CHAPTER 5

The Role of National and Provincial DFIs in Rural Development

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5.1 Introduction

Development Finance Institutions (DFIs) operate in the intermediary space between public aid and private investment. They provide finance to the private sector for investments that promote development. In South Africa, DFIs are expected to play an instrumental role in the implementation of developmental policies and act as catalysts for accelerated industrialisation, economic growth and human resource development. South Africa urgently needs to accelerate economic growth and expand human capital resources capabilities in order to get to grips with the crippling economic and social challenges of high unemployment, income inequality and poverty.

In developing countries, DFIs provide a broad range of financial services, such as loans or guarantees to investors and entrepreneurs, equity participation in firms or investment funds, and financing for public infrastructure projects. They also initiate or develop projects in industrial fields or in countries where commercial banks are reticent about investing without some form of official collateral. This approach benefits DFIs because they often find themselves with first-mover advantage in markets with strong growth potential. DFIs depend on profits from their investments to ensure resources for further engagements. However, pursuing a double bottom line of both profit and development can prove difficult, as the two can be contradictory. Nevertheless, DFIs have the capacity to make long-term investments at attractive rates in markets that are too risky for the private sector. They have a higher tolerance to risk and longer investment horizon, benefit from government guarantees and are free from the short-term constraints of private investors.

South African DFIs support agriculture and rural development activities, but their products do not appear to be tailor-made for rural communities. Instead of servicing rural areas and promoting rural development, they are having little impact on rural development and appear to serve the interests of the commercial and well-established wealthy clientele who can afford the high interest rate they charge, thereby reproducing patterns of uneven development.

The objective of this paper is to examine the role of four DFIs – the Land Bank, Development Bank of Southern Africa (DBSA), the Industrial Development Corporation (IDC) and the National Empowerment Fund (NEF) – in enhancing rural economic development, and to investigate how DFIs can support rural development.

5.1.1 Problem statement

Since 1994, the development finance system has been restructured to reflect government's developmental policy priorities, which include rural development. DFIs provide government with an alternative instrument for investing money in the poorest sectors in rural areas, thus accelerating rural development. The private sector tends to avoid investing in socio-economic development that would benefit the poor because the poor are viewed as high risk and unable to afford the high interest rates of commercial loans. Using concessional funding from DFIs to target rural development could extend public resources beyond relying exclusively on grants. Therefore, the role of DFIs as an alternative instrument to rural development needs to be investigated.

5.2 Development Finance Institutions

DFIs have rapidly expanded their lending in line with NDP objectives. In 2014/15, the three largest DFIs (IDC, Land Bank and DBSA) had a combined asset value of R233.8-billion and a combined loan book value of R117.2-billion. By 2017/18, their loan portfolios are forecast to grow by 3%, while their total asset base is projected to increase to R324.7-billion. In 2014/15, the combined borrowing of the three DFIs reached R52-billion against a budget of R70-billion, reflecting the impact of weak economic conditions and falling commodity prices. Borrowing budgeted for 2015/16 is dominated by the Land Bank at R45-billion, followed by the DBSA (R18.2-billion) and the IDC (R12-billion). Their combined medium-term borrowing is estimated at R275-billion.

The DFIs will need to manage prudently their expanding loan books, which are inherently risky because of new exposures. They will also have to pursue carefully the double bottom line of profit and development, and crowd in more private investment in order to finance rural development. The weak economic outlook could complicate this undertaking.

5.2.1 The Development Bank of Southern Africa (DBSA)

DBSA business model

The DBSA secures funding from various sources including reserves, capital markets, other DFIs and government. It then uses this funding to prepare, fund and deliver infrastructure projects. Some of this funding is provided on concessionary terms and conditions. These funds are also used to augment development impact in specific areas and to accrue interest and non-interest income (DBSA, 2014). It is worth noting that the cost of funding from capital markets is directly affected by the domestic and international interest rate policies. The equity investments are affected by movements in stocks in various stocks exchanges.

DBSA financial health

Profit and loss margins

In 2009/10, the DBSA posted a profit of R518-million, which declined to R29.4-million in 2010/11 and then a net loss of R370.8-million in 2011/12. The loss was attributed to investments in equities that were affected by the decline in the platinum price and increased platinum mining costs. In 2012/13, the DBSA reported a further net loss of R825.9-million, which was due to impairment losses and revaluation losses on financial instruments. Recovery began in 2013/14, when the DBSA recorded a profit of R787-million and R1.214-billion in 2014/15. The DBSA's profit grew negatively, by -1379% between 2010/11 and 2011/12 and -269% between 2009/10 and 2014/15.

Between 2009/10 and 2012/13, the return on assets (ROE) ratio decreased from 3% to -4.8% before recovering to 5.7% in 2014/15, while the return on average assets (ROA) ratio decreased from 1.2% to -1.6% before recovering to 1.8% in 2014/15. In the five years (2009/10–2014/15), the average ROA for the DBSA was 0.18%, which is very weak compared to benchmarks. ROA ratios greater than 5% are considered very good, ratios from 1–5% are average, and ratios of less than 1% are very weak.

Solvency analysis

Over the past six years, the DBSA has been carrying unacceptably high levels of debt, as reflected in the debt-to-asset and debt-to-equity ratios, which have worsened over the period. This also means that the already high debt levels are not improving. The high debt levels prevent the DBSA from generating additional resources for rural development. The equity-to-asset ratio was average but deteriorating, which will also have negative ramifications. In brief, the DBSA's role in rural development is hamstrung by its business model and weak profits.

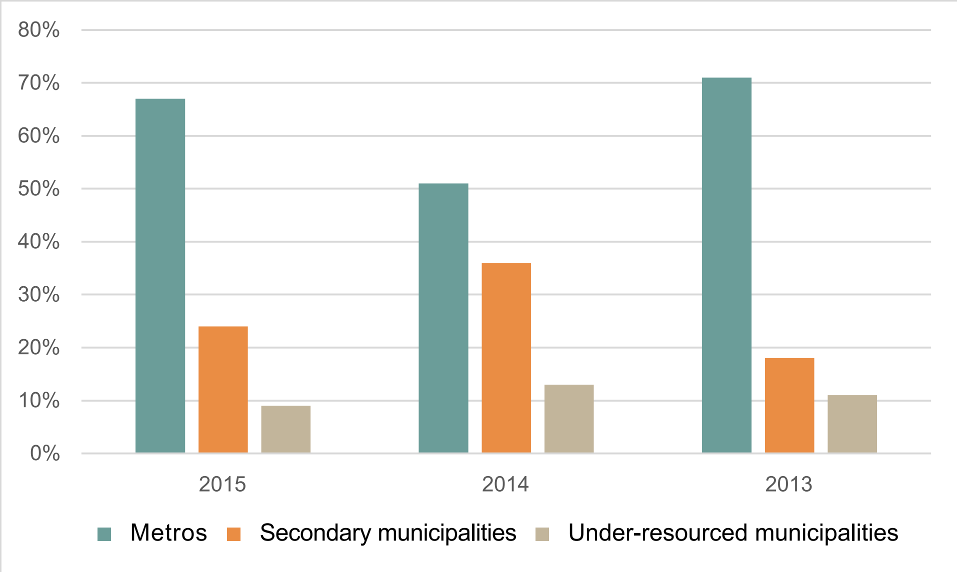
DBSA rural development programmes

Within the municipal space, the DBSA focuses on improving social infrastructure (water and sanitation, electricity, community facilities, roads and transportation) and economic infrastructure support (energy generation, bulk water supply, industrial transport and telecommunication services). The DBSA works with various national and provincial departments, including National Treasury, the Department of Energy (DOE) and the Department of Cooperative Government and Traditional Affairs (COGTA) to accelerate service delivery by providing bridging finance to municipalities for projects that will be funded by National Treasury through the Municipal Infrastructure Grant and the Integrated National Electrification (INEP) grant.

The DBSA provides funding to metros, secondary and under-resourced municipalities. It also offers technical support to under-resourced municipalities to strengthen their ability to plan and implement capital projects, thereby increasing efficient infrastructure delivery. The emphasis is not only on under-resourced municipalities that receive funding from the DBSA, but also other under-resourced municipalities with substantial service delivery backlogs and potential for accelerated infrastructure investment. For instance, the DBSA has agreements with five municipalities (Uthukela district and the Emnambithi, Elundini, Emfuleni and Theewaterskloof local municipalities) to provide support for planning infrastructure, based on infrastructure assessment outcomes. The DBSA approved nine water and sanitation projects valued at R224-million for the Emfuleni Municipality, as part of the bank's assistance to the agricultural sector.

However, the DBSA invests heavily in metros compared to secondary and under-resourced municipalities. In 2015, over two-thirds (67%) of DBSA disbursements went to metros (compared to 71% in 2013 and 51% in 2014), while just 9% went to under-resourced municipalities (Figure 43).

Figure 43. DBSA disbursements to municipalities (2013–2015)



Sources: Various DBSA annual reports

The DBSA used to have a rural development programme whose purpose was to identify, prepare and implement catalytic socio-economic infrastructure and to formulate tailor-made rural development solutions. The programme was housed under the Development Fund which was the capacity building arm of the DBSA. However, when the DBSA was restructured, the Development Fund was scaled down and the programme was discontinued.

The DBSA continues to be indirectly involved in rural development. In 2011, it established the National Rural Youth Service Corps programme, with the aim of creating economic opportunities for the rural youth, including skills training. The DBSA hosts the programme's technical support unit, and provides monitoring and quality assurance support to the Department of Rural Development and Land Reform (DRDLR). In 2015, the programme placed 850 learners in infrastructure employment opportunities, a substantial decline compared to 2014 when 2057 learners were placed. The DBSA also helped with the registration of eight youth enterprises by learners who are leaving the programme.

5.2.2 Land Bank

Business model

The business model for the Land Bank has three core income generating business areas to sustain the Retail Emerging Markets (REM) division: Retail Commercial Banking (RCB), Business & Corporate Banking (B&CB), and Land Bank Insurance Services (LBIS).

The Land Bank generates its income by extending agricultural loans to emerging and commercial farmers and large agribusinesses. It also earns interest on cash invested and generates significant income from its insurance portfolio investments. The Bank's lending activities are funded by participating in the open market through issuances of instruments such as promissory notes, call bonds, bills, floating rate notes and debentures. It is worth noting that the cost of funding from open markets is directly affected by the domestic and international interest rate policies, and equity investments are affected by movements in stocks in various stock exchanges.

Financial health

Profitability

The profitability of the Land Bank has generally declined in the past seven years. Between 2008/09 and 2009/10, the profit increased by 144%, from R145.4-million to R354.4-million, but decelerated by 25% (to R286.1-million) in 2010/11. Over the next two years, the profit declined further by 39.1% to R161.4-million (2011/12) and then to R154.3-million (2012/13). In 2013/14, profit increased by 29.4% (to R394.3-million) but declined again in 2014/15 by 25.8%, to R292.4-million. Between 2011 and 2015, the Land Bank's profits have seen a negative average annual growth rate.

Solvency analysis

Over the past five years, the three debt ratios (debt-to-asset, debt-to-equity and equity-to-asset) for the Land Bank have been in the red zone and deteriorated. The Land Bank is burdened by a high level of debt that is worsening and seriously constrains the Land Bank from generating additional resources for rural development.

Divisional performance and rural development programmes

As stated, the Land Bank has three divisions: B&CB, RCB and REM.

- The RCB provides farmers with secured long-term (5–15 years), medium-term (3–8 years), and short-term (up to 18 months) loans in excess of R3-million. The four main products are mortgages (for land), production finance, instalment sale finance (for moveable assets) and medium-term loans for infrastructure (e.g. for pack houses).
- The REM caters for emerging farmers who would ordinarily not be able to secure funds from conventional financial markets. It offers loans of less than R3-million with concessionary interest rates to emerging commercial farmers (not subsistence farmers) who can be individuals or corporations. Loans are specifically for black farmers with no or low assets but who have access to land through a lease, a Permission to Occupy (PTO) certificate or through traditional rights of tenure. Loans are for primary production only. REM also provides wholesale loans to intermediaries for on-lending to farmers as well as for lending directly to farmers. Wholesale loans are provided to, among others, cooperatives and former cooperatives, now operating as private companies, and commodity associations. These intermediaries are familiar with the needs of emerging farmers, provide support to such farmers and have the ability to reach farmers relatively easily.
- The B&CB offers insurance to farmers and the overall agricultural sector, while the LBI short-term insurance offering includes assets, crop and legal solutions.

The B&CB accounts for the largest share of the Land Bank performing loan book, followed by the RCB and the REM. The B&CB loan book decreased from R11.38-million in 2007 to R8.65-million in 2009 and then increased to R30.79-million in 2015. Its annual average growth was 17% between 2007 and 2015. The RCB loan book decreased from R3.64-million in 2007 to R2.21-million in 2010, and then increased to R5.11-million in 2015. Its annual average growth was 6% between 2007 and 2015. The REM performing loan book, which only came into existence in 2012, increased from R0.1-million in 2012 to R0.24-million in 2013 before declining to R0.77-million in 2015. Its annual average growth was 133% between 2012 and 2015, but this growth is from a very low base.

The Land Bank also administers some rural development funds on behalf of government departments:

- The Agri-BEE fund: The Land Bank administers this fund on behalf of the Department of Agriculture, Forestry and Fisheries (DAFF). The fund allocates grants to promote rural community-based empowerment groups. Between 2014 and 2015, disbursements increased to R5.89-million from R5.5 million, from an injection of R36.2-million (in 2014) and R33.3-million (in 2015) by DAFF.

- Emerging Farmers Support Facility: In 2011, the Land Bank received R208-million from the DRDLR to use as a guarantee for identified deserving emerging farmers who require rescue packages. The identified farmers all have mortgage loans with the Bank and can only access the guarantee after complying with conditions as set by DRDLR. This facility has not yet been used.

5.2.3 The Industrial Development Corporation (IDC)

Business model

The IDC uses its balance sheet, retained earnings and borrowings to provide funding. Capital and interest repayments from loans provided to businesses are used to cover obligations to lenders. Dividend payments from equity investments are translated to an annuity income, and exits from mature equity investments results in capital for new equity investments (IDC, 2014). The IDC business model is premised on soliciting funding from capital markets, which is directly affected by the domestic and international interest rate policies. The equity investments are affected by movements in stocks in various stock exchanges. For instance, the IDC equity-accounted investments suffered a total loss of R778-million between 2012 and 2014, but showed a significant improvement in performance in 2015, recording a profit of R656-million. The borrowing from capital markets is also subject to domestic and international interest rate policies.

Financial health

Profit and loss margins

Between 2010 and 2014, the IDC posted successive profits, peaking at R3412-million in 2012 before declining to R2447-million in 2014. The profits then recovered slightly to R2513-million in 2015. Between 2014 and 2015, the annual percentage growth in profit for the IDC was -60% and -9% between 2011 and 2015, meaning that the IDC's profit has grown at a negative rate over the period under review.

Solvency analysis

The three debt ratios for the IDC have mostly been strong for the past six years, i.e. the IDC had low debt levels, which have allowed it to generate additional resources for rural development. However, it should be noted that these ratios have deteriorated over the period reviewed. Compared with the other DFIs, the IDC has invested more in rural areas. The IDC is playing an increasingly important role in rural development, helped by its business model and its diversified portfolio in other investments (other than interest from loans).

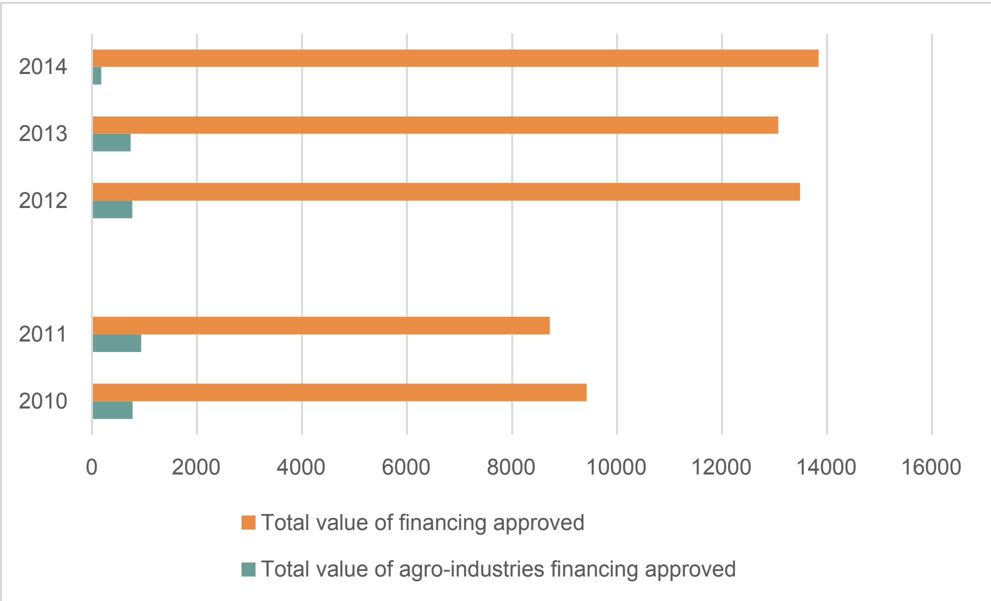
Divisions and rural development activities

The IDC has three business units/divisions:

- Agro and New Industries, consisting of Agro-Industries, Green Industries, Strategic High-Impact Projects and Venture Capital.
- Mining and Manufacturing Industries, consisting of Chemicals and Allied Industries, Forestry and Wood Products, Metals, Transport and Machinery Products, Mining and Minerals Beneficiation, as well as Textiles and Clothing.
- Services Industries, consisting of Information and Communications Technology, Healthcare, Media and Motion Pictures as well as Tourism.

The Agro and New Industries is the most relevant division to rural development. It focuses on agro-processing (food and non-food), beverages (alcoholic and non-alcoholic) and aquaculture. The IDC does not fund pure primary agricultural projects. As Figure 44 shows, between 2011 and 2014, the total value of financing approved by the IDC increased from R8.7-billion to R13.8-billion. Of this, agro-industries made up just 1.25% (R175-million) in 2014, compared to 8.17% (R770-million) in 2010.

Figure 44. IDC total value and agro-industries financing approved (2010–2014)



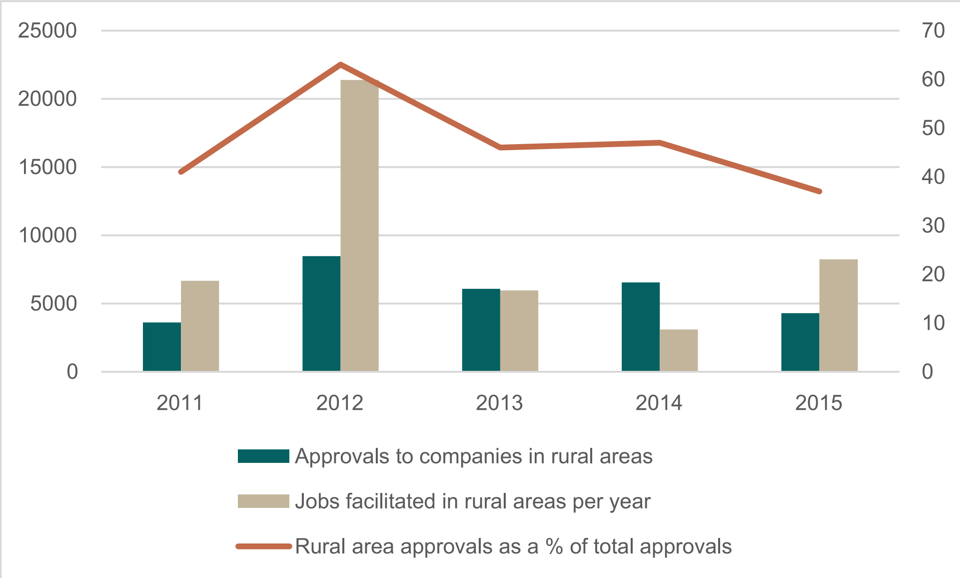
Source: Various IDC Annual Reports

Approvals to companies in rural areas almost doubled between 2010 and 2012, from R4.6-billion to R8.46-billion, before declining to R4.28-billion in 2015. The total value of financing approved by the IDC increased from R8.7-billion in 2011 to R13.8-billion in 2015. Out of the total approved financing, companies in rural areas received 49% in 2010, 63% in 2012 and 37% in 2015 (Figure 45). This resulted in thousands of jobs being facilitated: 6664 jobs in 2011, 21 382 jobs in 2012 and 8223 jobs in 2015.

Provincial investment by the IDC

The IDC mostly invests in rural provinces, but Gauteng (an urban province) also benefits from IDC investments. Between 2010 and 2014, the Northern Cape received 30% (R16.2-billion) of total financing approved by the IDC, while Gauteng received 26%, North West and Limpopo received 9% and the Free State just 1%.

Figure 45. IDC approvals to companies and jobs facilitated in rural areas (2010–2014)



Source: Various IDC Annual Reports

In 2002, the IDC launched the Agency Development and Support (ADS) Department to support the establishment of local economic development agencies at a municipal level. Through the ADS, 34 municipal agencies have been established with the aim of improving socio-economic development and leveraging job creation potential in marginalised communities. In 2013/14, funding of R38.5-million was approved to assist six of these agencies to expand their work in developing, packaging and implementing projects in their areas of operation. These agencies are mainly located in rural areas and play a critical role in facilitating projects that support local economic development in specific municipalities.

5.2.4 The National Empowerment Fund (NEF)

Business model

The NEF generates revenue from interest on development activities and investments, as well as dividends from development activities and financial market assets. Its lending activities are funded by participating financial markets. Its cost of funding from capital markets is directly affected by the domestic and international interest rate policies. The equity investments from financial markets are also affected by movements in stocks in various stock exchanges.

Financial health

Surplus and loss margins

Between 2010/11 and 2011/12, the NEF's profit dropped from R103-million to R28-million. In 2012/13, the NEF posted a loss of R138-million before recovering to a profit of R53-million and R38-million in 2013/14 and 2014/15 respectively. The annual percentage growth of profits was -593% between 2011/12 and 2012/13, and -208% between 2010/11 and 2014/15, implying a negative profit growth over the period.

Solvency analysis

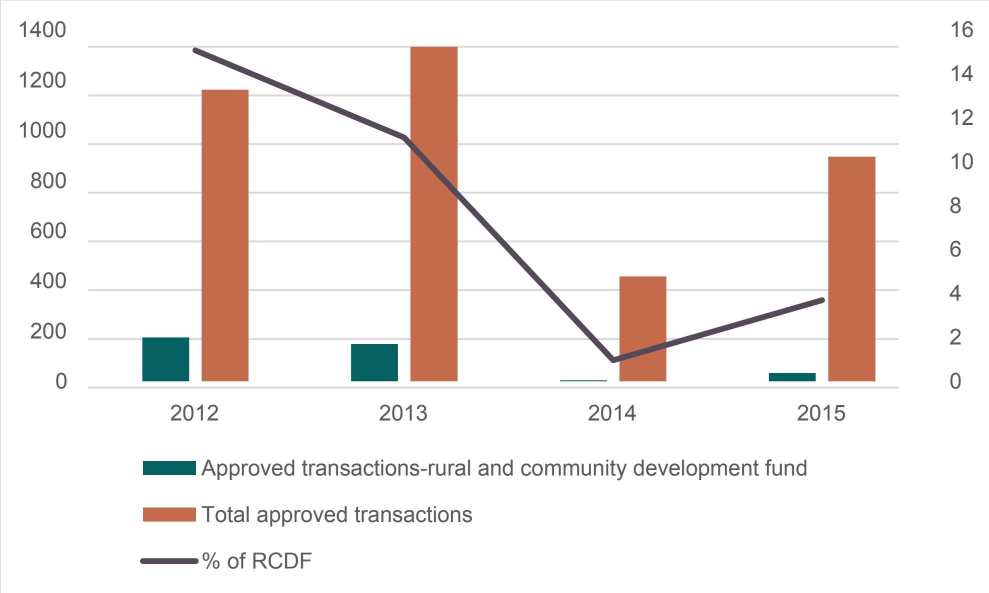
The NEF has a very low level of liabilities, which means it is not possible to calculate the debt-to-asset and the debt-to-equity ratios. The equity-to-asset ratio reveals that the NEF pays a lower interest rate and so has more free cash on hand for future expansions, growth and dividends. Therefore, the NEF has more funds available for further investments and growth.

Divisions and rural development programmes

The NEF has a fund specifically for rural and community development: the Rural and Community Development Fund (RCDF). The fund promotes sustainable change in social and economic relations and supports growth and development in the rural economy through financing sustainable enterprises. Rural communities are mobilised to form legal entities or cooperatives, in order to participate in the broader economic activities. The fund provides capital for project finance, business acquisition and expansion, and start-ups/greenfield enterprises. Funding ranges from R1-million to R50-million. The NEF is also involved in agro-processing investments.

Between 2012 and 2014, the value of approved transactions for the RCDF declined from R175-million to R4-million, reflecting the decrease in total NEF approved transactions, which declined from R1.16-billion to R895-million over the same period. The RCDF's share of total transactions also decreased, from 15.1% in 2012 to 3.7% in 2015. This decline is because other NEF programmes have increased their share of funding. For instance, between 2012 and 2013, the Imbewu Fund increased by 117% compared to 37% for the RCDF (Figure 46).

Figure 46. RCDF vs. total approved transactions (2012–2015)



Source: Various NEF Annual Reports

Provincial investment by the NEF

The NEF invests mostly in urban provinces, with Gauteng receiving over half (51.1%) of NEF financing between 2010 and 2015. Over the same period, KwaZulu-Natal received 18.7% of total NEF financing, followed by Western Cape, Eastern Cape, Limpopo, Free State and North West.

5.3 Conclusion and Recommendations

Within the municipal space, the DBSA improves social infrastructure (water and sanitation, electricity, community facilities, roads and transportation) and enhances economic infrastructure (for energy generation, bulk water supply, industrial transport and telecommunication services). The DBSA invests heavily in metros compared to secondary and under-resourced municipalities, and plays an indirect role in rural development through the National Rural Youth Service Corps programme, which creates economic opportunities for the rural youth, including skills training.

The Land Bank's divisions are designed to cater for agricultural commercial businesses. The RCB and REM are the closest mechanisms through which the Land Bank could contribute to rural development. However, these divisions receive less funding, which suggests that the Land Bank is biased towards agricultural commercial business, as opposed to rural development. The Land Bank allocates most of its resources to its B&CB division, implying that it is more biased to funding agricultural cooperatives and businesses than emerging farmers in rural areas.

The IDC's agro-industries business unit is the closest mechanism that can be used to finance rural development. However, its share of the total financing approved by the IDC is minimal. Nevertheless, the IDC approvals to companies in rural areas is significant, reaching 63% of all financing approved by the IDC in 2012. Moreover, in 2012 the IDC facilitated 21 382 jobs in rural areas. The IDC also supports development agencies through the Municipal Agency Programme, which aims to improve social and economic development and leverage development and job creation potential in marginalised communities.

The NEF contribution, through the Rural and Community Development Fund, is very small and is declining.

What is clear is that there is no single champion and coordinating entity for rural finance and development guiding investment by DFIs in rural areas. The investment and financial support they offer to rural areas is very modest and does little to crowd in the private sector.

With respect to creating conditions for rural development from infrastructure-led growth by DFIs, the Commission recommends that:

1. The Economic Development Department, in collaboration with the departments of agriculture, forestry and fisheries, rural development and land reform, and public enterprises, designates a single champion for rural finance and development. This champion should guide and coordinate investment by DFIs in rural areas, and encourage crowding-in by the private sector.

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Appendix: Results for debt ratios and benchmarks and interpretation

Table 29. Debt ratio formulas, benchmarks and interpretations

Solvency analysis	Calculation	Green	Yellow	Red
Debt-to-asset ratio	Total liabilities/total assets	<30%	30% to 55%	>55%
Equity-to-asset ratio	Total equity/total assets	>55%	30% to 55%	<30%
Debt-to-equity ratios	Total liabilities/total equity	<42%	42% to 122%	>122%

Source: Adapted from Northwest Credit Services

Table 30. DBSA debt ratios

	2010	2011	2012	2013	2014	2015
Debt-to-asset ratio	60%	62%	67%	69%	69%	67%
Equity-to-asset ratio	40%	38%	33%	31%	31%	33%
Debt-to-equity ratio	152%	166%	199%	223%	221%	200%

Table 31. IDC debt ratios

	2010	2011	2012	2013	2014	2015
Debt-to-asset ratio	18%	20%	23%	28%	25%	32%
Equity-to-asset ratio	82%	80%	77%	72%	73%	68%
Debt-to-equity ratio	22%	24%	30%	38%	35%	47%

Table 32. Land Bank debt ratios

	2010	2011	2012	2013	2014	2015
Debt-to-asset ratio	81%	77%	80%	83%	84%	83%
Equity-to-asset ratio	19%	23%	20%	17%	16%	17%
Debt-to-equity ratio	415%	343%	401%	473%	520%	492%

Table 33. NEF debt ratios

	2010	2011	2012	2013	2014	2015
Equity-to-asset ratio	99.16%	99.34%	99.15%	99.08%	99.07%	98.93%