of Zambia Ltd.	-	1,000,000
1980/81	Zambia National Commercial Bank Ltd.	-	1,000,000
1973/74	African Development Bank	-	1,399,042
1975/76	International Bank for Reconstruction and Development	1,957,175	8,513,875
1976/77	European Investment Bank	274,645	2,260,759
1980/81	African Development Bank	7,856,185	-
1980/81	German Development Company (DEG)	876,605	1,306,190
		12,451,510	20,704,283
	Less Repayment due within 12 months	-	1,549,809
		12,451,510	19,154,474

Source: Development Bank of Zambia Annual Report 1981

(1) Excludes repayments made on loans.

The Special Fund for Rural Development became operational in the 1978/79 financial year when the Bank received a grant of K261,000 from the Norwegian Development Agency (NORAD). In the following financial year, another grant was received from NORAD, thus increasing the total amount to K548,000 as at 31st March 1980. During the same financial year, a loan of C\$2,000,000 from the Canadian International Agency (CIDA) to the Government of the Republic of Zambia on lent to the Bank was received by DBZ. This was in accordance with the terms of the loan agreement. The loan is interest free and is repayable over 40 years beginning March, 1989. During the 1980/81 financial year, another grant of K665,640 was received from Norad. Thus total grants received from Norad rose to K1,213,640.

The funds discussed above are administered by the Bank in accordance with the terms of the agreements signed between the Bank on the one hand and NORAD and CIDA on the other. Under these agreements, it is required that all income, except a specified amount to cover the Bank's expenses, be credited to the fund to finance the promotion of further projects. As at 31st March 1981, total liabilities represented by the Special Fund for Rural Development, stood at K1,623,788. This amount comprises K1,213,640 from NORAD, K335,615 from CIDA (amount actually drawn) and K74,473 being accumulated surplus credited to the fund in accordance with the terms of the loan agreements.

The Special Fund for Technical Assistance was opened in the 1978/79 financial year, when the Bank received a grant of K355,092 from the Government of the Republic of Zambia. The aim of providing this fund is to assist the Bank in furthering its project promotions through feasibility studies. By 31st March, 1981, K216,252 had been disbursed from this fund.

The above analysis on DBZ's capital structure has shown that DBZ has been able to mobilise resources from both local and foreign sources. It should however be noted that the participation of foreign capital in the recipient country, poses a great danger of too large an indebtedness to foreign countries. This is due to the fact that foreign capital tends to be extremely sensitive to the political - economic atmosphere of the recipient country. Notwithstanding this fact, Boskey (1959) outlines some possible advantages offered by the participation of foreign capital in a development Bank. He writes:

It may help to insulate management against local political pressures to make or decline to make particular investments thereby strengthening the bank's independence. It may promote a flow of external capital to local industry and provide a point of contact with capital markets in the industrialised countries. It may facilitate the importation of technical skills in the industrial production and management. Finally, the evidence that overseas capital regards the bank as a good risk may give confidence to potential domestic investors and lead them to invest their own funds. (Boskey (1959), p. 28)

Boskey's analysis is in agreement with most of the activities of the Development Bank of Zambia. Although DBZ is an autonomous institution, it strictly adheres to the policies of the Party and its Government as they are from time to time laid down in the National Development plans. Notwithstanding this fact, DBZ only finances projects which are technically, economically and financially viable. Furthermore, pointing to the growth of the Banks' loan capital, one would conclude that this reflects the confidence that both foreign and domestic investors have in the Bank. However, in the final analysis, the Bank must step up the mobilization of funds from local sources.

## Organisation Structure

The responsibility for the Bank's policies and investment decision is vested in a ten-man Board of Directors (Board). The chairman of the Board and five other Directors are appointed by the Government through the Minister of Finance. The remaining four Directors including the Deputy Chairman are appointed by class B shareholders. It is required under the Development Bank of Zambia Act (now amended) that the quorum of the Board should be at least two class A Directors and one class B Director.

The responsibility for carrying out policies once established is vested in the Managing Director, who is also a member of the Board. The Managing Director is the Chief Executive of the Bank and is required to be present at all Board meetings except when a matter in which he is directly or indirectly interested is being considered. The Board does delegate some of its powers to him. In his duties, the Managing Director is assisted by the General Manager.

The General Manager is the Head of Management, and acts as Managing Director, in the absence of the Managing Director. He performs such duties that are delegated to him by the Managing Director, including those prescribed from time to time by the Board. Under the General Manager are the various Division and Departmental heads who are charged with the responsibility of implementing policies in their respective units.

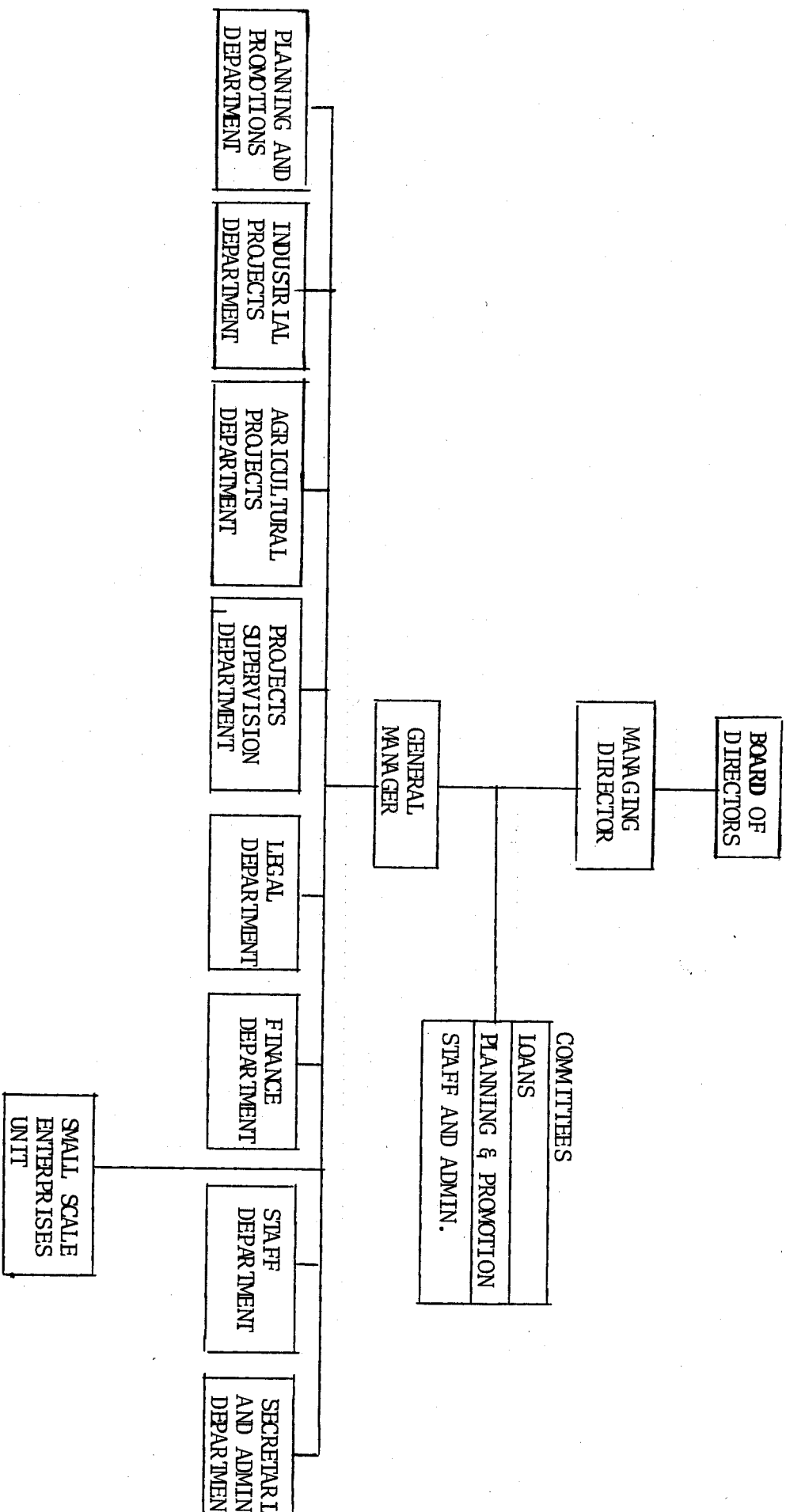
During the period under review, the Bank has had a changing organisation structure. This has been necessitated by the need to fit functions corresponding to the requirements of the Bank at a particular point in time. The evolution of the Bank's organisation structure has involved the identification of work

in terms of objectives, and arrangement of this work in properly determined groups in order to have a proper span of control. However, its not the purpose of this chapter to discuss the evolution of the Bank's organisation structure. It is however important to note that the organisation structure as at 31st March, 1981 comprised eight departments viz: Planning and Promotions, Industrial Projects, Agricultural Projects, Legal, Project Supervision, Finance, Staff, and Administration Departments (see figure IV (a)).

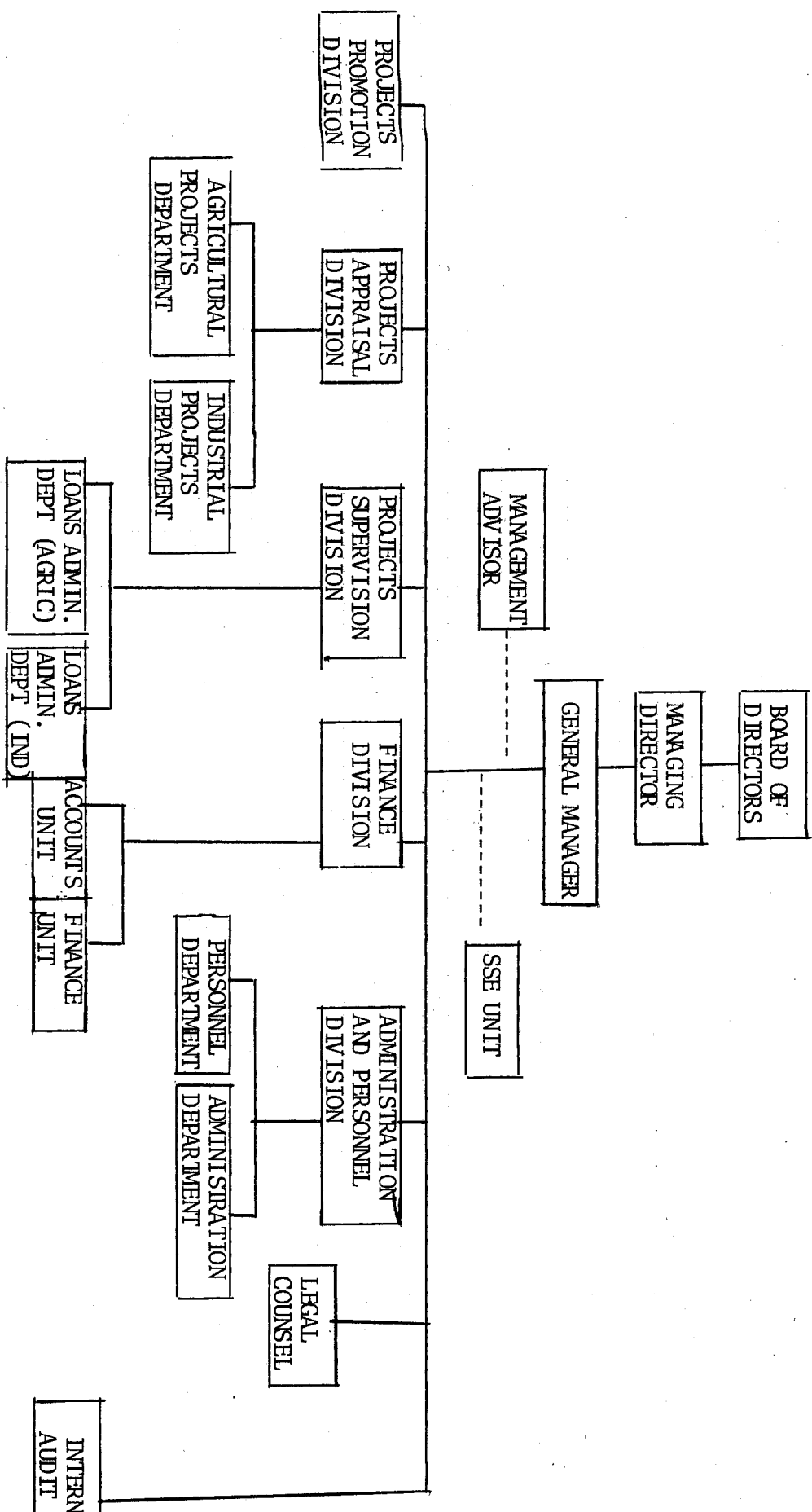
It need also be mentioned that at the time of this research, a further re-organisation had been made in the organisation structure. The revised organisation chart is shown in figure IV(b). This reorganisation which became effective in October 1981, involved the grouping of some of the related departmental functions into Divisions. For instance, the Industrial projects Department and the Agricultural Projects Department were grouped together to form the Projects Division; and the staff Department and the Secretarial and Administration Department were grouped together to form the Administration and Personnel Division. Other changes involved the elevation of some departments to division status. For instance, the Planning and Promotion Department became a Division and became known as the Project Promotion Division; the Project Supervision Department became a Division and became known as Projects Supervision Division; and the Finance Department became known as Finance Division. However, the legal Department remained unaffected but had its name changed to Legal Counsel. Lastly, a new unit - the Internal Audit was created.

If anything, the re-organisation was a welcome move in that it made it easier to co-ordinate related departmental functions and thereby reducing pressure on the General Manager's time. However, this re-organisation involved

FIG. IV (a) - THE DEVELOPMENT BANK OF ZAMBIA  
ORGANIZATION CHART



# ORGANISATION CHART





the creation of unnecessary positions in which case a number of people got promoted. At the same time, one should not preclude the fact that there is nothing that "rots morale" than when such re-organisations are made, especially when they involve changing the structure from one with a wide span of control to one with a narrow span of control, as was the case with DBZ. It should also be pointed out, that despite this re-organisation, the Departmental functions have basically remained the same. Thus the brief discussion on departmental functions outlined below is based on figure IV (b).

#### Divisional/Departmental Functions

Projects Promotion Division: is responsible for identification of projects and project promoters, preparation of pre-feasibility studies and commissioning of feasibility studies, and general planning matters.

Projects Appraisal Division: This Division is further subdivided into two departments, namely, Agricultural Projects and Industrial projects Departments. The agricultural projects and Industrial projects are responsible for appraisal of agricultural and industrial projects respectively. Details about project appraisals are discussed in the next chapters.

Project Supervision Division: is further subdivided into two departments, namely, Loan Administration (Agricultural) and Loan Administration (Industrial) projects. They are basically responsible for supervision of projects in their areas of specialisation. They are also responsible for loan administration and provision of advisory services for Bank's clients.

Finance Division: This Division is further sub-divided into two units, namely, Accounts and Finance Units. The Accounts unit is responsible for provision of

accounting services to the Bank, and the Finance unit is responsible for disbursement of loans and resource mobilisation. Resource mobilisation has already been covered in detail under financial structure.

Administration and Personnel Division: is sub-divided into two departments, namely, the Personnel and Administration Departments. The Personnel Department is responsible for staff recruitment, staff training and staff Administration, while the Administration Department is responsible for secretarial services, general administration, and procuring and maintaining Bank's property.

Legal Counsel: is responsible for preparation of loan agreements, security matters, and general legal matters.

Internal Audit Unit: is responsible for scrutinising the accounts, stocks and recurrent expenditures of the Bank. It is also responsible for examination of accounts of Borrower companies and highlighting of deficiencies in their accounting systems.

The Small Scale Enterprise Unit. This is not yet a department of the Bank. Although the SSE unit operates within the framework of the Bank, it is managed by an expert from the United Nations Industrial Development Organisation (UNIDO), who has been seconded to the Bank. The SSE unit was established in response to efforts by the Government to set up a framework of assistance to small scale enterprises. One major advantage of promoting small scale enterprises is that they tend to be labour intensive.

### Operation Policies

Pursuant to section 25 of the Development Bank of Zambia Act, the Board has formulated policies that guide the Bank's investment policy and criteria. These policies are discussed below under the following four categories:

- (a) Scope and Coverage
- (b) Investment Policy
- (c) Financial Policy
- (d) Relationship with clients.

#### Scope and Coverage

The scope of investment activities of the Bank is stipulated in the Development Bank of Zambia Act, 1972. DBZ as a national development institution contributes to the development of economically viable enterprises in Zambia in all sectors of the economy but mainly, manufacturing industries, ranching and large scale agriculture and tourism sectors. DBZ gives equal priority to both parastatal and private enterprises. However, over the past years, DBZ has tended to finance more of private enterprise than parastatal ones in terms of numbers.

In determining the eligibility of projects, the Bank adheres to the policy of the Party and Government as laid down in Development Plans. Notwithstanding this fact, DBZ finances only those projects which are technically feasible and financially viable. When these requirements are satisfied, DBZ gives priority to projects which should contribute towards the following:

- (a) Save or earn the country foreign exchange through import substitution

- exports and maximum utilization of domestic raw materials;
- (b) Creation of substantial opportunities for permanent employment;
  - (c) improving domestic skills or fostering the development of domestic technology;
  - (d) Producing intermediate goods which are used by other industries i.e. by way of fostering linkages with other industries;
  - (e) Diversify the country's industrial structure.

### Investment Policy

-DBZ grants medium - and long-term loans whose terms and conditions such as repayment periods, interest rates, commitment and other charges vary with the requirements of each project. These terms and conditions depend on the Bank's cost of capital i.e. the terms and conditions of the funds borrowed by the Bank on the domestic and foreign markets. The repayment periods for loans borrowed from the Bank are as follows:

Industry - up to 10 years  
Tourism - up to 12 years  
Agriculture- up to 15 years.

The repayment-free period varies from 1 to 4 years and interest rate varies from one project to the other, depending on the nature of the project being financed. During the period under review, interest rate has varied from 9 percent in 1974 to 12 percent in 1981.

-DBZ's financial assistance is primarily for expenditure for fixed assets. In this respect, the total amount of loan granted by DBZ in favour of a single project does not exceed 75 percent of the value of the total

- 70 -

investment in fixed assets. Exception to this rule must be determined by the particular nature and merits of a project.

-The Bank ensures that all its loans are adequately secured. They may be secured on land, Factory Buildings, and plant and equipment etc.

-The Bank's equity participation in a single enterprise is limited to 10 percent of the Bank's paid-up share capital and free reserves or 25 percent of the share capital of the enterprise whichever is less.

-Where appropriate, DBZ joins with other financing institutions, local or foreign in financing projects. This is what is referred to as syndicate operations. Syndicate operations have an added advantage in that they spread risks over a number of financiers such that in the event of a failure of an enterprise, the loss accruing to the Bank would be minimal.

-The Bank's minimum financial assistance to a single project is K25,000 while the maximum is limited to 20 percent of the Bank's paid up share capital and free reserves.

### Financial Policy

-As an independent financial institution, DBZ should at all times manage its funds in such a way that it can honour its obligations. The Bank's profit margin must at all times be sufficient to cover the operating costs, build up provisions and reserves, and to remunerate its shareholders. Normally the Bank operates on an interest margin of 2 to 3 percent which compares favourably with international practices.

To ensure the accomplishment of the above objectives requires:

- (a) an adequate security for its loans. As pointed out earlier, these could be in the form of land, factory buildings, and plant and equipment, etc;
- (b) that either the borrower or the Government incur the foreign exchange risk in respect of funds borrowed on foreign currency by the Bank; and
- (c) providing against potential losses and building up reserves to a level consistent with sound financial practices, taking into account the size and quality of its portfolio of loans and investments as well as the need to pay dividends to shareholders.

-Whenever the Bank considers it necessary to increase capital resources for operations, it endeavours to raise funds at best possible terms locally and abroad. Thus interest rate questions are vital for the Bank. They determine whether and how the Bank can mobilise resources, the risks to which it exposes itself, and the level of administrative costs it can bear.

#### Relationship with clients

The following outlines the Bank's relationship with clients: -

-DBZ does not seek to obtain controlling interest in a project or enterprise. It generally avoids assuming management responsibilities in such projects or enterprises. It can only do so to safeguard its investment when they are in jeopardy.

-When deciding upon its investment, DBZ takes into account all financial requirements of the project or enterprise for the duration of its investment.

-In accordance with normal banking practice, DBZ requires its clients to provide and maintain adequate security, keep records and accounts in accordance with sound accounting practices, and to furnish whatever information deems desirable. DBZ reserves the right to inspect the enterprises and projects it finances.

-Business secrets and other information furnished by applicants or clients are treated as confidential by the Bank.

CHAPTER 5  
PROJECT APPRAISAL AND INVESTMENT ACTIVITIES

The task of appraising projects is the responsibility of the Projects Division of the Bank. This Division is subdivided into two Departments, namely, Agricultural Projects Department and Industrial Projects Department. Depending on the nature of the project, it may be assigned to either of the two Departments for appraisal.

The Bank appraises projects in order to decide whether to invest in an enterprise or not. The decision to finance a project is based on the facts, forecasts, and recommendations contained in the project appraisal report. This report describes the project, assesses its merits, and includes a number of assumptions on which judgements are based about the project's cost and benefits and the borrower's capacity to carry out the project efficiently and promptly.<sup>1/</sup>

Central to project appraisal is the drawing up of budgets indicating the result of project acceptance. Due to scarcity of resources, the Bank must inevitably make some decision as to where and when to make an investment. Any decision so made is only as good as the facts and forecasts on which it is based. Hence, the importance of careful appraisal need not be overemphasized.

Investment is one of the main sources of economic growth. It is required not only to increase the capital stock but also to enhance the production of goods and services. Before such investments are made, proper and careful appraisal must be undertaken. Normally, project appraisal aims at evaluating the value of the project to the national economy against appropriate standards. By so doing, it aims at scrutinizing all aspects of the project against some standards even before it is implemented. The nature and intensity of appraisal depends on the consistency and clarity of its presentation to the Bank. Project appraisal in the Development Bank of Zambia is based to a great

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1/ See Hugh B. Ripman, "Project Supervision" Finance and Development, Volume 10, No. 2, June 1973 p. 14



extent on use of standard formats and work sheets. It is argued that this helps the Bank gather the necessary information as regards a proposed project and its promoter(s).

Adequate appraisal takes time and money, but the delays and expense involved are obviously minor compared to the losses which can arise if unsound projects are approved.<sup>2/</sup> It is however of crucial importance that an appraisal body should be built up with a staff or experts who are well qualified to do most of the economic, financial, and engineering investigations and analyses required. The Bank has made considerable effort towards recruitment of qualified and experienced personnel. It should be noted that where there is no competent and complete basic staff, there is always a danger that that the emphasis of appraisal will be on the area(s) in which the staff is experienced, and that, the other equally important aspects of a project will be neglected.

This chapter is intended to assess some concepts on the art and science of assessing projects in the Development Bank of Zambia. It also reviews the investment activities of the Bank.

### Project Appraisal

Appraisal work in the Bank begins when an inquiry is made, or when a project opportunity is identified. The applicant (client) is given a loan application form to fill in. If the project is an industrial one, the client is required to provide the necessary information contained in the structural make-up of the DBZ loan application form attached in Appendix 1. Conversely,

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<sup>2/</sup> S.J. Mnamba, Project Appraisal - The case of Tanzania Investment Bank, Unpublished research paper, University of Dar-es-Salaam, 1980.

if the loan is for agricultural purposes, the client is required to provide the necessary information contained in Appendix 2.

After the loan application form has been duly filled-in, the projects officer who is assigned to the specific project, extracts information for the purpose of writing a project report. The application form is a preliminary inquiry. The project officer has to go in detail and conduct a research as regards that particular project. It is important to note that the outcome of a project appraisal is a function of the facts and forecasts on which it is based. This is what necessitates the need to verify the information provided by the client. However, it is important to note that this exercise takes time and money.

After verifying the information as regards a project, the Projects Officer then writes a project report. The format of this report is very important and emphasis is placed on consistency and clarity. The length of the report however varies according to the complexity and size of the case, but the points to be covered remain the same. The format of the project report follows below:

1. Introduction
2. Market analysis
3. Technical analysis
4. Raw materials and other supplies
5. Management and labour
6. Project cost and means of financing
7. Financial analysis
8. Economic analysis
9. Security analysis
10. Main features of proposed investment
11. Recommendations
12. Appendices

A detailed analysis of the major constituents of the project report is presented below:

1. Introduction

The introduction consists of two parts, viz, the description of the project, and the project company. The part on the description of the project covers the following issues: Location of project site, products to be manufactured, processes and raw materials, market, planned volume, planned dates for construction and commissioning. This part also covers the project's history and how it fits in with any existing operations.

The part on the details of the project company covers all the necessary information on the composition of the project company such as:

(a) Background information. This section outlines the necessary information on the applicant, such as applicant's name, address and information on the applicant's bankers and auditors. It also includes information on certificate of incorporation, and necessary licences. Examples of necessary licences are manufacturing licence, import licence and currency permits for purchase of investment goods and raw materials;

(b) Ownership and Directors. This section includes information on the following:

- (i) Authorized share capital and paid-up capital
- (ii) Details of different classes of shares and their respective voting powers.
- (iii) Names of Directors, their nationality, occupation, extent of participation in the share capital, their functions in the company and other enterprises
- (iv) Zambian and foreign participation

- (c) Management and Organisation. Information covered under this section include names of the executive officers, their position, nationality, detail of their educational and professional background;
- (d) Financial analysis. In those cases where the applicant is an operating company, a professional analysis is carried out on the company's past performance in respect of: Turnover, Net profit after tax, Fixed assets, current assets, share capital, Reserves and Loan capital.

## 2. Market analysis

It should be noted that in some cases, a project has failed because the market for the project output did not develop as anticipated. Such problems can however be minimised through a careful market analysis. The Development Bank of Zambia undertakes a market analysis of the project output in order to establish the commercial viability of the project. This analysis is done in three parts, viz, the product, demand and supply, and marketing.

The part on the product probes into the following details:

- (i) Description of the product i.e. whether consumer, intermediary, or capital goods; whether essential or discretionary;
- (ii) Current consumer pattern i.e. whether it is in line with the use of the product.
- (iii) Characteristic of the product i.e. seasonal or perishable.
- (iv) Competitive advantages of the project showing: relative availability and cost of labour; availability, cost and quality of raw materials etc.
- (v) Whether anticipated standards of the product are satisfactory etc.

The part on the demand and supply of the product, proceeds with an

estimation of the total future demand and the potential market for the project output. When estimating the demand and supply of the product, the bank requires information on the following: quantities and values of sales of the product to be manufactured and those of closely related substitutes for the past five years, determinants which explain the past trend such as, prices, income, population, and its characteristics; and government price controls, import restrictions and competing products and raw materials indicating whether or not what extent the sale of the products will be influenced by them. There are several methods of estimating future demand of the project output. The simplest and most common methods are:

(a) Survey method. This is essentially a field study. It is generally adopted where estimating short term demand is involved. Under this method, a survey is conducted to collect information about the future purchase plans of the potential consumers. This method has the advantage of getting to the original source of information. The survey method is ideal for estimating demand for new products and is widely used. However, it contains certain inherent limitations such as:

- (i) consumers themselves may not know their actual future demand and may be unable or unwilling to respond to query.
- (ii) consumers' response may be biased according to his own expectations about the market conditions, and
- (iii) their plans may change with the changes in factors not included in questionnaire.

(b) Projection of the trend. This is a statistical based method applied to time-series on sales. It is recommended only when an assumption can be made that the historical condition will continue to prevail in the future. This method is not ideal for estimating demand for a new product because there may not be historical data on which to base a reliable forecast.

(c) Utilization of technical coefficients. This method is suitable for forecasting future demand for intermediate consumption used in the production of final consumer goods. This method may be facilitated by the use of input and out/tables. This method is not widely used by DBZ in that most of the industries promoted by DBZ are engaged in the production of final consumer goods.

(d) International comparisons. International comparisons make it possible to situate the various countries on a general trend curve and to show the analyst the probable course of development given appropriate condition. This method is suitable for estimating future demand of export oriented products. It is not however used by DBZ in that nearly all of the industries promoted by DBZ are geared towards meeting local consumption.

DBZ may use any of these methods depending on the nature of the project output being examined. However, in general, DBZ adopts the survey method. Under this method, DBZ undertakes a field study of a particular area intended for the project output. This method also enables the bank get access to original source of information on which it bases its forecast of market demand.

It should also be pointed out that if the intended project output is presently being imported, then importers are asked to state the quantity they have been importing and how they envisage the growth of such imports. This also calls for an analysis of import statistics provided by the central statistics office on such a particular product. On the basis of such statistics future demand is extrapolated. Extrapolation means using observed data to estimate the value of any variable (i.e. demand) outside the limits of observed data. In terms of demand forecasting, this means using data for sales demand in the past to predict sales demand in the future. However, it makes the

assumption that conditions which have existed in the past will also exist in the future, so that past data provide a reliable basis for forecasting.

The part on marketing analyses the possibilities that the company will have to sell its products. It probes into a number of issues which include the following: project's share of total market, prospective buyers and their orders, transportation and storage of the product, programme for market resource and sales promotion and so on.

Market analysis is important particularly as regards sales estimates in that the financial analysis of the project depends on such estimates. An inadequate market analysis would hence yield a biased financial analysis.

DBZ has been successful with its market analyses since it has been promoting mostly import substitution enterprises. It has thus been possible to forecast realistic demand estimates. However, in some cases some of the projects financed by the Bank have faced <sup>unanticipated</sup>~~un-anticipated~~ competition from other local industries resulting in lower sales than anticipated.

### 3. Technical analysis

This analysis aims at determining the technical feasibility of the project. The services of an engineer are sought here. The engineering aspect is covered especially as it relates to management, labour requirements and the project cost. The technical analysis is presented under four broad headings namely, location, existing facilities, proposed development and implementation.

Issues that are looked into as regards location include the following:

- Community. The adequacy of public services such as fire, police, water, sewer, power, living conditions, housing, recreation etc are examined. Also, the economies and diseconomies of the existing industry are looked into.
- Labour. Under this category, all factors affecting the supply of labour are examined. These include the following: trend of population growth in community and surrounding area, labour skills and potential, and wages paid in comparison to similar communities.
- Markets. The distance and transport possibilities to principal raw materials and sale markets is examined.
- Justification for selecting the site in preference to other sites which were considered.
- Transportation Services such as rail freight services, sidings etc; truck and bus facilities and air and water transportation are examined.
- Others include power services and service rates.

Under the section on existing facility, a description is produced on the applicant's physical premises to which the project is planned to be connected. The basic data required include the following:

- (a) Location, availability of services
- (b) Details of existing land, buildings and machinery as regard the following
  - (i) Ownership of the property;
  - (ii) Size, layout and condition of buildings;



(iii) Condition and capacity of plant and equipment, technology used etc.

(c) Flexibility of the project with regard to the project.

The section on proposed development probes into the sufficiency and adequacy of buildings, machinery, transport facilities, and factory services. It also looks into the plant layout and construction.

Lastly, the section on the implementation of the project, provides a time table which is analysed in order to verify that:

- (i) all activities are included
- (ii) activities are in the right sequence
- (iii) adequate time is given to different activities; and
- (iv) the plan is realistic and attainable without waste of time.

The importance of this analysis is evident in that insufficient planning may cause considerable delays in implementation and commissioning resulting in loss of profits.

In recognition of the fact that projects must not only be sanctioned but implemented with minimum delay and efficiently operated to achieve the desired objectives, the Bank has intensified its supervision work. For instance, a total of 73 follow-up visits to 51 projects was undertaken during the 1979/80 financial year, compared with 43 visits to 30 projects and 22 visits to 21 projects, in the 1977/78 and 1978/79 financial years respectively. During the 1980/81 financial year, the Bank increased its supervision activities considerably in line with growing business volume, and a manual on supervision procedures

was introduced to facilitate the work. More emphasis was laid on projects that showed weaknesses in their implementation or operations.

Through its project supervision work, the Bank is not only trying to safeguard its own investments but also to convince entrepreneurs that their investments need thorough monitoring during the project cycle, from project planning through the implementation and operation stage to the full repayment of the loan. The efforts are aimed at making the projects a success for the entrepreneur and the economy as a whole. However, the Bank does occasionally encounter problems in securing information necessary for careful planning and supervision.

4. Raw material and other supplies. This section analyses the main issues affecting the supply of raw materials and other vital materials for the project. The basic data required for this analysis include the following:

- (a) Quantity specifications, sources and availability of raw materials and semi-finished goods
- (b) If semi-processed products are proposed to be obtained from another unit, the technical and economic soundness of that unit
- (c) Estimated costs, including freight and insurance, custom duties, excise etc
- (d) Assurance for uninterrupted flow of vital materials supported by detail of firm arrangements made or proposed to be made with the suppliers.

This analysis is undertaken in order to verify whether sources are reliable for a smooth production process. Although the Bank undertakes this analysis since 1976, some of its customers have faced operational problems due to limited foreign exchange allocations being made to them for the importation of raw materials and spare parts. This has meant that most of the projects

could not obtain adequate raw materials and spare parts to sustain profitable operations.

In these circumstances, the Bank should emphasize on financing projects which are not oriented towards importations of not only the raw materials but other supplies as well.

#### 5. Management and Labour

The management aspect is concerned with the adequacy of management and staffing at all levels of the company. The proposed organisation is analysed to make sure that the internal structure can function reasonably efficient for decision-making purposes and information flows.

The labour aspect of it looks at issues affecting labour such as qualification and experience, availability of staff locally and abroad, condition of service taking into consideration legislations affecting labour in Zambia, total projected annual costs of labour, workers participation etc.

Technical agreements are also looked into. The Bank satisfies itself that management contracts exist with reputable, experienced operating firms. The issues that are considered in here include the following: the period of agreement, general conditions including clause for termination of agreement, cost, and responsibility for training local staff. These issues are scrutinized in view of the inadequacy of managerial acumen in the country.

Little and Mirrlees (1968) made a general observation that the question of management and skill is a more frequent cause for disappointment in developing countries. They write:

One should distinguish four different ways in which over-optimistic assumptions about the quality of management and the skill of the labour force affect the predicted figures for inputs and outputs. Firstly, the period of construction is underestimated. Despite exceptions, it has been the rule in developing countries that projects take longer to complete than allowed for in the project report.--- Secondly, the period, between when a plant is finished and when the new management team and labour force are sufficiently skilled to be able to operate it at its rated capacity, has usually been underestimated.--- Thirdly, of course, it is always possible that the rated capacity is never attained, despite their being no reason for this, either from a technical point of view, or because of insufficient demand or insufficient supply of materials. Fourthly, although the rated capacity is attained, it may be attained only with the use of more inputs, especially labour, than was allowed for. The excess use of labour is extremely common, and it is not always the force of the management itself. It is often forced upon the management for political reasons, or because labour laws make it virtually impossible to sack anyone. (Kittle and Mirrlees (1968) p. 17)

Most of the observations made by Little and Mirrlees above, are similar to those affecting DBZ sponsored projects. However, in most cases, the management problems faced by the assisted projects have been compounded by the difficult economic conditions prevailing in the country. As pointed out earlier, the limited foreign exchange allocations, for instance, meant that many projects could not obtain adequate raw materials and spare parts to sustain profitable operations. Needless to say, the Zambian labour laws make it extremely difficult to declare workers redundant. One case in point happened on the 9th of July, 1982, when a Haulage firm - Contract Haulage declared 256 workers redundant in a move to streamline its operations. Despite the fact that the company had even paid out all the terminal benefits due to all the affected workers, on the 12th of July, 1982, the Government instructed the management of the company to re-instate all the workers without delay.

#### 6. Project Cost and Means of financing

The project cost is divided between local and foreign components. This is further broken into the following categories: Site Development costs, Building construction costs, Machinery and Equipment, shop tools and service equipment, office furniture and fittings, other items of fixed investment

nature, and working capital (see Appendix 1 for details).

Working capital refers to a firm's investment in short-term assets - cash, short-term securities, accounts receivable, and inventories. In project analysis, working capital is determined on net basis i.e current assets minus accounts payable which represent the amount to be financed by long-term finance.

Technically, the level of working capital is determined by using the sales volume as an indicator, in which case working capital is assumed to vary proportionately with the sales volume. However, such an analysis may lead the firm into serious liquidity problems, and hence the need to determine each item of working capital separately. The major determinant apart from sales volume are the nature of the production process, average credit period available from the suppliers and the average period of accounts receivable.

The means of financing can be divided into the following categories:

(a) Equity participation. This may be provided in the form of cash or in kind. This contribution has to come from outside sources whether it be cash or various assets.

(b) Loan capital. This refers <sup>to</sup> long term finance. This is usually used to finance fixed investment including permanent working capital.

(c) Internal accumulation of finance. This is usually relevant only for expansion projects. The internal sources may be the operating income or the sales revenue of some extraordinary assets.

## 7. Financial analysis

This is an area whereby the Bank reviews the financial aspects of the project to be financed by means of financial data. The financial analyst makes use of any relevant information sources in excess to the data provided by the promoter. The following sources of information are usually available:

- Reference to similar projects previously carried out by enterprises in the same industry.
- Supplier information may be used to obtain latest prices of equipment, raw materials, components and consumables. The given price is ex-factory to which must be added the various expenses like transport, handling, insurances, taxes and duties, with a possible profit margin of the promoter before a relevant price of the item is reached. As a rule, DBZ requires at least two quotations on machinery and raw materials.
- Published tariffs, Surveys, and Official regulations. Some costs are laid down in official regulations or public tariffs e.g. water and electricity rates, minimum wages and salaries of the labour force, etc.
- Technical experts may provide useful information on estimating prices which depend on the characteristic of materials and equipment.

Financial analysis in DBZ is done in two parts. The first part is based on past performance and the other on financial projections.

Past performance. In cases where the applicant is an operating company, the Bank requires a detailed analysis covering normally the past 3 to 4 years and this is based on such materials as audited balance sheet, quantities and

value of production, Quantities of raw materials, Sales etc. The analysis of past performance is thus based on historical accounting. Once the Bank has the required data, it computes some ratios which are assumed to be indicators of past performance. The main ratios that are used are: (a) Profit Margin, (b) Annual Return on capital, (c) Debt to Equity Ratio, and (d) Current Ratio. A detailed analysis on these ratios is deferred to the discussion on financial projections.

Financial projections. This is when the project's future is analysed by means of financial data. When making these projections, the projects officer has to take into consideration the period of projection which will be analysed in detail. Usually, it is not necessary to continue a detailed projection longer than to a point of time when the full capacity is reached. This is because the success or failure of a business depends heavily on the operations during the first few years which need to be considered carefully. After that period, an assumption of constant annual income and expenses can be applied to the said profitability calculations without sacrificing the accuracy of the forecast. It should however be noted that the length of the detailed projection period depends on the nature of the project. For instance, for a small or medium sized project, a detailed projection of five years is enough. On the other hand, large scale projects may require that the first ten or fifteen years will have to be investigated.

After deciding on the period of projection, the projects officer would then prepare the following: (A) Projected Profit and Loss Statements, (B) Projected cash flow statements, and (C) Projected Balance Sheet.

(A) Projected Profit and Loss Statement

In financial management, this is also known as a proforma income statement.

In this statement, the sales income and volume with operating costs is projected annually over a period up to the planned capacity utilization and extended as necessary for financial and economic analyses. This analysis is based upon detailed estimates of costs which are basically assumed to be of two types viz. variable and fixed.

Variable costs. These are defined as costs that vary in total in direct proportion to volume. The variable cost per unit, is however assumed to remain constant. The following are the basic data required for the analysis of variable costs:

- Consumption of raw materials, average unit prices including carriage and calculations of possible wastage.
- Consumption of supplies and components, average unit prices including costs and possible wastage.
- Consumption of utilities (power, water etc)
- Direct labour costs
- Royalties, calculated on the basis of manufactured or invoiced quantities
- Commissions, calculated on the basis of the value of invoiced quantities
- Other variable costs.

Fixed Costs. These are costs that do not vary with changes in volume. On a per unit basis, they change inversely with changes in volume. The main types of fixed costs are:

- Administrative overheads
- Insurances, rent, rates etc.
- Salaries including social benefits
- Capital charges, i.e. depreciation of fixed assets and interest on loan capital.



It is also important to mention that income tax computations are determined separately by taking into account all allowances for which the company is entitled. The present tax rate is 45% on chargeable income. However, rural based projects are charged at the rate of 35%. This is done in order to stimulate investments in rural areas.

After the basic projections have been carried out, the profitability of the project is then determined by (a) applying discounted cash flow methods and (b) calculating profitability indicators on annual basis.

(a) Discounted Cash flow methods.<sup>3/</sup> Generally, four types of discounted cash flow methods could be considered in project appraisal and these are: (i) the Net present value (NPV) method, (ii) the Internal Rate of Return (IRR) method, (iii) the Annuity method, and (iv) the Benefit-cost Ratio.

(i) The Net Present Value method involves calculating the present value of a project's cash flows, both positive (receipts) and negative (outlays). A project has a positive net present value if the present value of its cash inflows exceeds that of its outflows. This can be written in a general form,

$$NPV = \sum_{i=1}^{i=\infty} \frac{S_i}{(1+r)^i} - I_0,$$

where  $S_i$  represents net cash inflows in each year from 1 to  $\infty$  and  $I_0$  the investment outlay assumed to be made at the project's start. It is assumed that the project will have an infinite life; thus the cash flows are assumed from  $i = 1$  to  $i = \infty$ .

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3/ For a comprehensive analysis, see Michael Bromwich, The Economics of capital Budgeting (pitman 1979)

- (ii) Internal Rate of Return. Under this method, we seek to find the rate of interest which equates the discounted value of a project's cash flows to the discounted value of its necessary investment outlay. That is we could find the rate  $r$ , in the equation.

$$\sum_{n=0}^{\infty} \frac{I_n}{(1+r)^n} = \sum_{n=0}^{\infty} \frac{D_n}{(1+r)^n}$$

The left-hand side of this equation represents the discounted value of the investment outlays for the project made at any time from the beginning year 1 until infinity. Similarly, the right hand side stands for the discounted value of the project's inflows over the same period. The rate of interest which equates the two sides of the expression is represented by  $r$  and is called the project's internal rate of return. This is the maximum rate of interest which the firm could afford to pay if the project were to be financed by borrowed funds and the project's cash flows as they appeared were used to repay the loan and interest. The internal rate of return is however calculated by a method of trial and error.

- (iii) Annuity Method. Under this method, annual net cash flows from a project can be treated as being constant over time and involves computing the annuity which, if received over the project's life, would have a present value equivalent to the project's investment outlay. Any opportunity having net cash flows greater than this annuity would be accepted.

- (iv) Benefit-Cost Ratio. This method involves dividing a project's discounted net cash inflows by the present value of its investment

outlay, thus obtaining a discounted Benefit-Cost Ratio. All project's having a ratio greater than or equal to 1 would be accepted.

All these methods have their own advantages and limitations, but it is not the purpose of this paper to discuss them.

Of the different discounted methods, the internal rate of return is calculated for the DBZ's projects. The major advantages of this method like those of the NPV is first, that it can be used for ranking different investments in terms of commercial profitability, second, it takes into account all earnings over the expected life of the project and third, that the time value of money is observed i.e. early earnings are worth more than late earnings.

The resultant rate of return (internal rate of return) is called Financial Rate of Return to distinguish it from the Economic Rate of Return. The major difference lies in the fact that units and output are valued differently under the Financial Rate of Return (FRR) and Economic Rate of Return (ERR). The FRR only take into account benefits accruing to the firm. Hence market values for inputs and outputs are used. On the other hand, the ERR takes into account the benefits accruing to the nation as a whole. Under this analysis, the valuation of the rate of return goes further to include shadow prices of inputs and outputs. This will become clear when discussing the Economic Analysis of the Project.

(b) Profitability Indicators. The profitability indicators that are calculated are (i) the Gross Profit Margin, (ii) Profit Margin, (iii) Annual Return on Capital, and (iv) Annual Return on Equity.

(i) Gross Profit Margin. The Gross profit margin is calculated by dividing the Gross Profit by sales and is given by the formula:

Sales - Cost of Goods sold x 100

Net Sales

= Gross Profit x 100

Net Sales

NB. Gross Profit = Sales minus cost of goods sold

Net sales = Gross sales minus sales tax, Discounts  
and Returns.

This ratio reflect the efficiency with which management produces each unit of product.

(ii) Profit Margin. This ratio is commonly referred to as the Net Profit Margin. It is measured by dividing net profit after tax by sales.

Net profit Margin = Net profit after taxes x 100  
Sales

This ratio establishes a relationship between net profit and sales, and indicates management's efficiency in manufacturing, administering, and selling the product. The ratio is the overall measure of the firm's ability to turn each Kwacha of sales into net profit. A high Gross Profit Margin or Profit margin would indicate the advantageous position of the project in the face of falling sales prices, rising cost of production, or declining demand for the product.

(iii) Annual Return on Capital is calculated by dividing the net profit plus interest expenses by the capital employed, and is given by the formula.

Net profit after taxes + Interest

Capital Employed

NB. Capital Employed = Net worth plus total liabilities.

This ratio indicates how well management has used the funds supplied by creditors and owners. The higher the ratio, the more efficient the firm is using funds entrusted to it. Generally, the Bank requires that the return should be above the cost of capital.

(iv) Return on Equity. This is calculated by dividing net profit after taxes by net worth:

$$\frac{\text{Net Profit} \times 100}{\text{Net worth}}$$

NB. Net worth (owner's equity) = Share capital plus Reserves and Retained earnings.

The purpose of calculating the return on equity is to determine the return to the owners of the business after all taxes and interest have been paid. However, a company may inflate the return on equity by using a heavy amount of debt. The Bank maintains a check on this by requesting the Applicant to have a Debt to Equity Ratio not exceeding the ratio of 3:1.

Having determined the profitability of the project, the project officer proceeds to undertake the sensitivity analysis of the project.

Sensitivity Analysis. It is advisable to undertake the sensitivity analysis when the sector is strictly price controlled. It is thus necessary to find out the minimum controlled price to keep the enterprise in operation. Basically, sensitivity analysis employs the method of determining the Break Even Point (BEP) of the project. This is given by the formula:

$$\text{B.E.P} = \frac{\text{Fixed Expenses}}{\text{Gross Profit Margin (\%)}} \times 100$$

What the Bank does in this case is to determine the effect of a rise in the price of its inputs (especially raw materials) on the project's earnings. The change in prices will be reflected in the change in gross profit margin and subsequently on the Break Even Point. In order to verify this, the Bank usually selects a few of the sensitive raw materials and analyses the effect they would bring to the venture's projected earnings. The selected raw materials are intentionally increased by a certain percentage. Then the effect of this rise in prices is then reworked up to the after tax rate of return point. When the market is also a problem, a minimum sales volume would be determined at which the financial viability of the project is still maintained. Should the financial (after tax) rate of return be above the rate at which the capital is borrowed, the Bank assumes that its loan is well secured.

(B) Projected Cash flow statements.

These statements not only show the amount of financing but the timing as well i.e. determine the availability of funds to construct the project on schedule and thereafter to run the company without interruptions. The analytical tools used to verify these requirements are (i) the cash flow analysis and (ii) Debt service coverage ratio.

- (i) Cash flow analysis. The Bank's main concern is virtually to know when the project will need money and where it will come from. This will show whether the financial planning has been sound or not. In the cash flow analysis, the major sources and uses of cash are shown separately.

Major sources:

- (a) funds from operation is the largest source and the one primarily responsible for providing funds for the payment of the loan. Given the net profit, funds from operations could be found by adding back depreciation.
- (b) Increase in paid-up capital
- (c) Longterm borrowing
- (d) Increase in Bank overdraft
- (e) Others i.e. sale of fixed assets etc.

Major uses:

- (a) Capital expenditure i.e. purchase and replacement of fixed assets
- (b) Reduction in Long-term loan
- (c) Decrease in Bank overdraft
- (d) Other.

(ii) Debt Service coverage ratio. This is a measure of a project's ability to pay the interest due on its long term debt and to repay the instalment principal itself as instalments come due. It is also known as cash flow coverage ratio and is given by the formula.

Net profit + Interest on L.T. Debt + Depreciation

Interest on L.T. Debt + Principal Repayment of L.T. Debts

This coverage is usually calculated for each year for which financial forecasts are prepared, as the amounts vary from year to year. If the ratio is above 1, this would be indicative of the project's ability to pay interest and the

principal amount. However, a higher ratio is desirable to provide a 'cushion' i.e. safety margin.

(C) Projected Balance Sheets (Proforma Balance Sheet):

The Balance sheet presentation in project analysis is based on the system generally utilized in the European continental countries and in America. This usually involves presenting the balance sheet in a report form (vertical presentation). The Balance sheet is designed to show the liabilities and assets of a project company at a specific time.

When estimating the future financial position of the company, the only information needed is first, the starting balance sheet and then the cash flow analysis and the projected profit and loss statements, which cover comprehensively the time period between two successive balance sheets. It should be noted that the balance sheet is technically assumed to be correct when the total assets equal total liabilities. The following items need attention when preparing the balance sheet:

Asset Side:

- (a) Different categories of assets are usually expressed on cost unit basis with an exception of fixed assets, which are shown on net value basis.
- (b) Preliminary expenses as they are estimated as a part of the project costs are shown on the asset side. These can not be deducted from the first year's profit, but are amortized over several successive accounting periods.
- (c) Accumulated surplus of finance as estimated on cash flow statement



is shown as a part of cash on hand. The total cash balance at the end equal to cash on hand in the beginning plus the cash surplus (deficit) during the year.

Liability side:

- (a) Current liabilities include current maturities of long-term debts, proposed dividend and short-term debts and others.
- (b) Net worth comprises of the share capital, reserves and the net profit (loss) for the year after deducting dividends.
- (c) Accumulated deficit of cash as estimated on projected cash flow statement is shown as part of liabilities. This represents the funds that need to be covered before the project is financially viable.

The indicators used on the balance sheet projections are the Debt to Equity Ratio and Current Ratio.

The Debt to Equity ratio has already been covered above.

The Current Ratio measures the ability of the company to meet its short-term obligations. However, the drawback with the Current ratio is that it does not take into account the revolving nature of current assets. It is thus not a very good measure of liquidity. This is what has led to many analysts advocating the use of such ratios as absolute liquidity ratio and Acid-test ratio (Quick ratio). Generally, the current ratio should be higher than 1:1, but it varies according to industry and nature of business.

An important ingredient of financial analysis especially as it relates to financial projections, should involve all aspects of the analyses described.

above. This is because the analyses covered above, say, (A), or (B) or (C) are not complete in themselves. They are meant to complement each other. For example, the analyses covered under (A) and (B) relate to the financial viability of the project and sufficiency of funds respectively, while (C) deals with the estimation of the financial position of the company while in operation.

DBZ undertakes comprehensive financial analyses of projects that it finances. In its investment policies, DBZ demands that a project that it finances, should be financially viable for undoubtedly, without this, DBZ itself would not remain a going concern. The financial viability of a project, can only be determined through the financial analysis described above.

#### 8. Economic analysis

Economic analysis seeks to evaluate the benefits of a project to the national economy. This is contrasted from financial analysis, which evaluates the benefits of a project from the firm's point of view. Thus economic analysis goes further than financial analysis to show how the project fits in the national economic setting. In this connection, the relevance of the project is evaluated in respect of the following broad areas: (a) project's priority in the development planning, (b) project's efficiency, and (c) economic profitability.

(a) Project's priority seeks to evaluate among other things, the extent to which the project is in line with priorities spelt out for economic development in the National Development Plans. The relative emphasis placed on this particular project is also evaluated. In its operations, though DBZ is an autonomous institution, it strictly adheres to the policies of the Party and its Government.

(b) The Project's efficiency: In economic sense, it is evaluated in terms of the project's contribution to the following: (i) economic growth, (ii) foreign exchange benefits, (iii) job creation, and (iv) linkage effects.

(i) Contribution to economic growth. The project's contribution is measured by the value added of its production. Emphasis is usually placed on the local value added. The local value added is the total amount of locally produced inputs that go into the manufacturing of the final product. In terms of costs, these are the cost of production excluding the cost of imported inputs. A higher local value added would be indicative of the project's effect not only on the national growth but also on other sectors of the economy.

(ii) Foreign exchange benefits. The importance of foreign exchange need not be overemphasized in the economic settings of most developing countries. The foreign exchange benefit is estimated by dividing the domestic costs by the net foreign exchange saving/earning of the project. The resultant ratio which is also known as the Bruno Ratio, indicates the domestic costs incurred for saving/earning one unit of foreign exchange. The value of the net foreign exchange saving/earning is determined by taking the value of the production domestically sold at import C.I.F price plus exports value added at f.o.b prices minus all foreign exchange items comprising:

- (a) Current cost of foreign inputs at c.i.f prices
- (b) Cost of imported labour
- (c) Dividends and management fees remitted abroad
- (d) Interest cost on foreign exchange finance, and
- (e) Depreciation on foreign exchange investment cost.

The cut-off rate is the shadow exchange rate, which represents the extent to which the domestic prices exceed the respective border prices. As a DBZ's thumb/<sup>rule</sup> all projects with a ratio equal to or lower than the cut-off exchange rate should be considered.

(iii) Employment effect. The impact of a project on job creation is also evaluated. This is not only evaluated in terms of new employment but also on the basis of the cost of the job creation. The cost of the job creation, which is also known as capital intensity, is calculated by dividing the cost of the project by the number of additional jobs. The resulting figure is then compared with that of the industry. If the cost of job creation turns out to be relatively high, alternative production techniques may have to be investigated. As a rule, DBZ demands that any project with K25,000 per job be unacceptable for investment in view of the high figure of unemployment in the country. However, this requirement has been honoured more in the breach than in the practice. For instance, a United Nations Industrial Development Organisation (UNIDO) study, noted that by 1979, the average cost of job creation for projects financed by the Bank was K33,354.<sup>4/</sup> It is of importance to note that even the minimum cost of K25,000 per job required by DBZ, is quite high owing to the lack of capital for investment and the high figure of the unemployed in the country. This is what points to the need for small scale industries in which the cost of providing for one job would be far much less than the minimum standard required by the Bank.

However, suffice it to say that lower cost of job creation need not imply reducing overall economic efficiency i.e. lower output relative to the combined capital and labour. Thus labour intensive alternatives need not be

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4/ United Nations Industrial Development Organization, Republic of Zambia  
Report on Small-Scale Industry, Report No. 12/Rev. 1, New York, May 1981.

invariably preferred. Quality standards, economies of scale and management or skilled labour requirements may sometimes tilt the balance toward more capital intensive options.<sup>5/</sup> In the case of DBZ the exceptional rise in average investment per job, is accounted for by the Bank's involvement in larger projects of a strategic nature which are in the main, highly capital intensive as well as by inflationary pressures. Notwithstanding this fact, the Bank must aim at stimulating new job creation at much lower average capital cost, both in manufacturing and other sectors.

(iv) Linkage effect. The project's impact on other sectors of the economy can be seen through its forward and/or backward linkages. Forward linkages may be defined as the total output that does not go to final demand but rather to other industries, and backward linkage may be defined as the proportion of the output that represents purchases from other industries. Linkages effects could best be determined by the use of input-output tables. This table would help indicate how well a particular project could fit in a given economic setting through the use of its technical coefficients. A quick look at the descriptions of the projects financed by the Bank reveals that since its inception, the Bank has been financing projects which are mostly fostering backward linkages in the economy. Examples of backward linkages are mostly found in agro-industries such as meat processing, dairies, grain-mills, bakeries etc which utilize and process agricultural products.

(c) Economic profitability of a project is determined by calculating the Economic Rate of Return (ERR). In the case of DBZ, this rate is calculated

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5/ World Bank, Employment and Development of small Enterprises, Sector Policy Paper, February 1978, p. 16.

only for investments by the Bank of more than K200,000. This is determined by using the discounted cash flow method. The procedure for computing the ERR is similar to that of the Financial Rate of Return (FRR) discussed above under financial analysis. The difference lies in the fact that the FRR is concerned with the evaluation of that part of surplus income which goes to the capital owners. It thus bases its analysis on the actual market prices of inputs and outputs. The ERR on the other hand does not pay attention as to who will finally receive the income over and above the cost of labour and other inputs.

When calculating the ERR, all taxes and subsidies are ignored, they, being merely transfer payments. Thus under the ERR, the Financing pattern is from the Economy's view point. If the ERR is equal to or above 10%, the bank accepts the project. This cut-off rate implies that the project meets the minimum economic standards. Thus, if the economic rate of return is above 10 percent, there would be a strong presumption that the project would meet minimum standards of economic attractiveness. In other words, it serves as a signal to management even early in the project cycle that an economically sound project is likely to emerge. The whole idea of economic analysis is to avoid committing resources to projects when there are better opportunities available. From the Development Bank's point of view, there may not be any alternative use for its funds at the time a decision must be made. But from the point of view of the economy as a whole, there will normally be alternatives for the employment of funds, even if the alternative is nothing better than holding reserves.<sup>6/</sup>

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6/ Central Projects staff, Development Finance Companies Department, Guidelines for calculation of Economic Rates of Return on DFC Sub-Projects, June 7, 1974 (mimeo).

It should be noted that there could be certain cases when the Development Bank would undertake financing a project whose economic rate of return is below 10 percent. In such cases, the bank must satisfy itself that there are special justifications which outweigh the quantitative assessment provided by the economic rate of return. Such special justification may consist of contributions made by the project to national objectives such as aiding development of backward regions, creation of employment etc. In some cases, these qualitative factors are relevant in assessing the overall attractiveness of a project. Hence, the computed economic rate of return serves as a basis for financing projects that contribute to the economic development of the country.

For decision making purposes, it should be borne in mind that it is not always that the Economic Rate of Return and Financial Rate of Return of a project are in harmony. There are certain cases when these analyses give conflicting results. The question then is what should be done in such cases? Bhatt (1977) writes:

If a project satisfies the economic criteria but is not financially sound, the top management has a good specific case to induce the government to modify its tax-subsidy policies so as to make the project financially sound. If it is financially sound, but does not meet both the economic criteria, it needs to be examined further or even rejected. If it is financially sound and also meets the criterion related to the economic rate of return, but does not satisfy the efficiency test, there is a good case for finding out the reasons why it does not meet this test. If on examination, it is found that this test is not met as the cost of a domestic input is higher than its import c.i.f price, the top management has a good specific suggestion to make to the government with regard to the relaxation of import control on this input. (Bhatt (1977), P. 650)

It is implied from the foregoing that there is a need to harmonize the economic and financial criteria of selecting a project. In other words, the project should be both economically viable and financially sound.

## 9. Security analysis

This involves analysis of the proposed value and nature of securities. DBZ grants loans which must be adequately secured by the estimated value of security offered. Security offered may be in the form of fixed assets such as land, buildings, machinery and equipment. DBZ demands that assets pledged to the Bank be noted in the policy. Guarantees from commercial banks are also accepted as security.

As a yardstick, the Security margin is calculated. This is a percentage loan by which the total value of the securities is higher than the DBZ/in question. This is computed as follows:

### Case 1. Where DBZ is the only lender:

$$\begin{array}{rcl} \text{Total assets available} & & \text{Loan amount secured} \\ = \text{as security for loans} & - & \text{against the assets} \\ \hline & & \text{Total assets available as security for loan} \end{array}$$

### Case 2. Where DBZ co-finances with other lenders

$$\begin{array}{rcl} \text{Total assets available as} & & \text{Loans secured against} \\ = \text{security for loans} & - & \text{those assets} \\ \hline & & \text{Total assets available as security for loans} \end{array}$$

For a project to be eligible for Bank's finance, DBZ demands that the security margin be not less than 25%. Besides this requirement, the Bank requires that the Debt to Equity ratio should not exceed the ratio 3:1. This requirement is reinforced by the fact that a high ratio is unfavourable from the firm's point of view. In a way, this introduces inflexibility in the firm's operations due to outside pressure i.e. from creditors



### Investment Activities

During the seven years of operations (1974-1981), the Bank approved a total of 233 loans valued at K105,343,000. The bulk of these loans were sanctioned to new enterprises and expansion of existing ones. In addition to these loans, the Bank also approved a relatively small number of loans for modernisation and rationalisation of existing enterprises, and financing the takeover of some enterprises especially by Zambian entrepreneurs.

However, after taking into account the cancellations and redemption of loans, the number of loans stood at 186 and were valued at K89,764,000 as at 31st March, 1981. This represents a cancellation of 47 loans during the period under review. Basically though such loans were earlier approved by the Bank, they may not have met the requirements of the Bank by way of implementing the projects.

An industry-wise analysis of the distribution of loans shows that the bulk of loans in terms of value went to the manufacturing sector, while in terms of numbers, there was a minimal difference between the manufacturing sector and agricultural sector. (See table V(1) for details. This divergence is attributed to the considerable variation in sectorial project requirements. The Bank observed that though the average loan amount per project stood at K577,000 at 31st March, 1981, averages in individual sectors differed considerably, ranging from K930,000 in manufacturing and K355,000 in transport to K208,000 in agriculture.

It is also interesting to note that the bulk of the loans financed by the Bank have been concentrated mainly in four provinces (Central, Copperbelt, Lusaka and Southern), which are traditionally referred to as the line of rail.

Taking the period between 1974 and 1979 as a case in point, the four provinces together accounted for 81% and 79% of total projects in terms of numbers and value respectively, (See Table V. (2). This shows that the urban-rural gap would not improve as long as the Bank continued to apply the normal lending terms.

The Bank however endeavours to improve the situation with the creation of a Special Fund for Rural Development which became operational in 1976. This fund gives loans to projects in Rural areas on concessionary rates varying between 3 and 6 percent. Currently, this fund comprises of grants from the Norwegian Development Agency and an interest free loan from the Canadian International Development Agency. These funds are administered on such terms as required by the Donor countries. Furthermore, during the 1980/81 financial year, the Bank initiated a change in the DBZ Act to lower the minimum lending amount of K25,000 and started to explore concessionary sources of finance. It is hoped that once this change is approved, the Bank will go a long way in promoting small scale enterprises.

TABLE V (1) LOANS/EQUITY SANCTIONED BY SECTORS

Industry	Number of Loans/Equity				Amount of Loans/Equity			
	1974/79		1974/81		1974/79		1974/81	
	No.	%	No.	%	K'000	%	K'000	%
Agriculture, Agro-Industry, Forestry	51	52	71	38	10,840	28	14,367	16
Manufacturing	33	34	86	46	18,313	47	62,387	69
Mining and Quarrying	5	5	7	4	4,377	11	3,052	3
Tourism	5	5	7	4	1,580	4	2,347	3
Distribution	2	2	2	1	2,500	7	2,500	3
Haulage	2	2	13	7	1,169	3	5,111	6
	98	100	186	100	38,779	100	89,764	100

SOURCE: DBZ Annual Reports for 1979 and 1981

TABLE V(2) LOAN/EQUITY SANCTIONED BY PROVINCES

Province	Number of Loans/Equity for 1974/79 (1)			
	No.	%	K'000	%
Copperbelt	21	22	9,820	25
Central	10	10	3,601	9
Eastern	8	8	3,846	10
North-Western	1	1	187	1
Luapula	2	2	1,519	3
Lusaka	31	32	10,519	28
Northern	4	4	638	2
Southern	17	17	6,720	17
Western	2	2	329	1
-	<u>2<sup>(2)</sup></u>	<u>2</u>	<u>1,600</u>	<u>4</u>
	<u>98</u>	<u>100</u>	<u>38,779</u>	<u>100</u>

SOURCE: DBZ Annual Report for 1979

Notes: (1) Figures for 1974/81 are not given

(2) These loans relate to two projects carried out in five provinces.

### Summary and evaluation

In this chapter, it has been shown that the Bank has developed project appraisal techniques of international accepted standards. However, the choice criteria of selecting projects is tailored to the needs and requirements of the country. In its appraisal work, the Bank places emphasis on adequate scrutiny and appraisal of all aspects of the project such as the managerial, technical, financial, commercial and economic aspects. This task takes time and money but the delays and expense involved are obviously minor compared to the losses which can arise if unsound projects are approved.

From this analysis, it follows that the nature of project appraisal work within the Bank does not agree with the school of thought that says: what matters for development is simply more investment, the kind of investment being of little importance. Rather, emphasis is placed on the soundness of the project, viz, the project should be technically, financially and economically viable. It is also important to mention that the success of the project, not only depends on the determination of the promoter but on their ability as well. In a way, project appraisal among other things evaluates this ability.

Since its establishment, the Bank has made an impact on the economic development of the country, through its appraisal methods and provision of medium and long term finance to enterprises that it finances. In its operations, the bank has been able to mobilize resources from both local and foreign sources, and, promote and finance viable industrial projects in addition to appraising their technical, economic and commercial viability. The bulk of the loans sanctioned by the bank have mostly been for new projects and expanding ones. Most of these loans have been extended to agro-based industries which are part of a priority sector of the economy viz, agriculture. However, suffice it to say, the bank has failed to make an impact on the rural sector of the economy, due its concentration of most of its loans to five of the nine provinces of the country, viz, central, copperbelt, Eastern, Lusaka and Southern which for instance, together accounted for 89 percent of the bank's loans in 1979. The bank however endeavours to improve the situation with the creation of a Special Fund for rural development which became operational in 1976. This fund provides loans to projects in rural areas on concessionary rates varying between 3 and 6 percent.

CONCLUSION AND RECOMMENDATIONSCONCLUSION

Since its inception, DBZ has made a significant contribution to the economic development of the country through the provision of medium-term and long-term finance to both private and parastatal enterprises for development purposes. However, the Bank's effort towards narrowing the urban-rural gap will not materialise for as long as it continues to apply the normal lending terms to rural sectors. The Bank has failed to make an impact on the rural sector of the economy due to the terms of its lending policies inherent in its Act of incorporation. The Bank has thus continued lending to financially big business, to the neglect of small scale enterprises which are not yet covered by the Act. This finding is supported by that of Chirwa and Chimwayinga (1981). Undoubtedly, the Bank maintains that lending to small scale industries would be expensive due to the fact that the amount of time and money involved in project appraisal would be the same as that of big businesses. However, with proper assistance from the Government i.e. in form of subsidies, the Bank would be able to assist small scale enterprises.

Financially, the Bank has done well during the period under review. In addition to its equity, the Bank has been able to mobilise funds (resources) from both domestic and foreign sources. Thus its financial decisions will continue to be influenced by its cost of mobilising such funds i.e. through interest rates and principal payable to service such loans. It is also important to note that the continued dependency on foreign resources poses a great danger to the nation due to risks inherent in them in the event of failure to service the loan. In these circumstances, the Bank would do well to mobilise such funds through subscription to its equity. Needless to say, it should be pointed out that adequate appraisal and promotional work can not be prudently carried out with borrowed funds. Hence, a substantial equity and a willingness to wait for a return on it is required if the Bank is to undertake some of its activities effectively.

Profitability wise, the Bank has done well during the same period. Though profitability is not a good measure of performance of a development institution such as DBZ, to some extent it is a good indicator of how well the Bank has been able to maintain its operational and administrative costs. It's also an indication that the Bank has been able to combine profit-making with a development orientation, for undoubtedly without that, the Bank itself would not remain a viable institution.

### RECOMMENDATIONS

(1) If the Bank is to make a profound impact on the economic development of the country, it should place emphasis on financing labour intensive projects. This is because the contribution of capital intensive projects to employment and income distribution is barely marginal. It need however be mentioned that though the value added per worker rises with capital intensive projects, capital investment per worker and wage rates rise, and the value added per unit of capital falls.

Hence, labour-intensive projects would lead to an optimal factor substitutability between capital and labour. This may inevitably point to the employment of intermediate alternatives in the production process.

(2) The Development Bank of Zambia's policies should be amended to cover some degree of foreign exchange risks of its customers. Looking at the nature of our dependent economies, most businesses would run aground in the event of a devaluation of the local currency or revaluation of the foreign currency due to the increased repayment burden. The Bank may ask the Government to undertake the foreign exchange risk instead of its clients. The Bank may also explore the possibility of opening up insurance policies

to cover foreign exchange risks.

(3) The Bank should also amend its Act to provide for the needs of small scale enterprises. This will require the lowering of the Bank's minimum financial assistance to a single project from the present level of K25,000.

(4) It need be mentioned that the record of the Development Bank of Zambia should not be judged by its financial contribution but also by its impact on the thinking, working and attitude of its clients. It is with this view that further studies should be recommended to look into the implementation and performance of projects financed by the Bank. This will involve working with the projects supervision Division, which is charged with follow-up task of projects financed by the Bank. This task was beyond the scope of this thesis.

APPLICATION FORM<sup>1/</sup>

The DBZ loan application form is made up of the following details:

(A) LOAN CONDITIONS COVERING:

- (i) Interest rate
- (ii) Maximum Repayment period
- (iii) Grace period
- (iv) Commitment fee

(B) REMARKS STATING THAT:

- (i) DBZ reserves the right to change the commitment fee before application is submitted to the Board
- (ii) Cost overruns to be financed by the promoter
- (iii) Borrower bears foreign exchange risk
- (iv) DBZ reserves the right to appoint a director
- (v) DBZ insists that Bank financed assets are secured and those mortgaged to the Bank are secured
- (vi) DBZ may attach additional special conditions to the loan if necessary

(C) DETAILS ABOUT THE PROJECT COMPANY WHICH INCLUDES:

- (i) Name(s) of applicants
- (ii) Location of project site
- (iii) Shareholders (capital structure)
- (iv) Board of Directors, their interest and profession
- (v) Management's background and the managerial competence
- (vi) Company's Commercial Bankers
- (vii) Auditors - present and proposed
- (viii) Company's past performance in terms of:

1. Turn over

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1/ Adapted from Chirwa and Chimwayinga, A Study into the structure, function and performance of the Development Bank of Zambia, University of Zambia, 1980



2. Net Profit after tax
3. Fixed assets
4. Current assets
5. Share capital
6. Reserves
7. Loan capital

(ix) History of the Company

1. Date of incorporation
2. Start of operation
3. Major developments such as change of ownership, name, expansions, diversification etc.

(D) PROJECT DESCRIPTION:

(a) Type of Project

1. New
2. Expansion
3. Diversification
4. Modernisation and Rationalisation

(b) Details about project type in the case of the above types.  
What is the effect of the project on capacity, quality, operating cost etc.

(c) Type of products/services

(d) Proposed production by products during initial years until achievement of full production (by volume and value)

(e) Number of jobs created by the project.

PROJECT COST AND FINANCING PLAN

PROJECT COST	K'000	Payable in		
		KWACHA	FOREIGN EXCHANGE	TOTAL
(A) SITE DEVELOPMENT				
Acquisition of Land				
Site preparation				
Land Scaping, Road, Drainage,				
Fencing and Yard Lighting				
Water connections				
Electricity Connection				
Sewage disposal				
Other				
TOTAL				
(B) BUILDING CONSTRUCTION				
Production areas				
Storage areas				
Workshop and service areas				
Offices				
Employee facilities				
Other				
Escalation on (A) and (B)				
TOTAL (A) AND (B)				
Machinery and Equipment				
F.O.B				
Freight				
Insurance				
clearing charges, duties & taxes				
Locally purchased machinery and equipment				
Installation				
Escalation and contingencies				
TOTAL				

	Payable in		
	KWACHA	FOREIGN EXCHANGE	TOTAL
Shop Tools and Services Equipment			
F.O.B			
Freight			
Insurance			
Clearing charges, duties and taxes			
Locally purchased vehicles			
TOTAL			
Office furniture and fittings			
Deferred Investments:			
(1) Interest on loans during pre-operating expenses			
(2) Other pre-operating expenses			
Cost of feasibility study			
Consultancy fees			
Staff training			
Project Management and supervision			
Import licence fees			
Recruitment and relocations			
Travel and Accommodation			
Legal fees			
Other			
TOTAL			
Initial working capital:			
Cash			
Inventory of spares			
Inventory of materials			
Inventory of goods in process			
Inventory of finished goods			
accounts receivable			
less accounts payable			
TOTAL			
TOTAL PROJECT COST			

SUMMARY OF QUOTATIONS

quotations

I                      II                      III

Construction Work	Name of company country price in Kwacha
Machinery and Equipment	Name of company country price in Kwacha
Other	Name of company country price in Kwacha

PROJECT FINANCING

K'000

Promoter's cash contribution

Paid up capital

Shareholders loan

Retained Profit

Other unsecured loans

Promoter's contribution in kind

DBZ loan

DBZ Equity

Other sources

Secured term loans

Overdrafts

Kwacha equivalent of foreign exchange required from DBZ

Description of contribution in kind and breakdown of total value

Who has valued the assets (copy of valuation report to be attached)

Date of valuation

With which Bank(s) has an overdraft been negotiated and to what result? Please request your commercial bank(s) to confirm this in writing.

PROPOSED SECURITY

(A) Real Estate

- (a) Has the title already been obtained
  - (i) If not state present position
  - (ii) Who is holding the title deeds
- (b) Is the property encumbered?
  - (i) If yes, who is the chargee
  - (ii) When and how will the property be discharged.

(B) Other Assets

- (a) Are they encumbered
  - (i) If yes who is the chargee
  - (ii) For what amount
- (b) Indicate whether the encumbrance is by way of
  - (i) Floating charge
  - (ii) Fixed charge

Give details in each case of property covered by the charge.

(C) Pari passu Arrangements

- (a) Who is the other chargee with whom DBZ is proposed to share a pari passu charge
- (b) What is the chargee's limit?
- (c) Copies of other chargee's security documents have to be attached (if applicable)

(D) Personal Guarantee

- (a) Do you agree to a joint and several guarantee of shareholders and for holding compan(ies)
- (b) If not, state conditions under which you agree to a joint and several guarantee (e.g. proportionate to shareholding).

(E) Commercial Bank or any other party's guarantee.

- (a) Who is the proposed guarantor
- (b) Provide evidence from the guarantor of acceptance to guarantee the loan.

MANUFACTURING LICENCE

Obtained

applied for

Still to be applied for


Raw Material Requirements

- (a) Main raw materials required for full production locally available and to be imported

Local

Imported

Type of Material	Quantity	Value

The application must be accompanied by quotations from suppliers indicating the availability of required quantities and current as well as future prices. In cases of more than one possible source for the same raw materials, competitive quotations have to be obtained.

- (b) Any price control on local raw materials?
- (c) Do you require any licence such as mining or timber licence?
- (d) Is there any duty and/or tax on imported raw materials
- (e) What arrangement do you propose in order to secure a continuous and sufficient inflow of imported raw materials
- (f) What was your actual supply of imported raw materials as a percentage of the requirement? What were your foreign exchange allocation in previous years
- (g) What is the required average stock value.

Prices of Products

- (a) Ex-factory, wholesale and retail prices of the proposed product
- (b) Are the prices controlled
- (c) Is there any sales tax or other tax on the products?
- (d) What are the C.I.F. Lusaka prices for comparable imported products?  
This information must be supported by respective quotations
- (e) How will your products compare quality-wise with respective imports.

Marketing

- (a) Proposed/Existing marketing system
  - Sales representatives (give details)
  - Sales depots (give details)
- (b) Proposed/Existing distribution system
- (c) Do you expect any protection from the Ministry of Commerce and Industry against imports of the same products and what is the expected protection rate?
- (d) Have you contacted the Ministry and what was their reaction?

Management

- (a) Organisation chart to be attached
- (b) Brief Curriculum vitae of top and senior management to be attached
- (c) Special experience of the top and senior management for the business in question.
- (d) In the case of management posts still to be filled, what are required qualification and how is the required staff proposed to be identified (DBZ reserves the right to be consulted before senior positions are filled and/or if management is changed)?

- (e) In case of any management agreements, a copy has to be attached (Bank of Zambia's approval might be required for such agreements with overseas companies).

Labour

- (a) Number of labourers required

Skilled	
Semi-skilled	
Unskilled	

- (b) Type of experience/skill required
- (c) Will the skilled/semi-skilled labourers be readily available or do they need to be trained
- (d) What are your proposals for training  
in Zambia  
outside Zambia (at whose expense)

Operating Costs

The application must be accompanied by a detailed breakdown of production cost for the initial years up to proposed maximum production. No cost of increases as a consequence of inflation shall be considered. The following list of cost items may be modified or supplemented according to the nature of the project:

- sales commission
- raw materials
- labour, direct and indirect
- Utilities
- Maintenance, spare parts



- fuel, lubricants
- salaries
- administrative expenses (insurance, telephone, postage etc)
- depreciation & respective percentages (or expected life time of the various assets) for
  - building
  - vehicles
  - furniture and fittings.
- Amortisation of pre-production expenses
- financial charges
- Sundry expenses, allowance

#### Market Information

The loan application must be supported by a detailed market survey covering the following points:

- (a) Present demand for products and how determined, preferably supported by statistical information
- (b) Estimated demand for products and how determined
- (c) How is demand met at present
- (d) Are there any other local manufacturers in the same product line (or substitutes) and what are their capacities and possible expansion plans
- (e) Main customers by product and quantity (letter of intent to be attached)
- (f) Export potential (letter of intent to be attached)

## The required information for appraisal of Agricultural Projects

### PART I: The Applicant

The Bank seeks to find out about the legal status of the applicant. The applicant has to be any of the following: private limited company, parastatal organisation or a Cooperative Organisation. In this section, the Bank seeks to find out about the following: the name(s) and nationality of promoter, names of shareholders and Directors, the amount of paid-up share capital and name of bankers.

### PART II: Farm particulars

This section is concerned with, the location of the farm and its distance from the urban centre; the farm land types, hectarage and their capabilities. It also gives an inventory of the farm assets, description and their estimated present value, and other developments on the farm.

### PART III: Farming activities

This part assesses crop and/or livestock performance for the past two years in terms of yield and number of breeding stock and sales respectively.

### PART IV: The proposed development project description

This section seeks to find out the objectives of the project i.e.

- the idea of producing to satisfy the local and, or foreign market,
- an expansion programme
- changing the quality of the existing product etc.

This section may also include the project components, details of the project in terms of proposed cropping or livestock programme for the next five years. The applicant is also asked to furnish the Bank on the market situation and the envisaged marketing arrangements; Raw materials and other supplies; the project cost and financing sources; time schedule for implementation; financial data e.g. past 2 years. Balance sheets; and security matters.

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