

Findings

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Good Practice
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Zambia : The Enterprise Development Project

The Enterprise Development Project (EDP) – 1998-2003 - was designed to support, with a credit of US\$ 45 million, Zambia's Economic Reform Program that began in 1991. One of the key aspects of this reform program was to dismantle traditional state-supported enterprise development mechanisms and replace these with market-determined enterprise development structures. Three specific objectives were identified : (i) enhancing Zambian firms' technical know-how by providing demand-driven assistance to Zambian firms in the form of matching grants; (ii) enhancing Zambian firms' access to finance by providing a long-term credit facility for investments and a short-term credit line for exporters; and (iii) strengthening the financial system and availability of information resources in Zambia by providing technical assistance to help strengthen the institutional underpinnings of the financial system at the wholesale, retail and regulatory levels.

Impact on the ground

- The Multipurpose Credit facility (MCF) offered by the project disbursed ahead of the project's closing date and in accordance with the original operational principles. About 15% of total private sector lending in Zambia is now funded by the MCF.
- One of the major benefits of the MCF was the establishment of an effective and efficient mechanism for channeling investment finance in Zambia without creating a burden on limited financial resources.
- The MCF succeeded in channeling significant resources to non-mining activities - consequently contributing to the diversification of the Zambian economy – as well as to small size projects.
- The agriculture and agro-processing sectors which were commonly regarded as having the most difficulty obtaining commercial credit were the biggest beneficiaries of the MCF, with about 44% of total loans financing these crucial sectors. The manufacturing sector also had a high share.
- Total lending increased from \$6.6 million by the end of the year 2000 to \$ 19.2 million by the end of 2001 and to \$51.5 million (by recycling payments) by the end of 2002. Total lending reached \$59.8 million by the middle of 2003. In other words, by the time of project closing, half of the MCF funds had been collected and re-lent.
- The MCF had a significant effect on the economy as it helped to create jobs and generate corporate and tax revenue as well as export proceeds. At the time of project's closing, it supported 192 projects, created approximately 6,000 jobs, generated some \$60 million in revenue, \$11 million in

taxes collected and \$15 million with regard to exports proceeds. These are conservative estimates as they do not take into account the jobs indirectly created by the MCF in the agriculture and agro-processing industries. An idea of the substantial impact made is obtained when one considers that the total number of jobs created is equivalent to 10% of formal employment in the manufacturing sector.

- No loss from lending activities was incurred since its inception and the facility so far has been recycled twice and it became a perpetual funding source.
- The MCF had 11 Participating Financial Intermediaries (PFIs). These included 8 commercial banks and 3 non-Bank financial intermediaries, mainly leasing companies. The three major foreign banks, are important PFIs; in addition, 5 smaller banks are active PFIs. The facility also allowed leasing companies to become eligible PFIs, thereby helping to diversify Zambia's financial sector.
- There was strong participation by small enterprises, as demonstrated by the size of the individual loans/leases. About one-third of the final borrowers borrowed/leased for less than \$100,000 with individual loans going as low as below \$10,000.
- The MCF has no default and none expected over the foreseeable future; its operational costs averaged about \$150,000 per year including the administrative fee income charged by the Bank of Zambia (BoZ); the sinking fund to pay off the IDA credit has accumulated to about \$2 million.
- The Technical Assistance (TA) provided funded apex operations. The apex unit was able to set up systems to process PFI applications, loan applications and monitor the performance of outstanding loans in accordance with the operational policies and principles laid down by the project.
- The apex unit also developed the capacity to generate financial and managerial reports as well as monitor the economic impact of lending activities. In essence, the establishment of this apex unit resulted in the creation of a small second-tier institution.
- The project provided technical assistance to BoZ and was focused on improving BoZ's supervision of financial system and thus benefiting the economy in general.
- Training courses were conducted by the Zambian Institute of Bankers. Fifty-nine staff from almost all financial institutions participated and passed the final exams successfully. This helped to build skills in the Zambian financial sector.
- Institutionally, the introduction of the MCF helped to provide a source of reasonably-priced foreign exchange denominated funds to be lent by the banks to their clients.
- MCF also influenced the behavior of other international institutions (both multilateral and bilateral) as they introduced lines of credit on terms and conditions very similar to those supported by the project through the MCF.
- The MCF also contributed to the process of changing the credit culture in Zambia – earlier borrowers from the Development Bank of Zambia rarely repaid their loans and a culture of non-repayment had been established. The utilization of commercial banks changed this attitude as the lender of record and they pursued loan servicing.

Lessons learned

- With regard to preparing and designing lines of credit operations, line of credit operations must be prepared only after carrying out substantial economic sector work in the relevant areas; these operations should be aligned with overall macro economic policies and ongoing reform programs; credit lines are most effective when they are fully intermediated by commercial banks.

- Universal and transparent eligibility criteria are essential for the success of line of credit operations, i.e. compliance with prudential norms, and transparent credit line limits, i.e. equivalent to first-tier capital, simplifies the application and approval process of financial intermediaries.
- Automatic collections by the apex unit during the settlement process enhances credit discipline.
- Certification of financial intermediaries by the regulator promotes compliance with prudential rules and eliminates a costly financial intermediary evaluation process.
- Having the apex located in the central bank reduces costs and facilitates coordination with financial system supervisors.
- It is prudent to divide the risk into two components associated with foreign exchange denominated lending. First, the foreign exchange rate risk should be left entirely with the borrowers. Second, the foreign exchange availability risks, i.e. possible re-introduction of currency controls should be assumed by the apex by making it possible to pay in local currency at the prevailing exchange rate of the repayment date.
- MCF's sinking fund arrangement also shows that lines of credit operations in IDA countries can be designed in such a way that these credits can be repaid to IDA in time without relying on fiscal resources.

This Infobrief was excerpted from Implementation Completion Report no. 27559. For more information, e-mail Ahmet Soylemezoglu : asoylemezoglu@worldbank.org

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