AN EVALUATION OF COMMERCIAL BANKS LENDING TO THE PRODUCTIVE SECTORS: EVIDENCE FROM NAMIBIA

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ABSTRACT

The primary objective of this study is to evaluate the commercial banks on lending to the productive sectors in Namibia. The problem that the study has identified is that the commercial banks are reluctant to lend to the productive sectors of the economy. Most of the deposits that are mobilised locally by the commercial banks are not used to develop the domestic economy. Commercial banks in Namibia do not see it as their business to lend to risky long-term investments which are the driving force of the economy.

This study reviews the main barriers to credit allocation to the private sector, small and medium enterprises, and the productive sectors. It also examines the extent to which the expansion of financial institutions offices, and improved links between these and the informal financial sector, could help to fill the credit gap. The quantitative approach analyses the data from bank's annual reports. Qualitative approach is used through semi-structured interviews to get the relevant information required for the study.

In addition to the issue of access, the study observed that the issue of collateral played a crucial role in SME access to bank credit. Commercial banks insist on the "strict" form of collateral (insurance, salary/income, investment guarantees) which the SMEs cannot afford.

Several actions, policies and recommendations are suggested to address these obstacles. The study suggests that it is necessary to establish the Development Bank of Namibia to avail financial resources to productive sectors of the economy in order to propel the country's growth. The study reviewed initiatives that relates to venture capital taking place in Namibia and outlines some of the potential areas in which venture capital can play a role in the Namibian economy. It also reviewed different forms of private equity and established that there is a scope for the private activities in Namibia in both venture capital and non-venture capital forms. However, it suggests that the venture capital component could be the most appropriate vehicle for Namibia. This is so as venture capital ordinarily known to be critical in the promotion of start-up companies, which seems to be more important in the case of Namibia.

The study points out that the situation in Namibia is not a lack of funds but rather the perceived level of risks by banks in lending, especially to new clients. Finally the study recommends that Government should institute laws and regulations to encourage the sharing of credit information amongst lenders and credit bureaux. These calls for a review of the existing laws to enable lenders develop some level of confidence in borrowers and the design of targeted mechanisms to reach hitherto excluded populations.

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DEDICATION

This study is dedicated to my beloved parents, Malakia and Anna Uukelo, for their unforgettable love and inspiration that brought meaning to my entire life.

Special thanks to my late father for having shown me the value of education at a very early age. His strong character and respect for individuals remain adorable to me.

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DECLARATION

This is a research paper submitted in partial fulfillment of the requirements of the degree of Master of Public Policy and Administration, the study programme of the University of Namibia (UNAM) in Windhoek and the Institute of Social Studies (ISS) in The Hague, The Netherlands.

This dissertation is the original work of the author and it has not been submitted for a degree elsewhere. The views stated therein are those of the author and not necessarily those of the two institutions.

Signature:

Date:

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LIST OF ACRONYMS

BON	Bank of Namibia
BLNS	Botswana Lesotho Namibia and Swaziland
CMA	Common Monetary Area
DBN	Development Bank of Namibia
DBSA	Development Bank of Southern Africa
DFN	Development Fund of Namibia
DFI	Development Financial Institution
ESME	Emergent Small and Medium Enterprises
FNB	First National Bank
GDP	Gross Domestic Product
GDS	German Development Service
GTZ	Gesellchaft fur Technische Zusammenarbeit GmbH
IDC	Industrial Development Corporation
ITC	International Trade Centre
MTI	Ministry of Trade and Industry
NDC	Namibia Development Corporation
NGO	Non-Government Organisation
NSX	Namibia Stock Exchange
SACU	Southern Africa Customs Union
SADC	Southern Africa Developed Countries
SBCGS	Small Business Credit Guarantee Scheme

SBCGT	Small Business Credit Guarantee Trust
SME	Small and Medium Enterprise
SSA	Sub-Saharan Africa
UK	United Kingdom
USA	United State of America
USAID	United State Agency for International Development
WB	World Bank

CHAPTER 1: INTRODUCTION AND BACKGROUND

1.1 Introduction

The study seeks to evaluate the role of commercial banks lending to the productive sectors in Namibia. Sherbourne (2001) defined commercial banks as institutions that accept deposits from savers and lend the money to borrowers. They are therefore, financial intermediaries.

There are four main commercial banks and two non-commercial banks in Namibia. The commercial banks are First National Bank (FNB) Namibia Holdings Ltd, Standard Bank of Namibia Ltd, NedBank Namibia Ltd and Bank Windhoek Ltd. FNB dominates the banking sector holding between 60 per cent and 62 percent, respectively of total assets, deposits and loans. The non-commercial banks are Agribank and Development Bank of Namibia. This study emphasises the commercial banking system because of data availability. The commercial banks in Namibia are regulated by the Bank of Namibia through its founding Act (the Bank of Namibia Act 15 of 1997), and the Banking Institution Act 2 of 1998 (BoN 2000).

Most of the commercial banks in Namibia are branches of South African banks. South African commercial banks' ownership is as follow: First National Bank (58%), Standard Bank (100%), Bank Windhoek (42%) and Nedbank (98%). It is not surprising because Namibia was occupied by South Africa and was regarded as the fifth province of South Africa. This factor has negative implications for the development of the national economy (BoN 2000). The cause for concern in Namibia is that deposits derived locally by the commercial banks are not used to develop the domestic economy.

There has been rapid expansion in commercial bank lending in Namibia. The total commercial bank credit as a percentage of Non-Government Organisation (GDP) currently stands at about 66 percent as at December 2005. This is quite high compared with the norm of 13 percent in sub-Saharan African countries. Except for South Africa and Mauritius, the ratio of credit to GDP in Namibia is the highest amongst the SADC countries. Although substantial credit is still allocated to individuals, lately, there has been a gradual shift in the allocation of credit to the manufacturing, real estate and construction sectors. Credit extended to the productive sectors of the economy has not been that encouraging and also not healthy for the long-run growth of the economy in terms of job creation and poverty alleviation. This is an area that needs immediate attention and where the current study focuses.

In spite of the expansion in overall commercial banks' credit, the allocation of credit to the various sectors of the economy remained unchanged over the years. The largest recipients of commercial bank credit are retail individual borrowers, followed by trade and service businesses, which together absorbed 81 percent of commercial banks credit as at December 2005. Only 19 percent of commercial banks' credit during the same period was shared by all productive sectors of the economy including construction, manufacturing, mining, fishing and the agricultural sectors (BoN 2004).

The Government of the Republic of Namibia has tried to reduce these problems by encouraging commercial banks to enter the market through the Small Business Credit Guarantee Schemes (SBCGS). Under this agreement, commercial banks lend money to small businesses, administer and monitor the loans, but the government bears most of the risk in the event of default. This will be explained in detail in the chapter that deals with lending to Small and Medium Enterprises (SMEs). Commercial banks, however, continue to bear a portion of the risk to eliminate the problem of moral hazard. Furthermore, the government entered into an agreement with two South African banking institutions i.e. the Development Bank of Southern Africa (DBSA) which already lends to the Namibia Development Corporation (NDC) and Windhoek Municipality; and the Industrial Development Corporation (IDC) which funds agricultural, mining and manufacturing projects in Namibia (BoN 2005).

For Namibia's banking sector to play an even more constructive role, a lot has to be done not only in terms of efficient service delivery but also in terms of reaching out to all the corners of the Namibian economy. Banks in Namibia need to extend their service provision and financial facilities to the regions and to all previously disadvantaged rural and urban communities. These banks act as facilitators of transactions and payments in the economy. As an intermediary sector of the economy the financial institutions are expected to be efficient in their operations.

Although the Namibian banking sector is highly concentrated, most of the bank branches are located in urban centers. Few are in rural areas. About 35 percent of all bank branches are concentrated in Windhoek.

1.2 Background

Namibia has a dual economy characterised by a highly developed modern market economy and the typical traditional rural economy. The productive sector in Namibian economy is the major source of national income and employment. The formal sector produces most of the country's wealth. This sector controls about 44 percent of total production and is owned by about 4000 people while more than two third of the Namibian population depend on subsistence agriculture in rural areas. A large number of the Namibian population is engaged in subsistence agriculture and livestock production. The people involved in subsistence agriculture produce for their own consumption. However, recent developments in Namibia indicate that a growing number of rural farmers produce not only for their own consumption but also for commercial purposes. The role of adequate credit to this up and coming sector of the economy cannot be overemphasized (BoN 2005).

1.3 Statement of the problem

The overall problem that this study has identified is that the commercial banks are reluctant to lend to the productive sectors. Although credit growth was remarkable over the years since independence, the growth in credit was highly biased toward certain sectors of the economy.

Credit in Namibia grew at rapid rates to the private sector from 15 to about 56 percent during the period between 1990 and 2005 as compared to the total credit transmitted in the economy. On the average 62.8 percent of private sector credit went to individuals between 2001 and 2005. The remaining share was almost equal to credit going into agriculture, fishing, mining and manufacturing. The range of what these four sectors contribute to GDP was recorded between 36 and 40 percent during the period of 1992 and 2005. This was not that encouraging in terms of job creation and economic growth (BoN 2005).

In Namibia, credit transferred to the private sector is higher than to the public sector as compared to other developing countries. In most African countries commercial bank credit to the public sector far outweighs the credit channeled to the private sector. This situation reflects badly on economic development as the public sector investment tends to crowd out private sector investment.

The rapid growth in credit to the private sector and the sluggish GDP growth rate that has remained stagnant or barely 3 percent since independence suggests that there might not be a strong causality between financial institutions development and economic growth. Therefore, policy initiatives designed to increase saving with the intention that the latter will increase the level of investment, and lower the spread in the economy might not actually produce the intended results. If the financial sector predates real growth in the economy, policies that are designed to promote the efficiency of the sector will induce growth. Policy makers need to focus on the reasons why finance has not been able to induce growth in the economy.

1.4 The research question

The research question guiding the investigation is: what are the reasons for commercial banks not lending to Namibia's productive sectors?

The following are the sub-research questions:

(a) What roles do the commercial banks play in terms of lending to the productive sectors?

(b) What are the trends in the sectoral allocation of credit in Namibia?

(c) How effective are the policies and procedures in terms of credit provision?

1.5 Objective of the study

It was established that Namibia is a net saver country, but most of these resources are not utilized within the economy of the country. As a result the country does not benefit much from its net saving because the huge amount of Namibian saving is invested in the South African economy. By nature of their business and activities, financial institutions are expected to encourage investments and development of the domestic economy by making credit facilities available to the productive sectors of the economy. Therefore the objectives of the study are as follows:

- To examine the trends in the sectoral allocation of credit in Namibia (1990-2005)
- To explain the trends observed in the (first objective) above
- To suggest policies and recommendations to remedy the above situation

1.6 The significance of the study

The result of this study will be helpful to policy makers, business people, NGO's, and other stakeholders to make the necessary decisions based on the situation of Namibia's economy with particular reference to lending process of the banks. It will also benefit the future researchers and scholars, and contribute to the growth of knowledge and academic debate.

1.7 Methodology of the study

Both qualitative and quantitative approaches are used in this study. Qualitative approach is used through semi-structured interviews to get the relevant information required for the study. Quantitative approach analyses the data from bank's annual reports. These approaches seek to uncover the interaction and relations between commercial banks and other financial institutions regarding credit allocation to various sectors of the economy.

1.7.1 In-depth Interviews: semi-structured interview, this allows the interviewer to rephrase questions to elicit for the relevant information required, whilst analysing information drawing from the informant's experiences, knowledge and opinion. Each category of respondents was questioned by using different semi-structured interview guidance, due to the varied nature of involvement in the provision of credits to the productive sectors. Respondents identified include economists, senior managers of banks, financial analysts, etc. from each commercial bank.

1.7.2 Document analysis: this forms an important part of data collection from those different annual reports, documents, publications and the report papers, for this study purposes. Given the general constraints in relation to available resources, the evaluation was based upon a review of relevant documents (e.g. financing agreement, project, Small Business Credit Guarantee Scheme, consumer credit market, etc). This enabled the researcher to obtain the relevant information from those documents on strategic decisions and processes that resulted in those decisions being taken.

1.7.3 Data analysis: statistical approach such as the means, standard deviation and other tools were used to present and analyse the data collected from the in-depth interviews and document analysis.

1.8 Limitations of the study

In undertaking a study of this nature, one is not unmindful of the limitations that attend it. This study places more emphasis only on the commercial banking system due to the limited data that is available. The study is conducted by using the different sources of data such as the annual reports of different banks, the annual reports of the Bank of Namibia, and confined only to the period from 1990 to 2005, to gain in-depth knowledge of why the commercial banks are reluctant to lend to the Namibia's productive sectors which are the driving force of the economy. In this way it should be possible to draw lessons on the basis of the methodology adopted rather than the details of operation, and this is where the relevance of this approach comes into play.

1.9 Study outline

The study is structured as follows: Chapter 1 contains the introduction and background part. It gives an overview of the statement of the problem, the research question. Chapter 2 deals with the literature review and theoretical framework.

Chapter 3 focuses on trends in the domestic credit growth and trends in sectoral allocation of credit over the years under investigation. Chapter 4 deals with the commercial banks lending and policy responses. Chapter 5 gives the policy responses to remedy the situation. Chapter 6 concludes the study. In addition, it provides some of the suggested policies and recommendations.

CHAPTER 2: LITERATURE REVIEW AND THEORETICAL FRAMEWORK

2.1 Literature review

Since banks constitute such a large part of the financial system in developing countries (including Namibia), their activities have a significant impact on the economy. The degree of lending to the private sector is particularly important because private sector firms can generally use domestic savings more productively than public sector entities. (Levine and Zervos 1998).

Of course, increased lending to the private sector will not necessarily result in higher per capita growth rates. The manner in which the lending occurs is critical. If banks recklessly augment the volume of lending to the private sector (perhaps by lending to insiders or politically connected firms), then the allocation of capital will not be efficient and savings will go to relatively unproductive sectors rather than the productive sector of the economy (Murinde 1996).

The Bank of Namibia (2000) commented on the decline experienced in private sector credit since 1995. In addition to the problem of collateral, another possible explanation given in the report was that the local economy could not effectively exploit the available supply of credit. The Bank of Namibia conducted a study on the supply and demand of commercial banks loans in Namibia and found that there are several other possible causes for the decline. The rise in government borrowing could have crowded out credit to the private sector, increases in the interest rates over the period could have dampened the demand for credit, and over the period commercial banks perceived that lending risks in the economy increased and this could have led to a decreased supply of credit.

According to the World Bank (2000): “The plethora of Development Financial Institution (DFI) in the early 1970s increasingly viewed and acted as tools of development policy, channeling resources to publicly promote or owned enterprises and to priority sectors which commercial lenders were unwilling to finance. The management of DFIs that were heavily dependent on government resources and operators in highly regulated financial markets were unable to make lending decisions based on independent assessments of business risks and profits. In addition, the intermediary spreads often did not reflect the true costs and risks involved in long-term lending to higher risk productive sectors. Commercial banks choose not to lend when the perceived risks are too high. Hence, specialised financial institutions are set up deliberately to lend to high-risk borrowers. However, they are not compensated for assuming higher risks with higher loan rates. Invariably, therefore, the specialised financial institution set up to support a problem in a sector of the national economy by itself becomes a problem institution”.

The World Bank (2000) comments on the difficulties of debt collection: “The banks are reluctant to widen their range of borrowers or to extend credit facilities to industry and agriculture, owing to inadequate protection under existing laws”.

One of the reasons why economic prosperity has remained elusive throughout the developing world is a widespread lack of access to credit for individuals and businesses. Financing constraints make it difficult for entrepreneurs to launch new businesses to grow and expand, especially in the productive sectors that comprise the main source of employment in Namibia (Demirguc-Kunt and Maksimovic 1998). In an efficient financial system, individual savings are mobilised by financial intermediaries and allocated to their most productive uses (World Bank 2001). In most developing countries banks are the primary financial intermediaries; in an efficient financial system these banks would therefore mobilize savings, usually in the form of deposits, and allocate them to productive sectors through loans. The allocation of savings to productive sectors results in increased employment and higher GDP.

Firm-level studies have shown that financial development reduces obstacles to firm expansion and is particularly beneficial for the growth of SMEs (Beck, Loayza and Levine 2000). Industry-level studies have shown that industries with significant external financing needs, such as textiles, machinery or drug manufacturing, have grown more rapidly in countries with greater financial development (Rajan and Zingales 2003).

Page and Steel (1984) divided the range of possible policy initiatives designed to promote the sector into two categories: demand and supply side policies. Demand side policies focus on income levels and distribution; countries have tended to favour larger enterprises, and reducing the system of regulations governing smaller enterprises.

Supply side policy measures include provision of financial and technical assistance, training, and provision of technology, infrastructure and assistance with input supplies.

In addition to the emphasis on supply side issues much of this support has focused on providing increased access to credit for small entrepreneurs rather than big projects. The fact that special loan programmes have tended to dominate small enterprise assistance projects was noted by Adams (1992) who warned that this response may have been due to the fact that it was much easier for donors and governments to create and fund credit programmes than it was to address other, more serious problems of the sector. The issues concerning the correct balance between supply and demand side initiatives, and the apparent bias towards a credit based solution to the problems of the productive sectors are two of the major themes underlying this study.

2.2 The role and importance of credit in development

The lack of access to credit is generally seen as a constraint to self-employment and enterprise development in the developing world. Few dispute that access to affordable institutional credit for fixed assets and working capital can improve livelihood and business survival as well as permitting entry and establishment of new enterprises (Dwyer and Bruce 1988).

At the most elementary level, credit is part of a system of financial intermediation that allocates resources over time and transfers resources from one individual, household, or firm to another. Credit is one of the strategic factors that determines the pace and pattern of socio-economic development. It facilitates as well as stimulates the development process (Adams and Okeahalam 1992). Credit can play a role in the development process by providing the needed liquidity to the poor who do not have sufficient investible funds to exploit opportunities.

As a result, the provision of credit brings about what is known as financial development through the widening, deepening and integration of capital markets (Nicholas 2002). Such financial development accelerates the pace of economic development through a favourable impact on savings, investment and increase in output. Credit is said to be a means of achieving development through the generation of productive employment for the growing labour forces in both rural and urban areas (Fry 1988).

Ipangelwa (2001) stated that credit extension is very important for rapid economic development particularly in a bank-based economy. The volume of credit as well as its allocation to key sectors of the economy can help to stimulate productive activities. Although the statistics show that the ratio of private sector credit to GDP is quite high in Namibia, more still needs to be done especially in the area of long-term loans. There is a strong need to direct credit to the previously disadvantaged people who because of the accident of history may not possess the specified collateral required by banks.

Credit facilities are also an integral part of the process of commercialisation of the economy. However, no amount of credit by itself, even at the most reasonable rates, can guarantee higher productivity or incomes amongst the poor if it is not complemented by the provision of the necessary inputs, extension services, stable macro economic factors, sound credit policies, well managed institutions and appropriate delivery channels (World Bank 2001).

As a logical step forward towards transforming the banking system, there seems to be a greater need for a review of our lending procedures, practices and credit assessment mechanisms with a view to ensuring supply of credit to the genuine clients and particularly to the hitherto neglected sectors. Available evidence shows that most of the credit extended by commercial banks is mainly used to finance properties and other personal items, and few to the productive sectors of economy. There are also reports by loan applicants that banks do not carry out proper investigation on project viability, particularly when this has to do with projects falling outside the purview of their traditional areas of financing (BoN 2001).

Commercial banks in Namibia have been able to meet the credit requirements in the economy, particularly the short-term financing requirements. However, the situation regarding mobilising and allocation of resources for meeting the medium and long-term financing requirements of the economy has not been that encouraging. While realizing that commercial banks in Namibia are efficient, the fact remains that a financing gap still exists in the economy. An effort to meet this financing gap requires the creation of appropriate institutional structures. This is reflected in high unemployment rate and disappointing performance of the manufacturing and services sectors that are in dire need of long-term capital (BoN 2003).

2.3 Theoretical framework

The traditional thinking on the relationship between interest rates, the supply of credit by commercial banks and economic growth is rooted in the loanable funds theory. According to this theory, the demand for loanable funds is assumed to be a declining function of the interest rate while the supply by banks is an increasing function. There is therefore an equilibrium interest rate at which the demand for loanable funds by firms is almost equal to the supply by banks and other financial institutions, and the market is cleared. Thus, it is expected that as interest rates on loans fall, the demand for investible funds should rise. Until recently, this conventional market-clearing analysis has remained fundamental for most theoretical and empirical deduction on the relationship between credit and interest rates (Pilbeam 1998).

The importance of commercial banks emanates from their very core function of intermediation. They act as a conduit through which the surplus institutions pass on their excess savings to deficit institutions in anticipation of earning a return as per the prevailing price for making funds available to deficit units within the economy (BoN 2001).

According to King and Levine (1993a), in a study involving 80 countries, they found that the level of financial development is a good predictor of economic growth. Furthermore, King and Levine (1993b) employed an endogenous growth model in which financial intermediaries obtain information about the quality of individual projects that is not easily available to private investors, and concluded that this information advantage enable financial intermediaries to fund innovative products and productive processes, thereby inducing economic growth. Levine and Zervos (1998) incorporated the stock market as a measure of financial development that had a positive effect on economic growth, capital accumulation and productivity.

According to Adams (1992), the formal banking sector appears to have an oligopolistic structure. This has implications on the delivery of services to the consumer. It raises the question as to the role, which other agents might play in the delivery of bank type financial services. This is particularly so if it is anticipated that there may neither be the will nor capacity to deregulate the formal sector (especially in Namibia) in such a way as to enhance competition and improve welfare.

Levine and Zervos (1998) stated that the relationship between the level of credit provided to the private sector and economic growth rates are substantially higher in countries with relatively robust lending to the private sector. A modest rise in the volume of credit to the private sector is often associated with a significant rise in GDP (Beck, Loayza and Levine 2004).

As an intermediary, commercial banks can take risks or act as brokers without a direct liability. The risk implies that the financial institutions can make use of savings made available by households, enterprises and the government to lend to deficit sector of the economy at a profit. The role of a broker without a direct liability implies that the financial institutions can just serve the role of facilitating transactions and safe keeping of the public savings. As mentioned above the banks are expected to be credible and efficient in their operations of facilitating transactions and wealth creation within the domestic economy.

For the sake of promoting economic growth and ensuring the availability of banking services and credit facilities to all Namibian people, new banking institutions could still join the banking industry, without compromising the overall profitability of the sector. This is mainly so because the existing commercial banks are producing below the average cost curves. It is also worth noting that most of the Namibian commercial banks are branches of South African banks. Though this has a negative national connotation, this fact has contributed to the financial service soundness in Namibia.

Commercial banks are institutions that accept deposits from savers and lend the money to borrowers. They are financial intermediaries. Savers and borrowers may include individuals, households, businesses or government. Banks make profits by charging borrowers higher rates of interest than they pay savers. They play an important role in the economy because they help channel savings to investments. However, they must carefully assess the risks they are taking when they lend because they guarantee the rate of interest they pay to savers. For them to remain financially sound and sustainable, banks must always ensure that the risks they are taking on the lending side of their operations do not endanger their ability to pay interest on the deposit side of their operations.

Non-commercial banks can be defined as those banks that do not generally take deposits from customers but instead raise money from governments and other financial institutions. They lend this money to the specific projects in both public and private sectors. Development banks may be funded by shareholders who provide money in exchange for ownership of the bank (equity), by loans that can be lent to projects at higher rates of interest (wholesale finance), or by selling debt (bonds and other debt instruments). Shareholders are generally governments or government institutions. Development banks typically get involved in lending to projects that commercial banks find too risky. Because of this, and because decisions are often made on political rather than commercial grounds, development banks often make little or no profit. Many have made considerable losses which then have to be paid for by the taxpayers (Sherbourne 2001).

Freedman (2006) defines credit as a condition which enables people to extend their control, as distinct from ownership, over resources. At the most elementary level, credit is part of a system of financial intermediation which allocates resources over time and transfers resources from one individual, household, or firm to another. Financial intermediaries accept deposits, providing their clients with a secure place to hold money while offering a monetary return. These funds are used as loans to others who lack sufficient funds for working capital or investment. The availability of credit is important to on-going production as well as initial investments. For instance in agriculture, credit is a useful ‘bridge’ because production is seasonal and considerable lag occurs between the outlay of major expenditure and the resultant flows of income.

The issue is whether there are gaps in the market for lending which are currently not being filled. Talking to business people in Namibia, there certainly appears to be much evidence that such gaps do exist. Business people large and small complain that their banks are not willing to lend to all but the safest bets. It is alleged that entire industries, such as the fishing industry, mining, etc, have grown up despite the lack of support from local lending institutions (Sherbourne 2001).

2.4 Review of the Namibian economy

Namibia is a very young republic and the last of the Botswana, Lesotho, Namibia and Swaziland (BLNS) countries to have become independent. In 2000, it had a GDP equal to about 3 percent of that of South Africa with a population of 1.8 million (4% of South Africa). Although Namibia has a high per capita GDP, it is also characterised by extreme inequality as measured by a Gini coefficient of 0.7 (which was the highest in the world in 1997). The richest 5 percent of the population enjoy 44 percent of the total income (BoN 2001).

Economic prospects in Namibia improved during 1999, compared to the two previous years. Domestic growth for the year was estimated at 3 percent. This is in line with the overall growth expectations and represents an improvement on the 2.4 percent and 2.6 percent growth rates recorded in 1998 and 1997, respectively. Declining interest rates since the beginning of 1999 contributed to the improved domestic economic conditions. Furthermore, it was recorded that the performance of the Namibian economy improved in 1999, supported mainly by a strong growth in value added in the Construction, Tourism, Agricultural and Mining sectors, as well as by an expansion in government consumption expenditure. The Bank of Namibia estimated the growth in the real gross domestic product (GDP) for 1999 at around 3 percent representing an increase of about half a percentage point above the rate recorded in the preceding year (BoN 1999).

The composition of the economy has remained stable over the last few years. The economy is also fairly balanced with no clearly dominant sector. Since 1996, the mining and manufacturing sectors have grown somewhat in their contribution to GDP while Agriculture, Construction and Transport and Communication have declined. The producers of Government Service category was still the largest component of GDP at 23 percent in 2000. This is a reduction from its 25 percent level in 1996, but it is still fairly high compared to 15 percent in South Africa. Mining and Quarrying is in second place contributing just over 14 percent to GDP in 2000. Although Agriculture contributes a fairly small 6 percent and has declined somewhat since 1996, 70 percent of the population is dependent on farming for their livelihood (BoN 2000).

The Namibian economy is fairly open and exports have been a significant component of economic activity over the last decade contributing on average about 50 percent to GDP. However, 84 percent of Namibian imports are still sourced from South Africa.

Table: 1 Contribution to GDP by Sector, 1995-2005 (%)

Industry	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Agriculture and forestry products	6.9	7.2	6.4	5.3	6.0	6.2	4.1	5.1	5.4	5.2	6.2
Fishery Products	3.9	4.6	4.3	5.5	5.3	5.4	5.2	4.9	5.2	4.3	5.0
Mining and quarrying	8.3	11.3	11.4	10.8	10.5	14.4	13.2	13.9	8.8	9.6	8.6
Manufacturing	11.5	9.8	10.9	12.0	11.2	11.3	9.4	10.0	11.4	11.1	10.7
Electricity and water	2.0	2.3	2.4	2.7	2.9	2.6	2.2	2.6	3.0	3.3	3.5
Construction	2.8	3.3	2.9	3.1	2.6	2.2	2.8	2.2	3.0	3.1	3.2
Hotels & Restaurants	1.7	1.6	2.0	2.1	1.9	1.9	1.7	1.7	1.9	1.8	1.7
Transport and communication	6.7	7.2	7.2	6.5	6.7	6.4	5.5	6.3	7.0	7.3	7.4
Financial intermediation	2.6	3.5	4.0	3.8	4.0	3.6	3.5	3.3	3.7	3.4	3.8
Real estate and business services	9.7	11.3	10.7	10.6	10.9	10.4	9.0	8.6	9.3	9.8	9.5
Community, social and personal services	0.9	1.0	0.9	0.9	0.9	0.9	0.8	0.7	0.8	0.8	0.9
Procedures of government services	21.9	25.1	24.8	24.3	25.	22.8	21.0	19.9	20.3	19.7	19.0
Other producers	2.1	2.2	2.2	2.1	2.1	2.0	1.8	1.7	1.8	1.8	1.8

Source: BoN 2005

Namibia is much less dependent on Southern Africa Customs Union (SACU) receipts for its government revenue than the other BLNS countries. The main sources of government revenue are domestic taxes on goods and services (34.9% of revenue), taxes on international trade and SACU receipts (29.4%) (BoN 2001).

Although stable growth has been a positive factor in the Namibian economy, it has been too low to provide any substantial increase in per capita income. The government is also aware that income distribution is skewed and needs to be addressed. The government plans to invest in both physical and capital assets and human resources in order to achieve higher growth in production, incomes, and also to be able to address poverty effectively. The primary (raw material producing) and tertiary (services) sectors were the driving forces behind economic growth between 1995 and 2000. Average real growth in the mining sector has been below 1.5 percent since mid-1990s. Ongoing investment in new mining projects is expected to turn the sector around in the near future (BoN 2000).

During the 2001/2005 fiscal years, GDP grew by around 66 percent. The comparatively low growth is due to a decline in all primary industries but was offset by impressive growth in other sectors, particularly construction. Agricultural output declined by 11.4 percent in 2001, compared to a growth of 4.3 percent in the previous year. The fishing and fish processing sector fell by 7.7 percent in 2001, following a decrease in fish catches. The mining sector continued to decline due to falling production in diamonds and other mining and quarrying activities. The diamond production has also dropped by 5.1 percent. The star performer was the construction sector, which grew by 49.4 percent, driven by the NamPower construction project. There was also an increase in the number of building plans passed and completed in both the residential and commercial sectors (BoN 2001). Against a background of strict fiscal discipline, the 2002 budget theme was to stimulate and support economic development and employment creation.

Overall, the available indicators show that the Namibian economy portrayed positive signs of economic developments that are in line with the recovery in the global economy during the second quarter of 2006. Some key economic indicators in the mining sector improved, spurred by the prevailing high commodity prices and favorable exchange rates, although indicators in some other sectors, such as fishing and agriculture indicated slowdown in activities. However, consumption expenditure continued to increase an indication that the economy might have performed better in the last quarter of 2006.

CHAPTER 3: THE TRENDS IN THE SECTORAL ALLOCATION OF CREDIT IN NAMIBIA (1990-2005)

3.1 Trends in Domestic Credit Growth

The Bank of Namibia (2004) stated that bank credit account for close to 85 percent of total (formal) domestic credit to the private sector. Commercial bank credit to the private sectors has grown substantially since 1990 but the growth rate has slowed down considerably since 1996. Real credit to the private sector grew at an annual average rate of 17.8 percent between 1991 and 1995. However, between 1996 and 2000 it fell to 3.14 percent. The slowdown in the growth rate of domestic credit during the second half of the last decade is often attributed to the tight monetary policy stance adopted by many emerging market central banks, especially after the Asian financial crisis of 1997/8 and the expansion of financial markets.

The commercial bank credit to the central government grew at an average rate of about 25.9 percent during the period 1996-2000, while the private sector credit slowed down to a rate of about 11.6 percent during the period of 2001-2004. The annual growth rate of domestic credit comprising primarily of private sector credit and credit to central government increased by 15.2 percent at the end of December 2000, compared with an annual growth rate of 9.6 percent at the end of December 1999. The increase in private sector credit was reflected in both its components namely, individuals or households and the business sector (BoN 2004).

The total commercial bank credit in nominal terms represented 33.6 percent of GDP in 1983, and has grown rapidly to 66 percent as at December 2005. Commercial bank credit to the private sector has seen a major boost rising from 15 percent to about 56 percent during the same period after a slight down turn between 1996 and 1999. On the other hand credit to government, which was barely 1.3 percent in 1983 has seen an increasing trend, peaking in 1999 when it nudged 4.1 percent. Thereafter it has taken on a decline falling to 3.1 percent in 2005 (Ikhide 2006).

There is little variability in the allocation of credit to the different sectors over the years. Substantial credit is still extended to individuals mainly in the form of mortgage loans. On the average 62.8 percent of private sector credit went to individuals between 2001 and 2005. Most credit extended by banks (to individuals) is mainly used to finance properties (mortgage advances) and other personal items and for consumption (e.g. installment credit). Mortgage loans now consumes more than 50 percent of total loans and advances leaving other loans and advances consisting of overdrafts and installment credit to account for the remaining sectors. Overdrafts account for more than 50 percent of other loans and advances. This development is not growth oriented, as it does not increase output and employment directly. In addition, the devotion of a disproportionate size of loans and advances to mortgage could leave the banks vulnerable to credit risk (World Bank 2000)

Table 2: Analysis of Credit to Private Sector

	2001	**2002**	**2003**	**2004**	**2005**
Annual growth rates					
Types					
Individuals	2.3	25.2	49.6	19.4	26.6
Businesses	41.1	13.8	30.2	13.5	13.7
Composition					
Loans and Advances	8.1	21.4	57.8	18.3	16.7
Of which					
Mortgage loans	17.1	17.9	83.7	19.2	21.1
Other loans and advances	1.0	23.3	37.1	17.2	11.6
Installment credit	25.2	16.1	17.7	19.2	21.5
As share of total private sector credit					
Individuals	63.9	58.6	61.9	63.5	65.9
Businesses	36.1	41.4	38.1	36.5	34.1
Loan and advances	79.6	72.7	81.9	81.9	78.5
Of which					
Mortgage	43.2	47.5	53.7	54.1	56.1
Other loans and advances	55.1	52.5	46.3	45.9	43.9
Installment credit	17.9	19.2	15.4	15.6	15.5
Others	2.5	8.1	2.7	2.7	6.0

Source: Ikhide 2006

The average annual growth rate of domestic credit, consisting private sector credit and credit to the government sector slowed moderately to 15.6 percent during the first half of 2002, compared with the average annual growth rate of 17.0 percent registered for the corresponding half of the preceding year. Consequently, the average annual growth rate of credit extended to individuals remained constant at around 13.0 percent, moving from 13.3 percent in 2001 to 13.2 percent in 2002. Similarly, the average annual growth rate of credit to the business sector subsided substantially to 8.9 percent during the second half of 2002 from 30.2 percent during the first half of the year (BoN 2002).

3.2 Trends in Sectoral Allocation of Credit

Although commercial bank credit to the private sector has grown substantially since 1990, the rate of such growth has slowed since 1996. Real credit to the private sector grew at an annual average rate of 12.6 percent between 1990 and 1995, but between 1996 and 1999 it fell to 6.8 percent. There has also been little variability in the allocation of credit to the different sectors over the years. Substantial credit is extended to individuals, mainly in the form of loans and advances, followed by installment credit. In a number of developed countries, this picture is an exact mirror image: more credit is extended to businesses than to individuals (BoN 1999).

In terms of sectoral allocation, the share of private sector credit allocated to individuals is almost equal to the total of credit going into agriculture, fishing, mining and manufacturing. Yet the contribution of these four sectors to total national output ranged between 36 and 40 percent between 1992 and 2005. This lopsided credit distribution is also not healthy for the long-run growth of the economy (BoN 2005).

Table 3: Sectoral Allocation of Credit, 1990 – 2005 (%)

Industry	Dec 92	Dec 93	Dec 94	Dec 95	Dec 96	Dec 97	Dec 98	Dec 99	Dec 00	Dec 01	Dec 02	Dec 03	Dec 04	Dec 05
Agriculture/ Forestry	14.2	9.5	6.4	5.3	4.9	4.5	4.5	4.50	5.0	5.0	3.7	3.5	4.1	3.8
Fishing	4.1	4.3	3.7	5.7	4.9	5.2	4.9	6.1	5.3	4.0	5.0	4.6	4.2	3.6
Mining and Quarrying	9.3	10.5	7.4	0.3	0.7	1.6	2.9	1.1	0.8	1.0	1.6	1.9	2.3	2.0
Manufacturing	3.1	4.6	4.7	5.3	4.8	5.5	4.7	2.4	5.7	5.0	4.2	2.7	1.6	2.1
Building and Construction	5.6	3.8	2.4	14.2	14.1	14.1	12.9	13.3	4.5	6.0	5.0	4.6	1.2	5.4
Commercial and Services	24.6	25.0	28.0	27.9	27.6	26.3	29.4	28.3	27.0	31.0	27.7	25.1	29.9	26.8
Individual and Others	39.1	42.3	47.4	41.3	43.0	42.7	40.7	42.9	51.7	50.0	52.8	57.5	56.7	56.3

Source: Bank of Namibia: Quarterly – Bulletin – Various issues

The credit to individuals dominated the sectoral allocation of commercial bank credit to the private sector, constituting 43 percent of total credit as at December 1999, compared to 42 percent the previous year. The share of credit to the commercial and services sector declined slightly from 29 percent to 28 percent. The rise in commercial bank credit to individuals was caused mainly by a 17 percent growth in mortgage loans during the period under review. The share of commercial bank credit extended to the Agricultural and the Fishing sectors increased slightly by 2 and 1 percent, respectively. The total share of credit to these sectors, however, remained at 11 percent of the total commercial bank credit to the private sector. The share of commercial bank credit to the mining and quarrying sectors declined from 3 percent to 1 percent, while that of building and construction remained unchanged at 13 percent. The share of credit to individuals increased slightly from 41 percent at the end of December 1998 to 43 percent one year later. As a result, individuals and others remained the largest consumers of commercial bank credit (BoN 1999).

Furthermore, the credit to individuals constituted 51.7 percent of the total credit at the end of 2000 compared with 42.0 percent at the end of the previous year. However the share of credit to the commercial and services sector increased slightly from 28.0 percent at the end of December 1999 to 29.0 percent at the end of 2000. The rise in commercial bank credit to individuals has been encouraging because the bulk of it was caused by a strong growth in mortgage loans and, therefore, did not finance consumption. The agricultural and fishing sectors accounted for 5.0 and 5.3 percent of total commercial bank credit, respectively compared to 6.1 percent registered by both these sectors in the preceding year. This means that the total share of these two sectors declined from 12.1 percent in the previous year to 10.3 percent in 2000. The share of mining and quarrying in total commercial bank credit declined slightly from 1.1 percent in 1999 to 0.8 percent in 2000. There has been a sharp decline in the share of building and construction in total commercial bank credit from 13 percent at the end December of 1999 to 4.5 percent in 2000 (BoN 2000).

The growth in credit granted to the 'Commercial and Services' sector accelerated to 26.4 percent in 2001 from 12.6 percent in the preceding year. This could be attributable to the salary adjustments granted to civil servants, especially the re-introduction of the management cadre's motor vehicle scheme, which led to an increase in the demand for certain consumables. Credit extended to the mining sector fell by 5.9 percent as opposed to the construction of 9.9 percent that was registered for the preceding year. The increase in credit extended to the latter sector is attributed to some mining companies replacing machinery during the year, as well as Ongopolo's copper mine reaching its full capacity. The credit extended to the manufacturing sector grew by 12.2 percent during the year under review, while credit extended to the fishing sector expanded by about 11.0 percent, reflecting the difficulties they faced in the wake of adverse oceanic conditions. Growth in credit extended to the agricultural sector improved moderately by 3.4 percent, as opposed to a construction of 2.4 percent registered in the preceding year (BoN 2001).

The commercial bank's credit was dominated by credit granted to individuals, followed by credit to the "Commercial and Services" category. During the last decade credit to individuals consistently accounted for more than 50 percent of the total private sector credit, with credit to the Commercial and Services sector accounting for 30 percent during the 1995 and about 21 percent during the 2000 years, respectively. The other productive sectors of the economy, namely agriculture, mining, manufacturing, and building and construction, collectively accounted for 30 percent at the end of 1995 and

21 percent at the end of 2000, respectively. This situation is highly undesirable. For the economy to reach its optimal level of growth, more resources need to be channeled into the productive sectors of the economy.

In terms of sectoral distribution, individuals and others continued to take the largest share of the total credit extended by the banking sector, followed by Commercial and Services. These two sectors accounted for 52.8 percent and 27.7 percent respectively, of the total outstanding credit at the end of December 2002. The combined credit extended to the building and construction sector, fishing, agriculture and manufacturing, constituted 19.2 percent of the total commercial bank credit. Growth in credit to the fishing sector also increased from 11.0 percent in 2001 to 18.0 percent in 2002. It is important to note that the growth in credit to the manufacturing sector declined by 17.4 percent during the year under review. This was in sharp contrast to the positive growth rate of 12.2 percent registered during the previous year. Growth in the credit allocations to the agriculture and mining sectors declined by 0.2 percent and 2.01 percent, respectively during 2002 (BoN 2002).

Growth in the credit allocations to the building and construction was recorded at 35.4 percent in 2002 and 41.5 percent in 2003. The increase in the growth of credit was attributable to the fall of interest rates during 2003. Similarly, growth in credit to the mining and quarrying, and commercial and services sectors rose during the year under review. Growth in the credit granted to the fishing sector, on the other hand, slowed down from 20.0 percent in 2002 to 18.0 percent during the year under review. The commercial and services sectors, registering increases of 46.6 percent and 39.9 percent, in 2005 compared with a decline of 7.5 percent in the fishing sector and increases of 23.1 percent and 28.4 percent in the mining and quarrying, and the commercial and services sector during the previous year. Similarly, the credit extended to the agricultural sector had risen by 35.1 percent as against an increase of 29.8 percent in the agricultural sector during the corresponding period of the previous year. Growth in credit which had been extended to the building, construction, and manufacturing sectors, had declined by a significant 76.0 percent and 3.7 percent, respectively, during 2005, compared with an increase of 39.9 percent and a decline of 6.9 percent respectively, during 2004 (BoN 2003).

Commercial bank's lending capacity in nominal terms measured as the difference between total commercial bank liabilities and total reserves plus capital account increased substantially over the past few years. Domestic credit to GDP at 49 percent is higher that the developing countries modes of 48 percent though lower than the middle income countries mode of 89 percent. Going by these figures, commercial banks in Namibia ought to be able to lend to enterprises and individuals especially enterprises that are engaged in productive activities (BoN 2002).

This chapter has attempted to review the progress made to diversify the Namibian economy since independence. It has found that despite a number of initiatives and policy measures put in place by the government to diversify the economy, this has not yet shown the desired sectoral allocation of credit shift. This suggests that measures put in place to promote this sector have not achieved the intended results. Nonetheless, some interesting developments in terms of diversification have been observed in the agricultural sector. Though the service sector appears to have the greatest potential for moving the Namibian economy forward, the agricultural sector should not be ignored in any development effort. Since about 70 percent of the population derived their livelihood from the agricultural sector, development in the long run, will also depend on improvement of this sector.

Finally, there has however, been no significant change in the composition of the assets of commercial banks. Lending to individuals has dominated credit facilities exclusively during the period under review, in contrast to the experience of some dynamic developing countries, such as Mauritius and Singapore.

CHAPTER 4: WHY ARE COMMERCIAL BANKS NOT LENDING TO THE PRODUCTIVE SECTORS?

4.1 Findings

From our data analysis in Chapter 3, Namibian banks do not see it as their business to lend to risky long-term investments. However, Namibia's banking sector has strong links with lending institutions elsewhere. Critics of the local banks have to explain why profitable opportunities are being overlooked since these sister institutions spend considerable time and energy seeking out profitable opportunities. It may be that certain projects requiring credit are simply too big for these banks to lend to since no bank is allowed to invest more than a certain amount of money in a single project. These prudential requirements are designed to stop banks from putting all their eggs in one basket. They must spread risk widely so that if one investment fails, the return from the others will ensure a positive overall return is achieved. These larger projects include major infrastructure projects and other large investments. However, this is precisely why it is so advantageous to be an economy open to the rest of the world.

The other underlying finding in this context arises from the fact that the commercial banking system normally operates under certain regulatory framework. The regulatory framework requires that banks should pursue prudent lending activities. This in most cases has meant adherence to strict lending norms as per regulatory requirements. Furthermore, the short-term nature of the liabilities of commercial banks dictates that the term structure of their loans should be tailored to suit their balance sheets. It is very important that banks should pursue a policy of maintaining a most appropriate asset-liability structure. In other words, there should be a consistency between the asset structure and liability structure in terms of maturity and yield structure. These regulatory requirements often constrain banks in fulfilling the medium and long-term requirements of financing or in extending more loans to productive sector of the economy even though their requirements are genuine in Namibia.

In addition, the following factors have been identified as evidence and possible causes of the unwillingness of banks to lend to the productive sectors. One possible cause of the supply constrained phenomenon is the perception by banks of a high lending risk. In theory, dealing with risk is one of the reasons the financial sector exists in the first place. Riskier projects can be funded provided lenders can ask for higher returns. Furthermore, lenders can reduce risk by lending to several projects at once taking into account that a proportion will fail. Provided institutions are allowed to price risk and spread risk properly, risk should not present a problem. If it is possible for commercial banks to constrain their lending in an attempt to minimize their lending risks without necessarily compromising their profitability, they will do this[1]. Some of the evidence from commercial banks balance sheet that tend to support the view that perception of risk in lending is the main constraint to lending in Namibia is provided below:

[1] Commercial banks profitability could not have been constrained in the face of high real interest rates and excessive bank charges.

4.1.1 High Liquidity ratio by banks

It was argued earlier that the ratio of credit to the private sector to GDP is relatively high in Namibia. But a more realistic assessment would involve looking at the ratio of liquid liabilities to GDP. A relatively high ratio of liquid assets to GDP might be suggestive of the fact that commercial banks may be keeping a substantial part of their deposits in liquid assets, such as cash, deposits with other banks, central bank debt, and short-term government securities (Freedman and Click 2006). The ratio of liquid liabilities to GDP in Namibia is currently put at 35 percent. Compared to a median average of 45 percent for a sample of 35 developing countries and 19 percent for five developed countries (Japan, USA, UK, Germany and France), it can be inferred that the figure for Namibia is high. South African reported 14 percent and the figures for the United State of America (USA) and the United Kingdom (UK) are respectively 6 and 2 percent. For bank-based developed financial systems like Japan and Germany, the figures are slightly higher at 19 and 21 percent respectively.

Why would Namibia commercial banks keep such levels of liquidity granted that they do not earn comparable returns as loans? Two explanations are possible; a lack of investment opportunities in the domestic economy, and the second explanation, which seems more realistic, is the need by banks to avoid a perceived risk in lending.

4.1.2 Decline in ratio of Risk-weighted assets to total assets

It was also observed a decline in risk-weighed assets to total assets of banks. The risk-weighted assets of banks consist essentially of their loans. Risk-weighted asset as a ratio of total assets is expected to decline with prudent supervision and management. However, the sudden drop especially after 1998 could be a pointer to a decline in commercial bank loans supply.

4.1.3 Decline in overdrafts in total bank lending

The share of overdrafts in total bank lending has also declined over the period. Under normal circumstances, this is a welcome development but the phenomenon here has more to do with the tendency to avoid risk by banks. Banks have tended to exercise more control over their lending.

4.1.4 Pronounced rise in collateralised lending

Collateralised lending has been on the increase during this period in Namibia. Banks require collateral from borrowers to minimize their losses should the borrower default. Collateral also serves as a device for screening prospective borrowers to make sure they are going to repay, and a borrower's willingness to risk the loss of collateral suggests that the borrower is confident to repay the loan. The prospect of losing collateral serves as a powerful incentive for a borrower to avoid default. Most legal systems in developing countries fail to provide for the repossession and sale of collateral without going through judicial proceedings, resulting in significant delays from the time of default to the time the collateral is sold to pay off the loan (World Bank, 2004). That is why it reviewed early in chapter 3 that mortgage loans as a percentage of total private sector loans has hovered between 44 and 49 percent between 2001 and 2005 in Namibia.

4.1.5 Increase in government borrowing from the banking system

The other important finding that may have played an important role in commercial bank lending to the public sector is the increase in government borrowing from the banking system. Higher government borrowing may have helped to “crowd out” bank credit to the private sector. The possibility of a crowding out through the interest rate effect has been a subject of much controversy in the domestic economy because of the existence of the CMA arrangement, which tends to anchor domestic interest rates to the South Africa interest rates. It is still possible inspite of this arrangement for government borrowing to crowd out the private sector through the interest rate effect. Higher government borrowing whether domestic or external is generally associated with country risk and domestic interest rates tend to rise in line with the risk-premium adjusted uncovered interest parity condition. In the same vein, large domestic firms that borrow from international capital markets will tend to face steeper supply curve for loanable funds resulting from higher relative country risk.

Credit to government as a percentage of total credit rose steadily after independence from a low of -17.3 percent in 1991 to 15.7 percent in 1996. Thereafter it declined. This ratio stood at around 8.2 percent for the period 1996-2000 and declined further to

4.1 percent between the period 2001 and 2005. By providing banks with a high return and relatively less risky outlet for their increased liquidity, higher government borrowing from commercial banks may have indirectly discouraged banks from searching for new private borrowers.

Despite this constraint Banks have begun to downstream their service offerings towards the marginal small enterprise sector by offering microfinance (Harper and Arora 2005). In Namibia Bank Windhoek has a branch sorely dedicated to lending to the emerging SMEs sector and other banks in Namibia may soon follow suit.

From the foregoing, it would appear that the observed apathy to lending especially to SMEs and the real sector is not due to a lack of funds. On the other hand, banks choose to channel only a small proportion of their funds to productive sector lending while keeping a sizeable proportion in liquid assets to avoid risk. This strategy has resulted in increased net lending to government and the persistence high liquidity in the banking system.

4.2 Lending to SMEs

The commercial banks stated that they could only lend to viable business initiatives on a market related interest rate. It is a known fact that commercial banks are profit oriented and backed by shareholders equity and depositors funds. Therefore, there is the issue of accountability by commercial banks to their Shareholders, Depositors and Bank

Supervisory Authorities. It has been experienced that the financial institutions are starting to recognize the importance of financing the SME sector. In one of the interviews with an economist of one of the commercial banks in the region, said, “The SME sector is our future; they are the big businesses of tomorrow. It is in our best interest to support this sector if the financial sector is to achieve any meaningful growth in the future.”

Although the banking sector is beginning to recognise the importance of financing this sector, the question one can ask is how far are the banks ready to go in financing this sector? Banks in the Southern Africa region [including Namibia], being mainly European banks operate under the British banking system which is collateral based. SMEs usually lack the required collateral, therefore their access to credit is constrained. How flexible are the banks [in the SADC region in general and Namibia in particular] in experimenting with new financial instruments for financing SMEs?

Currently, to finance this sector, banks require risk sharing in the form of guarantee facility from a third party (e.g. government or donors). Creating sustainable access to finance this sector does not necessarily have to involve guarantee through donor funding or subsidized credit from the government. The interventions affect financial institutions, especially, control over interest rates on deposits and on lending can have very negative effects on access to credit for SMEs. A maximum lending rate could restrain lending to SMEs because the higher operational costs cannot be transferred.

So far we have tried to establish that due to perceived risk, credit might be supply constrained in Namibia. There are two broad aspects to this. First and foremost, access to financial services (including credit) and relatively high costs of financing are major challenges for a disproportionately large segment of the economy. There is limited physical access to bank branches as banks mainly serve the urban rich. Second, banks impose high bank charges on minimum balances. Third, real interest rates on loans are still high. All these issues cannot be addressed in this study.

In a Finmark Trust survey conducted for Southern Africa in 2004, it was found that close to 49 percent of the population in Namibia do not have access to banking services[2]. For a country with M2/GDP ratio over 65 per cent, this is an absurdity[3].

The second aspect is the inability of the banking system to reach the unbanked-low income earners, micro enterprises, and the poor[4] due to a combination of high risks, high costs and low returns associated with financing this group. To overcome asymmetries, which could lead to the poor defaulting, banks often require collateral, which the poor seldom have. Conventional forms of collateral such as title over fixed property are, due to the immediate past history of many households and firms are not available. This problem is more severe with lending to micro enterprises. As a matter of fact, banks

[2] Finmark Trust has tried to compute unmet household demand for financial services in the region. Their efforts led to the adoption of the "Financial Access Charter" in South Africa. The Mzansi accounts, which involve low cost banking for low-income earners, is one of the outcomes of this effort.

[3] The fact is that this aggregate measure of performance of the banking sector hides a number of microeconomic issues relating to commercial bank's performance in the credit market.

[4] Commercial banks in many developing countries have this problem. However, the problem is unique in Namibia and South Africa because of the legacy of apartheid.

have devised means of perfecting their lending mechanism for salaried low income earners by providing deposit and withdrawal facilities for them, though a lot still needs to be done when it comes to providing credit to the SMEs group. Moreover, the nature of poverty in Namibia is strongly rural-based. Thus, providing loans to those employed in the formal sector of the economy still excludes the majority of the poor (Ikhide 2006).

However, efforts at providing loans to SMEs still remain a major issue in Namibia. This segment of the unbanked is more risky and constitutes a major problem for the economy. Micro enterprise lending could considerably boost economic activity if properly coordinated. Financial asset availability due to asymmetric information and lack of collateral has been shown to be a binding constraint for entering self-employment in many developing countries.

Various studies have documented the lack of access to credit as major constraint to the development of SMEs in Namibia. The Ministry of Trade and Industry (MTI) survey (1998), found that the majority of SMEs do not have access to bank credit. In a similar study conducted by the Bank of Namibia, it was established that though commercial banks have made substantial inroads into this sector in recent years (SMEs received about N$449 million loans across the country in 2003), with the total number of SMEs put at 33,403 and loan accounts at 10206, it is clear that about 69.4 percent of SMEs are not able to access credit from banks (BoN 2003).

Table 4: Commercial Banks SMEs Loans by Region

Regions	Total Loans to SMEs (N$)	Total number of loan accounts of SMEs	Population	No of Bank branches
Caprivi	524957	5	79852	3
Kavango	3468689	61	201093	3
Otjozondjupa	45597639	710	135723	11
Oshikoto	7921484	247	160748	4
Oshana	36232812	813	161977	8
Ohangwena	155000	5	227728	2
Omusati	1921928	45	228384	0
Kunene	8727401	169	68224	4
Erongo	61698107	1217	107629	13
Karas	18977352	452	69677	16
Hardap	9864725	417	67998	5
Omaheke	11170291	290	67496	2
Khomas	243.352,344	5775	250305	19
Total	449,612,728	10206	1826814	90

Source: Bank of Namibia

Ikhide (2006) observed that one of the major reasons why SMEs are not able to access loans from commercial banks is the lack of access to banking services. Generally, the regions where the banks have not established their presence are also the regions where SMEs tend to have the lowest loan accounts. Unfortunately, some of these regions also have the highest population density.

In addition to the issue of access, the study also found that the issue of collateral played a crucial role in SME access to bank credit. Commercial bank insists on the "strict" form of collateral (insurance, salary/income, investment guarantees), which the SMEs cannot afford. The less formal forms of collateral such as savings and physical assets are less often required. It has to be understood that from the perspective of the banks, the strict form of collateral enable the banks to cushion themselves against default risk. Commercial banks claim that they have experienced substantial defaults from SMEs. In 2003, the default rate was put at 20 percent in Namibia.

Furthermore, the other factor that militates against SMEs borrowing from commercial banks is high lending rates. Most commercial banks lend to SMEs at Prime rate plus 2 to 4 percent. The rate varies from bank to bank. While this might look high, the rate is substantially below what SMEs obtain from micro lenders whose rates remain undecided around 30 percent or more in Namibia. The fact that SMEs patronise most of these micro lenders tends to weaken the argument on high lending rates as a deterrent to borrowing (Ikhide 2006).

In an effort to encourage bank lending to SMEs, the government introduced the Small Business Credit Guarantee Trust (SBCGT) scheme. To benefit from this scheme, SMEs are expected to provide some information such as "bankable" business plans, ability to provide a 10 percent deposit, personal financial statements, and proof of business registration, bank records, guarantee and adequate collateral. It is obvious that some of these requirements might be too strict for SMEs, especially the informal ones that are either not registered with the Ministry of Trade or own (have access) bank accounts. Thus, it is not surprising that many SMEs do not have access to credit.

Bank Windhoek is one of the first banks in Namibia to recognise the important role small and medium enterprises (SMEs) play in the creation of wealth, livelihoods and employment. The sector's development requires technical support in the form of mentoring and training in order to enable SME operators to run their business more efficiently.

Currently, the Bank Windhoek Emergent Small and Medium Enterprises (ESME) Branch serves over 300 small business clients with varying levels of experience, 65 percent of these clients are previously disadvantaged Namibians from all over the country and one third are women. So far, the Khomas and Oshana regions have been the keenest applicants for finance (BoN 2005).

Financing is dealt with via a Windhoek-based centralised office, supported by offices in the Oshakati and Ondangwa branches and a network of retail officers stationed in Bank Windhoek branches throughout the country.

In November 2005, the German Development Service/Deutscher Entwicklungsdienst (GDS) entered into a co-operation agreement with Bank Windhoek to offer post loan mentorship and training programmes. Traditionally, GDS has solely worked with government and non-governmental organisations. The cooperation with Bank Windhoek is their first partnership for development with a private sector in Namibia.

One of the biggest challenges faced by Namibian SMEs is not only access to finance but also the lack of basic business skill, especially in financial management. GDS thus considers mentorship as an effective instrument to improve productivity competitiveness and the bank ability of SMEs.

The Deutsche Gesellchaft fur technische Zusammenarbeit GmbH (GTZ) agreed to support business development services, including training, business consultancy and marketing services.

Bank Windhoek is not only committed to providing Namibian small entrepreneurs with access to finance, but has taken this commitment one step further. Selected small business people (who have received loans from the Banks ESME branch) have also been given the opportunity to receive mentorship in various aspects of business. Experienced mentors assist SME owners to develop effective and efficient financial and operational systems, facilitate the development of networks and linkages within the business community, and provide assistance in achieving compliance with statutory requirements.

The key constraint for small businesses is managerial and entrepreneurial expertise. A big business has people that are experts in marketing, in finance and so on. Small business entrepreneurs need to be experts in everything. The challenges facing small entrepreneurs are enormous. That is why mentorship is so important to ensure that much support is given to emergent small businesses.

The experience of South Africa with bank lending to SMEs might be instructive. South Africa started with the linkage banking system, where banks link with informal financial sector, self-help groups, and grassroots social organisations formed to address the financial needs of their members in a collective manner. NGOs also come in to play an intermediary role. The strategy here is to avoid the high default risk banks have to face when lending to micro enterprises by utilizing the social collateral (peer pressure) provided by the groups. In addition, transaction costs are reduced when banks deal with groups instead of individuals. In South Africa where this was practice for a couple of years, linkage banking was not such a huge success. The big commercial banks did not see this as profitable and hence the project is almost dead (Schoombee 2000).

The other strategy is the downscaling approach, where banks create either a separate division or a subsidiary to enter the micro-lending market. Again the experience from South Africa shows that the big banks did not warm up to this idea for too long. The lack of managerial and entrepreneurial skills and adequate risk capital in micro enterprises were major impediments to lending to enterprises. The failure of the big banks with downscaling will tend to point to the fact that big banks may have serious problems with integrating micro-lending operations into existing bank structures. Linkage banking on the other hand requires more than an intermediary e.g. the NGO must position herself to train the loan beneficiaries. Trainers are not easy to come by due to the absence of adequate technical skills.

Given these shortcomings in the two approaches; a new method for reaching SMEs has been fine-tuned in the international literature. This new approach, the dedicated bank approach, involves specialized public-private partnerships in banking set up mainly to provide lending on a substantial scale to micro enterprises. This is able to overcome the two critical problems faced by earlier approaches. First, the specialised private investors provide the required technical assistance needed to handle micro enterprise lending. Second, the public development institution provides the funding thus taking care of the grant funding or government subsidies required. In the case of South Africa, the private investor is supposed to be a foreign investor who has the expertise in this area while the public institution more often than not is a major donor organisation (Schoombee 2000).

The existing banking arrangement in Namibia cannot be expected to tackle micro enterprise lending particularly under present circumstances. In a country where the unemployment rate is close to 35 percent, the role of self employment cannot be overstressed. Bank assistance with start-off capital is indispensable for entrepreneurs who wanted to embark on micro enterprises. The experience of South Africa with the various approaches especially the linkage approach (which involves the guarantee scheme) is instructive for Namibia. Banks in Namibia will continue to focus on short-term consumption related funding given the risk involved in production related lending. What this calls for is a new approach to delivering bank assistance to SMEs.

One can conclude that the SME sector in Namibia has flourished and met most expectations. However the issue of access to capital, entrepreneurial development, and enabling regulatory environment as well as competitive strategies pose serious challenges that require active government and private sector involvement if the huge potential in this sector is to be harnessed.

Most banks practice are more interested in corporate banking which is less tedious, has low transaction costs and is now done through electronic banking e.g. Standard Bank. This reduces their overheads because very few transactions require physical interaction. It has helped them to reduce labour costs. Hence wage accounts and small timer accounts such as those of SMEs are more costly for them.

Among other things the insecurity of SMEs as regards collateral is due to lack of titles in property, insurable interest in property; vulnerability-as they operate in poor serviced or disaster prone and insecure areas; they have higher transaction costs because of distance penalties based on where they operate from. Their areas are normally not well connected in terms of telephony, electricity, transport, etc. These are policy issues that need government attention to remedy the situation.

CHAPTER 5: POLICY RESPONSES TO REMEDY THE SITUATION

5.1 POLICY RESPONSES

5.1.1 The Development Bank of Namibia

Commercial banks' credit extended to the productive sectors of the economy has not been that encouraging. One of the policy responses by government to remedy the situation was to establish the Development Bank of Namibia (DBN). The Development Bank of Namibia was established through an Act of Parliament in October 2002 to avail financial resources to productive sectors of the economy to propel the country's growth.

DBN provides capital and advisory services to medium, large scale public and private projects with a positive development impact. This bank acts as a catalyst and structures financing packages in support of productive sectors capable of delivering sustainable growth. Apart from this, it also mobilizes finance and technical know how through its international networks and provides investment packaging assistance to launch viable projects.

Furthermore, the DBN offers businesses start up capital and finance for expansion through these broad facilities such as public sector, private sector, enterprise development and SME finance. Loan amounts are set at a maximum of N$ 3 million with various repayment periods depending on the type of financing facilities utilized. Financing for SME's range from N$ 250 000 to N$ 3 million.

The bank received income from lending activities amounting to N$ 2 million while money from investments was recorded at N$ 16, 4 million. It also launched its project involving N$ 30 million targeted for the small and medium sized enterprise (SME) sector and entered into an agreement with Bank Windhoek under which DBN advanced N$ 10 million for the commercial banks SME activities (DBN 2004).

However, the institution should be development-oriented but run on business principles where possible. As a lending agency of the government it should trigger medium and long-term projects for developmental purposes. In addition, it should be charged with the responsibility of channeling scarce capital into selected industries, minimise risk taking through issuance of guarantees, for medium term and long term loans. Therefore, its structure should ensure that resources flow widely and efficiently to promising sectors that are capable of creating additional employment and value addition to the Namibia economy. What is important here again is the fact that the institution should be well capitalised, because without sufficient resources, it will never be able to perform its assigned responsibilities as per expectations.

One of the responses from interview on why it was necessary to establish the development bank in Namibia is because of the finance gap that exists in the economy. It is strongly believed that Namibia lacks an institution that provides medium and long-term project finance both to the private sector and the public sector. The development bank is helping to achieve a higher level of fixed investment in the economy.

In the response to the question why the private sector is not involved in lending, respondents claim that the private sector is doing a good job and playing its part but there are institutional limitations that can only be addressed by lending institution of the magnitude proposed here (DBN). Commercial banks by nature of the structure of their assets and liabilities inevitably prefer to grant short-term credit. They only venture into long-term lending where they have already developed the long-term relationships with their client. Given the past history many projects may remain unfunded not necessarily because they are too risky but simply because banks cannot be sure of potential borrowers and because of the limited information.

The main issue here is the absence of medium and long-term credit to finance industrial projects. The evidence in finance and economics has shown that such term credit is important for economic growth and development but it is scarce in Namibia. This is disappointing in an economy with relatively plentiful savings yet high unemployment. Again, the structure of the current financial system has contributed to the lending gap in the economy and this is the issue that needs to be resolved.

Looking at Namibia's record in development finance so far, there are a number of institutions in this sector, such as the Namibia Development Corporation (NDC), and the Development Fund of Namibia (DFN). The performance of the DFN and the NDC is disappointing and do not really do what is expected from them primarily for the following reasons: lack of capital, lack of proper management, lack of skills and lack of focus. But, the DBN is structured in such a way that it is autonomous, transparent and accountable to the shareholders and stakeholders.

Furthermore the bank needs to be managed in line with the international standard and with the best practice. In this situation, what matters most are the individuals, policy makers and stakeholder's views and ideas in contributing to the success of the bank.

The policy makers have been mentioned because the performance of the DBN is affected by the overall macroeconomic policies and it is difficult to measure the performance of the bank if the overall economic policies are not prudent. However the bank must ensure that credit decisions are sound and based on commercial principles to ensure a sustainable and profitable institution that creates value to the economy.

Lastly, the performance of the bank has to be judged according to the objectives of the DBN. The objectives of the bank are to help in economic growth and in improving investment activities. This reflected on the lending side in terms of the size of loan portfolio and also in terms of the quality which is very important. If the projects are good the return for the bank will also be good. Again, one need to look at the sustainability of the projects funded by the bank, the employment creation, component and the most important one is the overall sustainable value addition to the economy.

5.1.2 Venture Capital

Venture capital can play a major role in providing equity capital to finance high-risk investments e.g. grape projects and many other productive ventures allowing investors to share more fully in the rewards to a successful venture and also helps firms in avoiding cash flow problems associated with debt financing. This is one of the options that need to be looked into by the policy makers.

Currently, various players in Namibia have also realised the importance of the private equity industry finance companies with high growth potential, particularly in the SME sector. Previous research has shown that small medium enterprises (SMEs) employ a large number of people[5]. However, these enterprises are faced with a lack of access to credit, and thus undermine their growth and employment creation potential. This is attributed to the fact that these borrowers (entrepreneurs) do not have sufficient collateral. This situation coupled with the risk-averse behaviour of commercial banks makes the undertaking of investment by these entrepreneurs extremely difficult. As a result economic growth has been hampered, and this is largely attributed to a conspicuous lack of risk capital to enable SMEs to realize their full potential.

The private equity market mainly attracts companies with limited access to internal funds or bank loans. These companies normally do not have a sufficient collateral or

[5] According to the Small Business Impact Assessment study conducted by NEPRU during 2003, 19.8 percent of Namibia's labour force is employed full time in the SME sector. This translates into 132,187 thousand employees of the estimated Namibian labour force of 667,609 thousand in 2003.

track record of profits to support bank borrowings or debt raisings. In instances, where debt financing is available, it may be relatively expensive. The advantage of private equity funding for companies, is that it also provides expertise to the management and restructuring of poorly performing companies.

The venture capital firms raise money for investment from a variety of sources such as institutional investors (public and private pension funds, insurance companies, and banks), wealthy individuals, corporate investors and government agencies. Venture capitalists raise funds into a blind pool. This means that investors do not know for which purpose their money will be used when they make the investment. Once the money has been raised, venture capitalists explore business plans which have the potential to grow into successful companies and which are then financed by venture capital.

The venture capital firms invest money in a newly created firm. The goal of the venture capitalists with such an investment is to develop this start-up business into a stable, growing and profitable company. Constant monitoring and overseeing the developmental stage of the company is one of the key roles of the venture capital.

The Venture Capital for SME sector[6], the role of private equity is to assist in transforming ideas into real world businesses, which cannot be financed by commercial banks. It is argued that big businesses can raise money from commercial banks and the NSX, while the micro and small businesses[7] get loans through the Small Business Credit Guarantee Trust (SBCGT). However, the medium sized enterprises in Namibia suffer greatly as they do not fit well within the existing financial structure.

Furthermore, it is argued that Namibian financial markets are characterized by a lack of equity capital for unlisted companies leading to debt-heavy balance sheets[8] for these businesses. Consequently, once these enterprises attain a certain level of indebtedness in relation to their assets, they are unable to obtain further financing for expansion, given the conservative nature of commercial banks lending practices in Namibia and the absence of formal equity financing outside of the NSX. The conservative lending practices of commercial banks in Namibia imply that long-term, unsecured lending for younger enterprises is extremely rare.

This situation has been precipitated by the fact that the size of institutional equity/loans required by medium scale enterprises for their sustainable growth is relatively expensive to obtain from the NSX, while it is perceived to be large for risk-averse commercial

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[6] This part is mainly based on Gibson and Davis (2001), Venture Capital for Medium-Scale Enterprises in Namibia, a report prepared for the Namibian Ministry of Trade and Industry in September 2001 and sponsored by the United State Agency for International Development (USAID), Namibia office.
[7] Financing needs for small businesses rarely reach N$250,000 (Gibson and Davis 2001)
[8] A debt-heavy balance sheet simply means that, there is a lack of equity financing for Namibian unlisted enterprises. Namibian unlisted companies mainly raise their finances through debt.

banks to provide. This undermines the development of these enterprises in the Namibian economy. Therefore, it has been observed to be imperative that alternative sources of financing should be sought to realize the potential of these medium-scale business sector[9] financing for expansion. Apart from the lack of finances for medium-scale enterprises, there are also other challenges to be addressed by private equity. These challenges range from a lack of managerial expertise in the new enterprises to get funds which can facilitates the transfer of ownership through Black Economic Empowerment (BEE). These challenges could be partly addressed by a non-venture capital form of private equity financing which could take the following forms: black economic empowerment, privatization of public enterprises (public-private partnerships), formation of infrastructure funds, and establishment of strategic alliances in investment.

According to Uanguta (2005), in comparative sectors, there is a trend towards specialization among the venture capital firms in terms of the sectors they invest. Since the 1990s, communications and computer related, electronic related, industrial products, biotechnology, energy, financial services have become popular with venture capital firms. This could be a valuable lesson for Namibia to design its venture capital strategies along the lines of sectoral specialization. Lastly, Namibia must identify certain sectors in which it has some competitive advantages and start promoting investment in those sectors.

[9] The medium-scale business sector is defined in the context of this paper to include equity ranging from N$ 1 million to N$ 10 million.

CHAPTER 6: CONCLUSION AND RECOMMENDATIONS

6.1 CONCLUSION

The primary objective of this study was to evaluate the commercial banks on lending to the productive sectors in Namibia. It has identified problem that the commercial banks are reluctant to lend to the productive sectors of the economy. Most of the deposits that are mobilised locally by the commercial banks are not used to develop the domestic economy.

The Namibia financial sector is still under-developed. It is still dominated by the commercial banking institutions. Though there are a few specialized financial institutions, a well-designed financial super-structure is yet to evolve. On the question whether commercial banks do play a developmental role, the answer would be: Yes, commercial banks have played, are playing and would play a much greater and much more proactive role in economic development.

This study has reviewed developments in bank credit to the private sector in Namibia and highlighted the barriers to access to bank credit. With the return of most SSA countries to broad financial stability over the past few years, including containment of inflation and government deficit, and the banking systems to a large extent restructured after the difficulties encountered in the 1990s, banks have the resource for supporting an expansion of bank credit to those sectors.

The availability of credit has been shown to have positive impacts on investment and hence economic growth. However, because of asymmetric information, the ability of banks to lend especially to the productive sectors and to SMEs has been severely circumscribed in Namibia. The study reviewed that SMEs usually lack the required collateral. Given the role of SMEs in the generation of self-employment, access to capital at this level is inevitable for rapid economic transformation.

The study points out that instead of setting up an expensive new institution, Government could try and be a bit professional about the way it encourages the private sector to invest. Domestic asset requirements could be reshaped to allow fund managers to invest smaller amounts of money but in real projects in Namibia rather than in dual-listed shares on the Namibia Stock Exchange (NSX). Government could require the banks to get involved in small business lending and extend banking services to the rural areas and the poor. This could increase competition by ending uncompetitive practices and demanding greater disclosure of information

The study also suggests that the establishment of the Development Bank of Namibia was necessary to avail financial resources to productive sectors of the economy in order to drive the country's growth. It attempted as well to establish whether there is a scope for the establishment of the private equity market in Namibia. To this end, the study reviewed different forms of private equity and established that there is scope for the private equity activities in Namibia in both venture capital and non-venture capital forms. However, it is pointed out that the most appropriate vehicle for Namibia is venture capital. The venture capital industry is known to be critical in the promotion of start-up companies, which are generally more important in the case of Namibia.

Finally, the study concludes that the situation in Namibia is not a lack of funds but rather the perceived level of risk by banks in lending, especially to new clients. These calls for a review of the existing laws to enable lenders develop some level of confidence in borrowers and the design of targeted mechanisms to reach hitherto excluded populations.

6.2 RECOMMENDATIONS

Financial sectors in Namibia are far from reaching the level of access to capital. This is the case because uncertainty and asymmetric information are too costly to be completely eliminated by private agents such as lenders and borrowers. Hence, it is quite clear that for financial development to contribute even more effectively to growth, employment and poverty alleviation, sound and adequate policies must be developed. A variety of issues affecting the financial market directly or indirectly must be addressed by a variety of well-designed policies:

- Policies that protect existing customers from moral hazard such as prudential regulations and from non-competitive behaviour by banks such as anti-trust legislation.

- Policies that improve access to financial instruments by small or low income customers who are credit worthy by lowering requirements as well as transaction costs;
- Policies that lower barriers to entry perceived by financial institutions in specific markets such as regulations that induce banks to offer credit and savings services to low income populations;
- Fiscal policy which does not crowd out private investments;

Some of the recommendations that could be deployed to resolve the situation are:

- Strengthening the legal and institutional framework dealing with the loan process. Research has shown that this has an impact on the credit extended to the private sector in many African countries. Namibia currently has one of the most comprehensive legal frameworks for dealing with loan defaults. However, commercial bank responses to our enquiries show reservations in two core areas: difficulties in enforcing contacts without significant time delays and expense, and difficulties in obtaining security over pledged assets and quick repossession and sale of such assets to recover borrowed funds. This calls for a review of the collateral laws.

- Lack of technical skills in risk assessment and management is a major constraint in credit allocation. A proper understanding of cash flow analysis is needed to shift bankers' emphasis from evaluating credit based on the amount of collateral to more on a borrower's expected revenue flows. This is more so with micro enterprises.

- To create an environment that induces banks to increase prudently the level of credit to the private sector, resulting in the allocation of savings to the most productive sectors.

- Action should be expedited on the enhancement of the credit bureau for the exchange of credit information on borrowers. The International Trade Centre (ITC) is the credit bureau that is mostly used by banks in Namibia[10]. The problem with it is that it only helps banks to identify borrowers with bad credit record and hence reduce credit risk, but it does not provide positive information about borrowers with good repayment track records. A credit bureau that enables lenders to share positive information will benefit small borrowers since this will enable them to establish good reputation with small loan and improve their chances to increase their borrowings (World Bank 2000). This is particularly useful for SMEs.

- Asymmetric information problems need to be tackled by government support for private credit bureau. Government should institute laws and regulations that encourage the sharing of credit information amongst lenders and credit bureau.

[10] The other credit bureau is the Compuscan which is mainly used by the microlenders.

The widespread sharing of information will create competition among banks, reduces the likelihood of defaults, lowers interest rates and results in higher levels of credit. The outcome from information sharing will immensely be beneficial to the economy. Laws and regulations that penalised banks for failing to share credit information with private credit bureau can also help to overcome this problem, and this may result in accelerated economic growth due to increased levels of credit to the productive sectors. Stiglitz and Weiss (1981) attributed the phenomena to adverse selection that results from asymmetric information. Asymmetric information occurs because banks do not have sufficient information about each potential borrower investment project and therefore are not able to calculate the projects riskiness since they do not know the probability distribution of returns on the projects.

- SMEs should be encouraged to (mainly) use alternative avenues to credit, such as micro-lending schemes or guarantee support. A number of successful micro-credit schemes exist, although they do not cover all demand for financial services. Alternative financial banking arrangements such as credit savings schemes or mutual guarantee schemes might be useful instruments to increase the usage of financial services. Most important in this context is the information campaigns to effectively inform SMEs about existing schemes.

- As a logical step forward towards transforming the banking system, there seems to be a greater need for a review of our lending procedures practices and credit assessment mechanism with a view to ensuring supply of credit to the genuine clients and particularly to the hitherto neglected productive sectors. Available evidence shows that most of the credit extended by commercial banks is mainly used to finance properties and other personal items. There are also reports by loan applicants that banks do not carry out proper investigation of project viability particularly when this has to do with projects falling outside the purview of their traditional areas of financing. There is therefore, a need for both the commercial banks and the policy makers to explore ways of evolving appropriate assessment mechanisms and credit evaluation techniques with view to extending credit to all viable projects.

- Finally, the important role of deposits as a determinant of bank's lending capacity suggests that efforts at resource mobilisation should be enhanced. The extension of banking services to the unbanked as tool for the mobilisation of deposits and the granting of loans cannot be overemphasised in this regard. The study for instance has shown that the absence of banks in many communities stalled SMEs access to bank credit. Evidences also abound to show that the impact of the establishment of a commercial bank branch in a hitherto unbanked area could serve as a strong stimulant for the mobilisation of deposits. Efforts should therefore be made to continue to encourage commercial banks to extend their branches to the unbanked areas of the economy.

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APPENDICES

APPENDIX 1. Interview Questions with Mr. Shiimi & Kadhikwa of the Bank of Namibia.

1. Why do we need a development bank in Namibia?

2. Why isn't the private sector involved in that sort of lending and if not why not?

3. Are you saying structurally there is a certain type of lending that the private sector cannot do?

4. What are your own specific ideas about lending money to the productive sector?

5. Where are these organisations going at the moment to get funds?

6. Do you believe that the Namibian development bank could offer a better deal?

7. We've had several attempts since independence to try and encourage the private sector to do more medium and long-term lending – the domestic asset requirements for pension and life insurance funds, the Namibian Stock Exchange. Have these worked and why do we need something else?

8. Do you see the development bank competing with existing institutions?

9. Won't the DBN present unfair competition to other commercial sources of finance such as the NSX?

10. Looking at Namibia's record in development finance so far. We've had a number of institutions the Namibia Development Corporation, the Development Fund of Namibia, to name just two. What in your own view are the lessons you have learnt from those experiences in the last eleven years?

11. Explain how you have been able to manage with these experiences?

12. Can DBN be a professional autonomous institution?

13. Will the stakeholders accept that DBN becomes a professional autonomous institution?

14. How much is government providing to DBN?

15. Is the amount provided by the government sufficient for the bank and if not, where will the remainder come from?

16. Will the DBN focus on specific sectors of the economy, for example fishing, agriculture or manufacturing?

17. Will it assist exclusively Namibian companies or foreign companies too?

18. Will the DBN have a specific black empowerment role?

19. What form will that take? Will it be, for example, mainly on SME, development or joint ventures with foreign fishing companies? Can you give us an idea?

20. Do you see the DBN helping to develop new green field businesses run by black business people?

21. What has been the reaction of the private sector to the DBN?

22. Have you had any firm commitments to provide capital?

23. How will DBN management be selected? We have had experience in Namibia of even going abroad for by Namibian standards very expensive CEOs who still haven't managed to run the business successfully.

24. What part has the shareholders in deciding whether directors are to stay or go?

25. How will we know whether the DBN has performed well or not? What performance measures have been established – is it profitability, or the number of jobs created, the amount of money lent?

26. Do you expect the DBN to be a profit-making institution?