

**THE IMPACT OF THE FINANCING OF SMALL ENTERPRISES BY
THE MPUMALANGA ECONOMIC EMPOWERMENT
CORPORATION**

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DECLARATION

I, Vusi Lawrence Mashabane declare that the mini dissertation hereby submitted to the University of Limpopo for the degree, Masters in Development has not been previously submitted by me for a degree at any University; that is my own work in design and execution, and that all material contained therein has been duly acknowledged.

Signed

Date.....

Place.....

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ABSTRACT

The purpose of this study was to explore the challenges facing Mpumalanga Economic Empowerment Corporation (MEEC) in its quest to funding the emerging small enterprises in Mpumalanga. The study was conducted in 2004-2005, in the Nkangala District Municipality in Mpumalanga. Interviews were conducted amongst the existing clients of MEEC and its predecessors. Senior Managers and Operational staff were also interviewed in order to solicit the effectiveness of the tools used to granting loans and guarantees. The findings have since shown that there are operational challenges facing MEEC, which are in nature similar to those faced by a number of Development Finance Corporations in this country and around the globe as the benchmarks showed in the study. It was therefore important to undertake this study considering the need to improve the role pplayed by MEEC and the approaches to be adopted in improving the course in which parastatals do business.

CONTENTS

	PAGE
DECLARATION	I
ACKNOWLEDGEMENTS	II
LIST OF ABBREVIATIONS	III
ABSTRACT	IV
DEFINITIONS OF SELECTED CONCEPTS	V
CHAPTER 1: BACKGROUND INFORMATION	
1.1 Introduction	1
1.2 Problem Statement	1
1.3 Motivation	2
1.4 The aim of the study	4
1.5 Objectives	4
1.6 Research questions	5
1.7 Significance of the study	6
1.8 Definitions of concepts	6
CHAPTER TWO: DEVELOPMENT FINANCE IN SOUTH AFRICA	
2.1 Introduction	11
2.2 Development finance institutions	12
2.3 The need for Development Finance Corporations	18
2.4 Development Corporation in South Africa	23
2.5 Objectives of the MEEC	24
2.6 Evaluation of performance	26
CHAPTER THREE: RESEARCH METHODOLOGY	
3.1 Introduction	28
3.2 Research design	29

3.3	Area of study	30
3.4	Population	30
3.5	Sampling Method	30
3.6	Choice of instruments	30
3.7	Data collection Methods and Procedures	31

CHAPTER FOUR – ANALYSIS OF PERFORMANCE

4.1	Introduction	33
4.2	Tribal development institutions: The pre-1994 Period	35
4.3	The Development Finance Program	37
4.4	The Contractor Support program	41
4.5	The restructuring phase 1994-2000	43
4.6	Shift in Provincial Policy	44
4.7	Other shortcomings	53
4.8	Benchmarking with other Development Corporations	54
4.9	Political impact on performance	56
4.10	Legislative framework	57
4.11	Skills and performance	58
4.12	Beneficiation of performance	58
4.13	Government policy	59

CHAPTER FIVE – CONCLUSIONS AND RECOMMENDATIONS

5.1	Introduction	61
5.2	Conclusions	61
5.3	Summary	62
5.4	Limitation of the study	63
5.5	Ethical considerations	63
5.6	Recommendations	67

REFERENCES		70
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VI

LIST OF ABBREVIATIONS

Agriwane	Kangwane Agricultural Development Corporation
BIC	Bantu Investment Corporation
DBSA	Development Bank of Southern Africa
BRAC	Bangladesh Rural Advancement Committee
DFA	Development Facilitation Act
DFI	Development Finance Institution
ECDC	Eastern Cape Development Corporation
FDC	Free State Development Corporation
GEAR	Growth, Employment and Redistribution
HOD	Head of Department
IDC	Industrial Development Corporation
ITHALA	Ithala Development and Finance Corporation Limited
MDC	Mpumalanga Development Corporation (for the purpose of this document, this will include its predecessors and successor – in some cases it will be referred to as the Corporation)
MEEC	Mpumalanga Economic Empowerment Corporation
KEDC	KaNgwane Economic Development Corporation
KFC	KwaZulu Finance Company
KNDC	KwaNdebele National Development Corporation
LIMDEV	Limpopo Development Enterprise
MEC	Member of the Executive Council
NWDC	North West Development Corporation

VII

PDI	Previously disadvantaged individuals
RCP	Rural Advancement Committee
SASOL	South African Synthetic Oil Company Limited
SMME	Small, Micro & Medium-sized Enterprises / Entrepreneurs
STATS SA	Statistics South Africa
PFMA	Public Finance & Management Act

CHAPTER ONE

1.1. Introduction

Mpumalanga Economic Development Corporation (MEEC) was established to focus on the development and financial support of SMME in Mpumalanga. It has been a trend throughout the world to establish development institutions to take care of the development needs of a nation. Even some of the world's most industrialized countries still have development institutions which facilitate the entry and sustenance of new entrepreneurs and ensure that a country or a region's comparative advantage is exploited for further development.

Small Medium and Micro Enterprises (SMMEs) on the other hand play a vital role in economic development by enabling people to meet their basic needs for survival. (DTI, 2002: 33). Moreover it has been proven in many parts of the world that the SMME sector stimulates economic growth, redistributes wealth and creates jobs. Whether this scenario can play itself in the lives of the young people will still need to be established.

According to the report by National Manpower Commission (Development Southern Africa, 1982: 223), a small business firm can be regarded as an independent economic unit. Its aim is to account profitability for the capital and risk attached thereto (McAleese, 2001:98). The firm manifests distinctive characteristics such as independent ownership, independent management, a simple organisational structure (Chandler, 1997: 41) and a relatively small influence on the market; and whose owners can be identified with the entrepreneurs, the part suppliers of capital, the management of the business, the decision-makers and those you share in the profits (Penrose, 1997:29).

1.2. Problem Statement

Small and medium enterprises face many constraints, such as lack of credit, which hinder them from reaching their job-creating potential. Banks have reservations towards small enterprise, especially regarding start-up projects. They often require collateral that is

beyond the means of potential borrowers and are unwilling to bear the costs of examination of numerous small loans applications.

The SMME sector is growing and constitutes the largest group of vulnerable entrepreneurs in the labour market. The study will explore the problems faced by the sector with regards to the credit/loan facilities. Banking facilities for people lacking access to them and wanting to be self-employed should be investigated more closely in South Africa, to give access to credit to the poor and simultaneously make productive use of loans.

The rise of development finance institutions is not a development that is only peculiar to South Africa. It is a trend that has assumed global proportions, the prominence of which can be attributed to the impact of the Bretton Woods Conference on the reconstruction of post World War II Europe. Since then various development finance institutions have been established, both in highly industrialized countries and in the developing world. Whilst they all have a common objective of economic development, their ways of operation constitute a response to their particular economic and social environments. Their approach to facilitating development therefore differs.

1.3. Motivation

The SMME sector is important in the South Africa market. It is constituted by previously disadvantaged individuals (PDI), which by definition require some financial assistance.

The restructuring of financial assistance to the informal sector is however essential for improving the income earning of people involved in the sector (Wilkins, 1998). The main bulk of the informal sector lies in consumer services, but the current emphasis on the manufacturing SMMEs does not address the most vulnerable groups, which are found in services, these SMME development programmes are aimed at economic growth and not at addressing poverty.

This study will explore the problems faced by the sector with regards to the credit/loan facilities. The study will argue that for a corporation to be successful there is a need to observe best practice in the industry and for the following measures to be in place:

- A mentorship program for the loan finance clients with the purpose of ensuring that the clients receive both monitoring and training on the fundamentals of running a business.
- Creation of a legislative framework, which allows a corporation to have the flexibility to do business beyond that of the red tape of a government department.
- Ensuring that there is sufficient political support, which should translate into appropriate budgetary allocations and communicating to clients the need to service their debts with the corporation.
- Ensuring that the corporation respects best practice in terms of government measures.
- Creating opportunities for the beneficiaries to be capacitated even before the mentoring process commences.

Whilst the general context will be on development corporations in South Africa, the focus of this study will be on the Mpumalanga Economic Empowerment Corporation (MEEC), Our study will not focus on these areas.

The area which will be investigated will be financial and non-financial support for small and medium enterprises and the various programs which were put in place to support SMME's. The programs will include the following: industrial development, contractors' support, development finance and non-financial support.

Due to the lack of records from one of the MEEC's predecessors, namely the Mpumalanga development Corporation, Kangwane Economic Development Corporation (KEDC), the pre-1994 analysis of the Corporation will be based on the performance of its other predecessor, the KwaNdebele National Development Corporation (KNDC).

1.4. Aim of the Study

The study starts from the premise that development corporations in South Africa have not lived up to their mandates. Neither the main shareholder (state or provinces) nor the target groups (client base) has derived any satisfaction from the operations of the development corporations. This study will therefore focus on the following areas:

- Investigate the performance of development corporations in South Africa, with particular reference to the Mpumalanga Economic Empowerment Corporation (MEEC);
- Isolate the factors which have contributed to unsatisfactory performance or under-performance of the Corporation;
- Identify best practice for the management of development corporations;
- Recommend an appropriate framework to ensure that development corporations meet their mandates; and
- Develop a practical guide for the management of development corporations.

1.5. Objectives

The area, which will be investigated, will be financial and non-financial support for small and medium enterprises and the various programs, which were put in place to support SMME's. These programs will include the following:

i) Industrial and Commercial Development

The main objective of the industrial development programmes is to contribute to job creation and eradication of poverty by encouraging the development of local industry. Providing world-class commercial and industrial premises to investors and emerging entrepreneurs. The industrial development program was aimed at the creation of industrial parks in targeted areas. The following were features of this program:

- Encouragement of product manufacturing;
- Ensuring that the industries are labour intensive;
- Attracting foreign and local industrialists to KwaNdebele; and

- Importing foreign technology into South Africa.

ii) Financial services

The provision of financial services has always been one of the key objectives of development corporations. To this end the development corporations had set itself an objective of mobilizing financial resources from the private sector and formation of a financial company with a bank to satisfy short- term financing needs of clients.

iii) Infrastructure Development

In this regard the Corporation has the following objectives:

- Establishment of an electricity utility; and
- Plan schemes to ensure the availability of water.

iv) Training

This is aimed at developing a new class of black entrepreneurs, focusing on the following:

- Initiating a Technical Training Center;
- Formation of a small business advisory service; and
- On the job training related to development projects

1.6. Research questions

Questions that will be addressed include the following:

- i) What financial products and services are offered by MEEC?
- ii) What are the literacy levels of the MEEC clients?
- iii) Does the Corporation render an effective induction program for its clients?
- iv) What is the impact of an after-care program (or its absence)?
- v) What are the perceptions of MEEC clients towards the Corporation?
- vi) What are the reasons for non-performance of these clients?
- vii) To what extent in MEEC contributing to the development of SMMEs?

1.7. Significance of the study

It is very important that all players in the economy have a good understanding of the dynamics of the small business sector if they are to make a meaningful intervention in helping and assisting SMMEs. Also government has prioritised the youth in ensuring that they enter into the mainstream of the economy.

However the challenges facing them are enormous. This study will therefore attempt to deal with both issues of the SMME sector and the youth development. It will also serve as a valuable resource for policy makers, academics and business people.

1.8. Definition of selected concepts

Bad debt percentage: The percentage of money due to be paid by debtors to the MEEC (debtors are clients who owes the MEEC money for services rendered or loans advanced), which could / cannot be collected compared to total debts outstanding. Such monies are regarded as not-recoverable and are to be written off (Smith, 1999).

Bridging finance: Business loans for a relative short period (3 to 6 months), during which period a business experiences a cash flow situation of more outflow than inflow of funds. Mostly experienced in the contracting industry, and referring specifically to the period leading up to the receipt of the first progress payment.

Bretton Woods Institutions: DFI's that were established for the purpose of, amongst others, the reconstruction of post-World War 2 Europe, e.g. the World Bank (WB) and the International Monetary Fund (IMF).

Business Finance: Loan funding granted to a business to purchase assets, stock, or defray operating expenses

Commercial Commercial Development: Various forms of financial and non-financial support to emerging / SMME businesses and disadvantaged communities aimed at

establishing commercial facilities (e.g. shopping centers and other trade facilities) and commercial opportunities (e.g. access to contracts and markets).

Contractor Support: Assistance to civil and building contractors in the form of loans, guarantees and advice with the aim of providing such businesses with access to contacts, finance, and skills to increase their competitiveness and stimulate their growth.

Cost-to-income ratio: The ratio between operating cost (e.g. cost of salaries and other administrative expenses) and operating income (e.g. income derived from the rental of facilities and interest on loans). If the ratio is more than 1, it costs the institution more than one rand in terms of salaries and other administrative expenses to generate one rand in income.

Cost-to-investment ratio: The ratio between operating cost (e.g. cost of salaries and other administrative expenses) and the value of MEEC's investment (including investment in buildings at historic cost, and loans disbursed).

Cost-to-portfolio ratio: The ratio between operating costs (e.g. cost of salaries and other administrative expenses) and the value of MEEC's respective programs (e.g. industrial property portfolio value, or business finance loan book value).

Development Corporation: DFI's instituted by an Act of the National of provincial parliament, with a specific focus in respect of the economic sector (e.g. agriculture / small business) and / or geographic area (e.g. National or a particular province).

Development Finance: Various forms of financial assistance (including equity-, loan- and bridging finance) provided to emerging / SMME businesses at subsidised terms and conditions (e.g. lower security and own contribution requirements than demanded by commercial finance institutions).

Development Finance Institutions (DFI's): Institutions providing any combination of development finance and non-financial support to emerging / SMME businesses for the reason of overcoming the market inadequacies such emerging businesses are subjected to

(e.g. access to finance, -markets, -advice and consulting services, and business facilities). Market failures are mostly the result of past policies of the previous regime (e.g. it was not possible for PDI's to own land and thereby accumulate securities to offer financiers in order to access finance). Because of the concessionary terms and conditions at which such services are provided, DFI's are normally government / donor supported and controlled.

Equity Finance: Loan finance granted to purchase shares in a business.

Equity Investment : Taking up of a shareholding in a business by injecting money / assets or other means of production into a business

Gearing: The ratio between: borrowed funds (e.g. monies borrowed from banks); and own capital (e.g. monies received from shareholders and through profits). A high gearing ratio is not always bad, provided the Company generates a net profit that is higher than the interest payments on such borrowed funds.

Industrial Development: Assistance to manufacturing businesses in the form of loans, equity, advice, training and factory building rentals with the aim of providing such businesses with access to finance, manufacturing facilities, information and skills to increase their competitiveness.

Interest cover: The extent to which a company is able to pay interest on loans, from the profit generated through using (e.g. on-lending to small businesses and / or rental of buildings) such borrowed monies.

Non – financial support : Various forms of assistance at subsidised terms to emerging / SMME businesses that are not in the form of rands / cents, including training, business advice, mentoring, business information and consulting.

Nominal terms : The actual rand / cent value of an investment in the year which the investment is made

Performance guarantee: Guarantee issued on behalf of a business, guaranteeing that performance will be according to time and quality specifications. Should performance not comply with the contract specifications, the authority who awarded the contract can call up the guarantee (draw payments from the guarantor) to make good any losses incurred as a result of non-performance by the contractor. A guarantee issued by a financier (e.g. Standard Bank) is normally backed by an investment / deposit equal or higher than the guarantee amount. If the guarantee is called up due to non-performance, the depositing / investor institution stands to lose part or the entire amount deposited.

Real terms (1984): The value of an investment if the escalation effect of inflation is discounted to a base year of, e.g. 1984. If the inflation-effect is eliminated, R 1-00 today has the same purchasing power than approximately 15 cents in the year 1984.

ROI: The return on investment is the ratio of profit generated by an investment (e.g. a machine) after costs (e.g. costs associated with operating and maintaining the machine) has been deducted.

CHAPTER TWO: DEVELOPMENT FINANCE IN SOUTH AFRICA

2.1. Introduction

This chapter is premised on the fact that the objectives of provincial development corporations cannot be divorced from international trends in the industry. Indeed, the whole concept of development corporations bears close resemblance to regional development

institutions in many parts of Europe and North America. Institutions such as Business Link in England and the German Development Bank in Germany are typical examples: If these institutions were not a cardinal variable in economic development, they would not be such a common feature around the globe.

In defining the role of these institutions, Borkey (1959: P 3) argues that they are *“intended not only to provide capital for the private industrial sector, but also to mobilize savings, enterprise and skills for productive investment, and also to mobilize savings, enterprise and skills for productive investment in that sector, largely a post World War II creation”*. Borkey’s definition of the role of development corporations is important in that it represents a view on development finance institutions less than 15 years after the formation of the Bretton Woods institutions and before the world’s development finance institutions started playing a major role in the reconstruction of developing economies.

There is no doubt that homeland development corporations and, indeed, the establishment of the Development Bank of Southern Africa (DBSA) were influenced by a post World War II philosophy, which assumed that the Marshall Plan would also be applicable to the developing world.

The chapter will address the following: Current thinking on development finance institutions, the stated objectives of the MEEC, its predecessors and successor, the operational objectives of the MDC, its predecessors and its successor and will present a framework for the evaluation of the institution’s performance.

2.2. Development finance institutions

One of the key debates after the 1994 democratic election was the nature of institutions that were supposed to be put in place to support the development and thriving of small and medium enterprises. Prior to the 1994 elections, the African National Congress (which party was destined to win the elections) developed a document called the Reconstruction and Development Program (RDP), which was meant to provide a framework for post-1994

development in South Africa. However, the RDP document was silent on the role of development corporations. Whether this implied a lack of recognition of the role of these institutions or a determination on the part of the government in waiting to phase out the institutions, is a key question.

Whilst the first two years after the advent of a new government was characterized by a debate on whether development corporations should continue to exist, this debate soon developed to focus on how they should be structured, as opposed whether there was any justification for their existence at all.

The following constituted development corporations and their area of focus before 1994:

Table 1: Development Corporations (Pre-1994)

Institution	Area where they operated	Areas of focus
Ciskei Agricultural Bank	Ciskei	Financial support for farmers
Ulimo-Corporation	Ciskei	Non-financial support for farmers
Transkei Development Corporation	Transkei	Industrial development, -renting and maintenance of properties, SMME financing, farmer and availing other non-financial support services
Transkei Agricultural Development Corporation	Transkei	Financial support for farmers
Kwazulu Finance and Development Corporation	KwaZulu Natal	Industrial development, renting and maintenance of properties, SMME financing farmers and other non-financial support services
Transkei Bank	Transkei	Rural banking, SMME development
Bophuthatswana National Development Corporation	Bophutatswana	Industrial development, renting and maintenance of properties, SMME financing, farmer and other non-financial support services
Kwandebele National Corporation	KwaNdebele	Industrial development, renting and maintenance of properties, SMME financing, farmer and availing other non-financial support services
Agricor	Bophuthatswana	Financing and non-financial support for farmers
Kangwane Economic Development Corporation	Kangwane	Property development, -renting and maintenance, financing and non-

Institution	Area where they operated	Areas of focus
		financial support for SMME's
Agriwane	Kangwane	Financing and non-financial support for farmers
Gazankulu Development Corporation	Gazankulu	Industrial development, renting and maintenance of properties, SMME financing, farmer and other non-financial support services
LebNowa Development Corporation	Lebowa	Industrial development, renting and maintenance of properties, SMME financing, farmer and other non-financial support services
Lebowa Agricultural Development Corporation	Lebowa	Financial and non-financial support for farmers
Venda National Development Corporation	Venda	Industrial development, renting and maintenance of properties, SMME financing, farmer and other non-financial support services
Qwaqwa National Development Corporation	Qwaqwa	Industrial development, renting and maintenance of properties, SMME financing, farmer and other non-financial support services

What should be observed is that all the development corporations of the homeland era have since been replaced by provincial-based development finance institutions. They have all undergone a restructuring or re-engineering process, and are characterized by the following features:

- **Downsizing:** Before 1994 the average development corporation used to employ about one thousand two hundred (1,200) people. To date the staff complement of development corporations is about eighty-six (86). This represents nearly a 93% decrease in staff members since the 1994 democratic transition.
- **Geographical areas of operation:** The development corporations which were ethnically based have since come to operate within the confines of provincial borders.

- **The client base:** The client base of development corporations has since changed to include business persons residing or working outside the borders of the former homelands. This had major implications for financial resources.
- **Profile of management:** The profile of the management of development corporations has changed considerably. One illustration is that in 1994 all development corporations had white CEO's at the helm of their management structures. The situation has changed considerably. All development corporations throughout the country, by 2000, are being led by black CEO's. The management structures have also changed considerably in favour of black managers. In 1994, for example, 95% of the members of the MDC were white males. In 2003 90% of the managers of the MEEC were black executives, with 25% of the total management structure constituted by women.
- **The spread of development corporations:** They all exist in those provinces which had homelands or self-governing territories within their former borders. The Gauteng Province, the Northern Cape and the Western Cape do not have development corporations. Whilst some of these provinces may have development institutions, these institutions do not resemble the profile of the development corporations in the other provinces. The latter were characterized by the presence of homelands or self-governing territories. For example, the Gauteng Province has a development institution called Gauteng Economic Development Agency (GEDA), which encourages investment.

The following constitute the new development corporations since 1994, which focus on SMME financial and non-financial support:

Table 2: Development Corporations (Post –1994)

Corporation	Province	Focus
Limpopo Development Corporation (Limdev)	Limpopo	Property Management, SMME finances and running projects on behalf of Government

Corporation	Province	Focus
North West Development Corporation (NWDC)	North West	Property Management, SMME finances and running projects on behalf of Government
Mpumalanga Economic Empowerment Corporation (MEEC)	Mpumalanga	Property Management, SMME finances and running projects on behalf of Government
Eastern Cape Development Corporation (ECDC)	Eastern Cape	Property Management, SMME finances and running projects on behalf of Government
Ithala Development and Finance Corporation Ltd	Kwazulu-Natal	Rural Banking, Housing development, Property Management, SMME finances and running projects on behalf of Government
Freestate Development Corporation (FDC)	Freestate	Property Management, SMME finances and running projects on behalf of Government

Although development finance institutions all have certain similarities in their goals, one of which is to propel economic growth in their targeted area of operation, they will always have different ways of conducting their business and different sectoral emphases. This will be influenced by the environment in which these organizations operate, in particular the comparative advantage of the area and the general socio-political culture in the area of operation. There are general trends, though, in the industry. These trends constitute a framework for current thinking in the industry.

This framework is informed by, among others, the following factors:

- The need to increase the level of accountability on the part of executives of the institutions;
- The need to avoid political interference;
- The need to develop the beneficiaries; and programmes
- The need to ensure that programmes to be funded give rise to a long-term economic impact.

The following factors characterize current thinking on the management control and operations of development finance institutions:

One of the challenges development finance institutions have faced in the developing world in particular, is the inability to be self-sustainable. They have either continuously depended on donor funding or on Government statutory allocations. In emphasizing this challenge, Thomas (1992: 8) asserts:

“All over the world, parastatals in pursuit of development promotion, be it a sector, an industry, a number of programs or broad based bodies, have been discredited because of their inherent tendency towards loss-making, often in astronomic magnitudes”.

In arguing for performance and sustainability for one of the world’s best known development agencies, the Bangladesh Rural Advancement Committee (RCP), Khalily and Khandker (1996: XV) argue:

“Although the loan recovery rate has been consistently around 90%, the transaction costs of delivering social and human development inputs are quite high. Nevertheless, the BRAC strategy of providing self-sustaining bank services for the poor is built on its program design, as evident in the creation of the RCP. The RCP branches are financially viable.”

The sustainability of the institutions and indeed these programs funded by the institutions, have assumed a significant focus in current thinking on the management of development finance institutions.

Development finance institutions are not unaffected by developments throughout the world on good governance, nor by the need to ensure adequate accountability in their own geographic areas of operation. The collapse of Enron in the United States has unleashed a debate on stricter measures for good governance that no institution can ignore.

German institutions notably the German Development Bank, in reacting to the culture that led to the World Wars, have been characterized by strictness on accountability to an extent that some development institutions have two chief executive officers who run the organization jointly.

In South Africa, the Public Management Finance Act provides a framework for greater accountability on the part of development finance institutions in the country.

Development finance institutions are moving away from accessing their financial requirements from one source only, be it donors or Government. The trend is to access funds from other sources as well, including the private sector. In South Africa, development corporations have been largely funded by Government or by government designated financial institutions. The need to access funds from sources other than Government has major implications for the strategic positioning of these institutions.

Whilst development finance Institutions are a product of both state and market failure, there is a growing thinking to call upon these institutions to recognize the role of the markets in their operations. Regional bodies such as the European Union have in recent times subtly demonstrated their resolve to get regional agencies to observe the flow of markets. *“In the common market of Europe, a further dimension of control enters the regional development sphere through the role played by the Brussels Commission in the monitoring and shaping of market orientated regional development agencies. All over the European Union the Commission will increasingly question interventionist policies at national or regional level of member countries, stressing the need for an evolution to more competitive, non-interventionist development patterns”* Thomas (1992:10)

Commercial banks are willing to co-operate with development finance institutions on condition that the markets are respected.

2.3. The need for Development Corporations

It has been a trend throughout the world to establish development institutions to take care of the development needs of a nation (see objectives on page 13 and 14). Even some of the world's most industrialized countries still have development institutions which facilitate the entry and sustenance of new entrepreneurs and ensure that a country or a region's comparative advantage is exploited for further development.

The existence of the German Development Bank in Germany and the Mezzogiorno in Italy are indications of the need for government intervention to facilitate development. Eastern Europe has a number of development finance institutions that were aimed at addressing the development of entrepreneurs to enable them to participate in the economies of those countries after the cold war. The developing world in general has many institutions that are meant to support entrepreneurs.

The Mezzogiorno in Italy is a development institution which was tasked with the responsibility of stimulating economic activities in the south of Italy, which is compared to the northern part of the country, a relatively depressed area economically. The fact that this institution is focused on a particular population living in an economically depressed geographical area is lesson enough for South Africa.

In general the following constitute the reasons why there is a need for development finance institutions:

i) *Market failure*

There is no doubt that market forces, on their own, can be a source of economic development. The fact though is that market forces do not always take into account the long-term developmental needs of a nation. In the financing sector commercial banks are an outstanding example of how the private sector will not accept short-term losses in the interest of long-term sustainability. Those that do not have assets for financial guarantees usually cannot access bank finance, regardless of their potential to be good entrepreneurs.

ii) *State failure*

The state on its own has a poor record of propelling economic growth and the establishment and sustenance of entrepreneurs. These defects all contribute to the need for an environment for growth and the establishment of entrepreneurs. Development finance institutions should borrow the best from the market and the state.

iii) Need to develop entrepreneurs

Porter (1990:125) identifies entrepreneurship as a key condition to enhance national competitive advantage. Van Aardt et al (1999:5) take this further by arguing that entrepreneurship holds the promise of growth, expansion, and long-term financial gain. They further assert that a small business aimed only at the survival of its owner is not an entrepreneurial venture.

With an economy like ours, which in growth terms is not performing satisfactorily, there is a need for the development of entrepreneurs. Development corporations can offer a useful tool in this regard.

iv) Need to sustain the development of entrepreneurs

Whilst conventional finance institutions will assist new entrepreneurs only if they come forward and the bank can delink their relationship at the end of the project, development finance institutions have the latitude and flexibility to approach entrepreneurship as a program. They can therefore make major investments in developing entrepreneurship in communities even if the results are long-term.

In terms of this Act, no 86 of 1965, the objects of a development corporation "*shall be to plan and to promote in all spheres the economic development of Bantu homeland in respect of which it has been established and the general welfare and advancement of such Bantu homelands and its population*". The beneficiaries of the activities of the development corporations were targeted tribes. This only changed after 1994 with the advent of a new dispensation. The stated objective has, until the second half of the 1990's, been too broad. Except for the former Bophutatswana and Lebowa, the stated objectives normally covered areas which included industrial development, training, agricultural development, commercial development and entrepreneurial development. The stated objectives were generally too mechanistic. While they are quite clear on how the target groups should be assisted, there is no reference to the appreciation of local knowledge or inputs.

Interesting enough in its first strategic document of June 1984, the Kwandebele National Development Corporation recognizes, inter alia, the following as its weak points: limited knowledge of the environment and public, limited knowledge of socio-cultural traditions,

limited knowledge of politics. The document goes on to appreciate that the new corporation had a poor image due to the fact its predecessor is known to have been prescriptive in its assistance to people.

In general the stated objectives of development corporations as reflected in their founding acts, were identical throughout the country. This explains their origins, i.e. the policy of separate development.

As indicated earlier the stated objectives of development corporations are generally similar. One striking feature of the Mpumalanga Economic Empowerment Corporation is the similarity of its stated objectives to that of both its predecessors (the Kangwane Economic Development Corporation and the Kwandebele Development Corporation) and its successor, the Mpumalanga Economic Development Corporation (MEDA).

Until very recently, the Mpumalanga Economic Development Corporation's stated aims covered areas which ranged from industrial development to training of entrepreneurs. The following constitutes a summarized version of the stated objectives of the Corporation as reflects in The Mpumalanga Economic Empowerment Corporation Act, Act No. 5 of 1999, of the Mpumalanga Provincial Government:

- Promotion, planning, establishment, financing, co-ordination, and acquiring business ventures;
- To engage in projects of whatever nature as long as they would assist in the development of the Province;
- To extend loan finance to emerging entrepreneurs;
- To extend guarantee facilities to entrepreneurs who had won tenders from Government or other public sector institutions;
- To engage in training activities of its officials and clients; and
- To take up shares in public or private companies.

Whilst the stated objectives of the Corporations were enshrined in the relevant acts of parliament, the operational objectives of the institutions can be found in their business plans.

The business plans of the Kwandebele National Development Corporation in its early years provide an indication of the operational objectives of the Corporation. The challenge, though, is that whilst they are fairly clear on what the objectives are, they are unable to quantify the operational objectives of that Corporation. Recent business plans (from 1998 - 2003) have demonstrated a shift from merely stating the operational objectives, to making serious efforts to quantify these objectives.

The first strategic plan of Kwandebele National Development Corporation of June 1984 provides the key operational objectives of the Corporation. To a very great extent the operational objectives of the Corporation in successive years and under different phases of legislation were influenced by these initial objectives.

It must be emphasized, though, that there is no evidence of a culture of quantification of operational objectives in the business plans of the Corporation before the 1990's. Some quantification of the strategic objectives would have provided guidelines on the turnover the Corporation sought to achieve. There is, furthermore, no evidence of the desired rates of return of projects that were supposed to be established.

For the purposes of this study, the operational objectives were divided into six areas:

- Industrial development
- Commercial development
- Financing and on-lending activities
- Non-financial support of small business
- Publicity and promotional activities
- Infrastructure development

The industrial development program was aimed at the creation of industrial parks in targeted areas. The following were features of this program:

- Encouragement of product manufacturing;
- Ensuring that the industries are labour intensive;
- Attracting foreign and local industrialists to KwaNdebele; and
- Importing foreign technology into South Africa.

Among the steps that were going to be taken in pursuit of these objectives were the following:

- Complete construction of nine factory buildings and to find tenants;
- Complete four industrial plants;
- Complete Ekandustria infrastructure;
- Resolve problems at the existing bakery; and
- Commercial development.

These referred to the establishment of commercial centers to co-ordinate the informal sector, the establishment of marketing channels for dispersed individuals to access markets and sorghum beer distribution. Shopping center establishment was the key objective. In this regard the completion of shopping centers at Tweefontein and Nkangala were prioritized.

The provision of financial services has always been one of the key objectives of development corporations. To this end the development corporations had set itself an objective of mobilizing financial resources from the private sector and formation of a financial company with a bank to satisfy short- term financing needs of clients.

In this regard the Corporation had the following objectives:

- Establishment of an electricity utility; and
- Plan schemes to ensure the availability of water.

This was aimed at developing a new class of black entrepreneurs. To this end the following were the main areas of focus:

- Initiate a Technical Training Center;
- Formation of a small business advisory service; and
- On the job training related to development projects

2.4. Development Corporations in SA

The two most prominent finance institutions established in South Africa already decades ago are the Land and Agricultural Bank of South Africa and the Industrial Development Corporation in 1922 and 1940 respectively. The former was meant to support agricultural development and the latter industrial development in South Africa. Both played prominent roles in the development of agricultural co-operatives and capital-intensive projects such as SASOL.

The advent of apartheid's policies since the late 1940s implied crafting policies to sustain the separate development of various ethnic groups. For this reason, exactly eleven years after the victory of the National Party, the 1959 Bantu Investment Act was passed which resulted in the establishment of the Bantu Investment Corporation in 1965. This was followed by the establishment of various development corporations throughout South Africa.

The first development corporation to be established in the homelands was the Transkei Development Corporation, established in 1964. Soon after this, the 1965 Bantu Development Corporation Act was passed providing a framework for the establishment of ethnic-based development corporations. By 1984, every black ethnic group in South Africa which had its own homeland or self-governing territory, had a development corporation.

One of the areas of difference between development corporations in South Africa and the rest of the world is the fact that these corporations were supposed to be instruments to perpetuate the policy of separate development. In observing this peculiarity Thomas (1992:4) asserts:

“Unfortunately, the early history of these development corporations was already contaminated by prevalence, if not total dominance, of the apartheid principle of fundamental criteria for virtually all aspects of their operation. It determined the geographical boundary of their operation - a homeland, a prospective homeland territory or a (black / colored / indian) group area, the defined circle of ultimate beneficiaries (even

though the bulk of the more immediate benefits in many cases reached white operations), the control structure, the scope of activities allowed, and many more aspects.”

2.5. Objectives of the MEEC

The area, which will be investigated, will be financial and non-financial support for small and medium enterprises and the various programs, which were put in place to support SMME's. These programs will include the following:

i) Industrial and Commercial Development

The main objective of MEEC is to contribute to job creation and eradication of poverty by encouraging the development of local industry. Providing world-class commercial and industrial premises to investors and emerging entrepreneurs. The industrial development program was aimed at the creation of industrial parks in targeted areas. The following were features of this program:

- Encouragement of product manufacturing;
- Ensuring that the industries are labour intensive;
- Attracting foreign and local industrialists to KwaNdebele; and
- Importing foreign technology into South Africa.

ii). Financial services

The provision of financial services has always been one of the key objectives of development corporations. To this end the development corporations had set itself an objective of mobilizing financial resources from the private sector and formation of a financial company with a bank to satisfy short- term financing needs of clients.

iii) Infrastructure Development

In this regard the Corporation has the following objectives:

- Establishment of an electricity utility; and
- Plan schemes to ensure the availability of water.

2.6. Evaluation of Performance

The performance of the Corporation will be evaluated against its stated objectives. As indicated earlier, the stated objectives were fairly wide, ranging from infrastructure development to financial and non-financial support to small, micro and medium-sized enterprises. The performance tool employed, though, took into account a number of features characterizing the environment in which the development corporation has always operated. They are as follows:

- Development corporations are Government tools to address market imperfections in the developmental and financial sphere;
- Over the years these institutions have accumulated a vast number of clients who have experiences to share on the impact of development corporations;
- Empowerment of SMME's and infrastructure development requires immense skilling and reskilling programs of the human capital of the agency itself; and of the beneficiaries.
- For institutions of this nature to be efficient in respect of their mandate, there is a need for appropriate systems.

The Corporation, as indicated earlier, can be located within the broader family of financial institutions. The temptation of employing a traditional financial model to assess its performance is very appealing indeed. Financial reports would be one practical example of following this route.

This study has gone beyond the pitfalls of using financials as the main yardstick to measure the performance of the organisation.

The disadvantages of using traditional accounting models to evaluate a company's performance lead to the following:

- It focuses more on tangible assets as opposed to appreciating the company's intangible and intellectual assets.
- The sustainability of business organizations depends on, among others, client satisfaction. Financial statements have no method of measuring this, and, in the process a key determinant of the success of a business is being left out.
- The traditional accounting system does not appreciate the dynamics of the market and the fact that the organisation needs to continuously adapt to new market conditions. It is more interested in measuring history as if history unfolds in a vacuum.

The organization under investigation is more than an ordinary financial institution. Its objectives went beyond conventional financial results and the shareholder's evaluation of its impact would include, among others, customer satisfaction. In evaluating the performance of the organization, factors beyond the financial performance were included. These factors included but are not limited to the following:

In this regard the investigation focused on two main areas i.e. client satisfaction and whether clients were developed in line with the mandate of the organisation.

In this regard an analysis of the human capital *vis-a-vis* the mandate will be made to determine whether the human capital base and -structure was in line with the mandate of the organisation. Systems, in particular information technology, will be evaluated against the expected output of the organisation.

The post 1994 situation resulted in the development of new trends in business and the emergence of new markets, both inside and outside the country. Any organisation responsible for entrepreneurial development has to adapt to new reality and conceptualize their activities accordingly. The efforts by the organisation to adapt will be evaluated. Also the relevance of information technology for the need to provide an efficient service will be evaluated.

In asserting the effectiveness of a Balanced Scorecard in measuring the performance of an institution, Kaplan and Norton (1996: 21) argue: *“The balanced score card retains financial measurement and business performance, but it highlights a more general and integrated set of measurements that link current customer, internal process, employee and systems performance to long term financial successes”*.

The areas of emphasis include the following:

i). Financial Performance

In this area, the following items will be examined: Revenue management, Cash flow management, Asset management, Capital management and Funding Management. All these factors are evaluated against the mandate of the organisation and the need for development in the targeted area.

ii). Servicing the Customer

The following are some of the areas that are examined: Marketing Service, Accessibility Services, Effects of awareness on the Corporation’s service, and Customer satisfaction.

lii). Human Capital and Internal Systems

The Balanced Score Card is used to examine the following: Funding criteria, Human capital base, State of information technology, Service quality.

iv). Innovation and Learning

Most of the factors mentioned above are being evaluated with the objective of observing the overall performance of the Corporation apart from its financial results.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1. Introduction

As evident in the first two chapters, the nature of the subject under investigation is such that no single research project would be sufficient. By and large, the nature and role of development corporations is under-researched in South Africa. In developing a research methodology for this study, the following assumptions were taken into account:

- Evaluating Development Corporations financial performance can not be the only factor considered in assessing its nature and role;
- That political variables can best be examined by in-depth interviews; and
- The institution constituting the case study holds a wealth of documents in the form of reports and other strategic planning documents, which reflect the challenges and the direction the organizations sought to follow during its various phases. These are not accessible, and it might be possible to gain access to this information through abovementioned key informants.

3.2. Research Design

Against this background, this study employed both qualitative, and, to a limited extent, quantitative research methods to achieve its objectives. It was possible to gauge to what extent political influence, sometimes from political leadership of the day, interfered with the MEEC. This is interesting on its own, but illustrates to what extent interference with the MEEC affects performance.

The origin of development corporations was a political initiative. The Bantu Investment Corporation Act, Act No. 34 of 1959, which ultimately gave birth to various homeland-based sets of legislation, was a product of a particular political ideology and constituted the first indication of constant political intervention in the establishment and sustenance of development corporations.

Questionnaires, internal documents and published works would not be sufficient to explain political variables that influenced the performance of the Corporation. Against this background, there was a need to conduct in-depth interviews with

political and administrative officials of the provincial government and the Corporation.

At the initial stages of this exercise a literature survey was conducted with the following main objectives:

- Determination of best practice – To conceptualize the specific objectives of the case study, there was a need to establish both current thinking and best practice on development institutions. To this end literature relevant to the need was carefully perused. This covered both international and local trends.
- Development corporations in our case are creations of Government and as such they are part of the bigger family of State institutions. In investigating their practices, the role of the main shareholder, in this case the State, has to be analysed. This can only be done after all the theoretical issues have been determined.
- The determination of current status of development corporations: Development corporations have undergone great changes in recent times. It is important to scan available literature for more familiarity on the current status of these institutions.

3.3. Area of study

There study focused on the Nkangala District Municipality, where there are a number of entrepreneurs that have been funded by MEEC.

3.4. Population

The MEEC clients who received both the financial and the non-financial support were the population that participated during the study.

3.5. Sampling Methods

Random sampling was utilized during the selection process of the participants. MEEC has regional database through which the random selection was made possible.

3.6. Choice of instruments

Although the Corporation has information in the form of annual reports and a variety of internal correspondences and records, questionnaires were also employed to test certain variables. These variables included the following:

- The literacy levels of clients
- Whether the Corporation renders an effective induction program for its clients
- The impact of an after-care program (or its absence)
- Perception of clients towards the Corporation
- Reasons for non-performance

3.7. Data collection Methods and Procedures

Although the Corporation has information in the form of annual reports and a variety of internal correspondences and records, questionnaires were also employed to test certain variables. These variables included the following:

- The literacy levels of clients
- Whether the Corporation renders an effective induction program for its clients
- The impact of an after-care program (or its absence)
- Perception of clients towards the Corporation
- Reasons for non-performance

To this end, forty clients were targeted. Of this forty, thirty were clients who received loan finance from the Corporation, whilst the other ten clients who received support in terms of the contractors support program.

The thirty clients who were interviewed were evenly divided into the three phases of the development corporations existence. The demographic spread of the Province was taken into account in the selection of the target group .

The objectives of conducting in-depth interviews with political and administrative officials constituted some of the objectives:

- i) To establish linkages between political agendas and the legislative framework of the Corporation;
- ii) To establish the effect that various generations of politicians had on development corporations;
- iii) To establish the perception of politicians on whether the corporations met their mandates; and
- iv) To establish the role and influence of administrative heads of departments on the affairs of the development corporations.

The following were some of the more important individuals who were interviewed (all related to Mpumalanga):

- i) Present and former members of middle and top management of the Corporation were interviewed.
- ii) Heads of Department and Political Heads of departments responsible for the Corporation were also interviewed.
- iii) The Premier of Province and a Chief Minister of one of the former self-governing territories were also interviewed.

The interviews were very conversational in nature. Although there were basic objectives the exercise was meant to address, the individuals interviewed were given sufficient scope to analyse the performance of the Corporation, to indicate what they consider had gone wrong or right, and to advise on how the wrongs can be remedied. There were also follow-up interviews on important elements of views gathered during the interviews. After a while I gained a thorough, if somewhat personal view of the MEEC and its politics. This is reflected in this study.

Facets of the research methodology linked very well and provided a basis upon which further appropriate information on how the Corporation worked was secured. For example, due to the fact that the people interviewed were senior government officials and the Corporation's own executives, quite often they would link certain developments in the Corporation to documents they would still have a recollection of. In the end I had to peruse additional literature to be informed what these interviews meant and vice-versa.

It must be emphasized that the various tools employed in this study, i.e. analysis of appropriate literature on the subject, investigating how similar corporations are functioning, soliciting beneficiaries opinions and experience in their relationship with the Corporation, and conversation with both administrators and political heads, provided a sound basis of information to determine what is best practice to render Development Finance Corporations effective.

Three other development finance institutions were investigated, with the purpose of establishing what lessons can be learnt for rendering development finance institutions more effective.

The following categories of development institutions were identified:

- i) One development finance institution in South Africa, considered to be fairly successful, is Ithala in KwaZulu-Natal.
- ii) One development finance institution in South Africa which has succeeded in restructuring itself and operates differently from its predecessors: The Free State Development Corporation fits this description; and
- iii) A development corporation in the South African development region, which is considered successful. The Botswana Development Corporation was chosen as an appropriate candidate.

CHAPTER FOUR: ANALYSIS OF PERFORMANCE

4.1. Introduction

The programs of the Corporation had very noble objectives, which included, inter-alia, job creation, development of new entrepreneurs, stimulating economic activities in the targeted homelands, and attracting new technology. The results of these efforts, though, were not what the champions of a development corporation would have preferred to witness. In addition analyse the reasons behind the failure of the program. In this Chapter, the various programs of the Corporation are assessed. The key objectives of the program are tested against both the efforts put in by the corporation and the results achieved. The reasons behind failure are identified. It must be emphasized that vast amounts of financial resources were set aside to facilitate, amongst others entrepreneurial development and employment creation.

To this end, the following have been analysed:

- The financial resources allocated and spent on the various programs. Where appropriate this will be done in nominal and in real terms.
- The employment impact of the various programs through the different phases of the Corporation's activities.
- Financial performance of individual programs: which includes assessing variables, such as the rates of return, provisions for bad debts, and other efficiency related variables.
- The extent to which entrepreneurs were developed. This will be going beyond merely financial support to after-care services such as mentorship and related activities.

4.2. Tribal Development Institution: Pre-2004

The analysis focuses on the three phases:

The Pre – 1994 Period: This ranges from 1984 when the Kwandebele National Development Corporation was established to 1993. However, where information for certain years' operations is unavailable, this will be indicated in the analysis.

The 1994 – 2000 Period: This will constitute the first five years of the democratic Government. Although the first five years ended in 1999, part of the 2000 financial year's budget was determined in 1999.

The 2000 – 2003 Period: The significance of this period is that this was a second term of the Provincial Government of Mpumalanga and its Cabinet had by now started settling. It has been argued earlier that the Central or Provincial governments had until 2000 not given any clear direction of its support to the Corporation, which makes this period significant.

In some cases, real (1984) value figures are reflected, based on the following STATS SA derived figures:

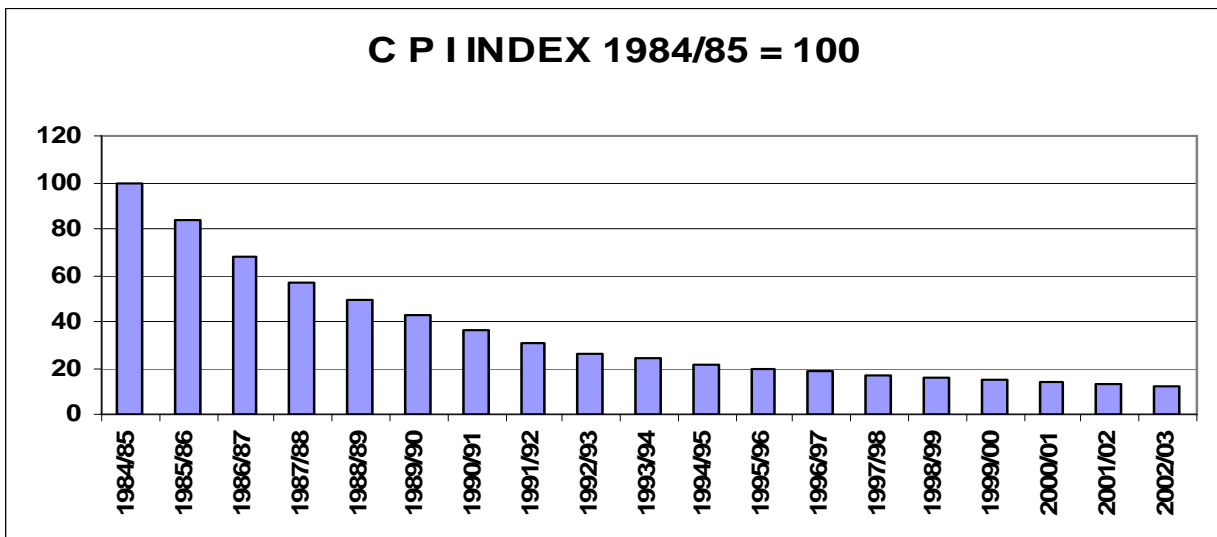


Figure 1: CPI 1984 TO 2003

(Throughout this document, reference is made of the term “Real terms”, which refers to the above CPI index. This graph clarifies that an investment of R100 million today has the same value as approximately R15 million in 1984 – see definition of “Real terms: page 8)

The programs, which will be assessed for all these phases are as follows: industrial development, development finance, contractor support and non-financial support programs.

The Industrial Development Program was the most important initiative period in the conception and implementation of the industrial development strategy program. For one thing, the Development Corporations were established in that period. For another, the major programs of the Development Corporation were conceived and implemented in that period.

In assessing the performance of this portfolio at that time, the following variables were employed: the financial investment set aside for this purpose; employment impact of the program; multiplier effects of the program; and efficiency aspects of the program.

a). Total Financial Investment set aside for this Program:

About R 116 million was set aside between 1984 and 1989 to develop a number of industrial parks in both the Kwandebele and the Kangwane homelands. The real (1984) value of these amounts in 1998 would be R 48 million.

These investments were done in respect of the following area:

- Development of the Ekandustria Industrial Park in Kwandebele;
- Development of the Kabokweni Industrial Park in the Lowveld (in the former Kangwane self-governing territory);
- Development of the Siyabuswa Industrial Park;
- A string of small industrial parks on the Highveld; and
- A string of small industrial parks in the Lowveld.

Investments in these programs were as follows:

Total investment in nominal value: R 191.6 million

Total investment in real (1984) value in 2003: R 23.05 million

Judging from the above efforts, there is no doubt that this program was implemented with vigor and commitment.

b) Employment impact of the program

During this period, the programs created a total of 5,140 employment opportunities. The bulk of employment opportunities created over the lifespan of the corporations were at Ekandustria, which had created a total of more than 7,680 job opportunities. This constituted more than 85% of the total employment opportunities created by the whole Portfolio. The small industrial parks created only 633 jobs.

c) **Multiplier effects of the program:**

By creating more than 7,313 jobs, the Industrial Development Program made a significant impact on the livelihoods of the targeted communities. In fact, other than in government, there is no evidence of employment opportunities created on such a scale elsewhere in KwaNdebele.

This impact translated into 32,500 indirect employment opportunities and benefited an estimated 162,500 family members. This is arrived at by employing a dependency ratio of 5:1. However it must be mentioned that whilst factors of production in the form of labour were purchased from the targeted community, other important factors of production such as machinery and related inputs were sourced from areas outside the targeted homelands. The multiplier effects were therefore felt more in areas other than the targeted ones.

d) **Efficiency aspects of the program**

In this respect, the following variables are analysed: the Return on Investment (ROI), bad debt ratios, the cost to income ratio and the cost to investment value (see definition of selected concepts).

The analysis of these variables provide a general picture of the efficiency aspects of the portfolio during this period.

The rate of return on properties stood at 8%. This is less than the average cost of capital which was at 10%. If maintenance costs are taken into account, it becomes very clear that the rate of return was very low.

Bad debts: This is based on the quality of the administration of this portfolio as expressed in terms of the percentage of bad debt provision to rental income. In terms of this formula the average annual bad debts provision of the portfolio during this phase was 10%.

Cost to income ratio: This ratio refers to the value of operating expenses incurred in an effort to generate R1.00 in operating income. The operating cost in this phase amounted to 60% of the operating income. This meant that it cost the Corporations 60 cents of operating expenses to generate R1.00 in rental income.

Cost to property value ratio: This is calculated as a percentage of the operating cost to the historic property value. In terms of this ratio operating costs was 5% of the portfolio value. Combined with the cost of capital it burdens the performance of the portfolio.

4.3. The Development Finance Program

The Development Finance Program constitutes the core of the MEEC's mandate. When the mandate of the Corporation is under scrutiny, what receives most attention is the Development Finance Program. When the Premier of the Province in the second phase of the existence of the Corporation explained the reason for his Government's desire to dismantle the MEEC, he singled out the under-performance of the loan portfolio as one of the key reasons.

In assessing the Development Finance Program over time, the following were identified as key variables: financial investment set aside for the Program; the impact of it on job

creation; extent to which entrepreneurs were developed; and the financial performance of the Program.

Financial investments

Between the establishment of the KEDC / KNDC and 1994 a total of R 80.9 million was set-aside for this Program. In real (1984) terms this amounts to only R44,43 million. The illustration below provides an indication of how government provided more and more resources, year after year, since 1984.

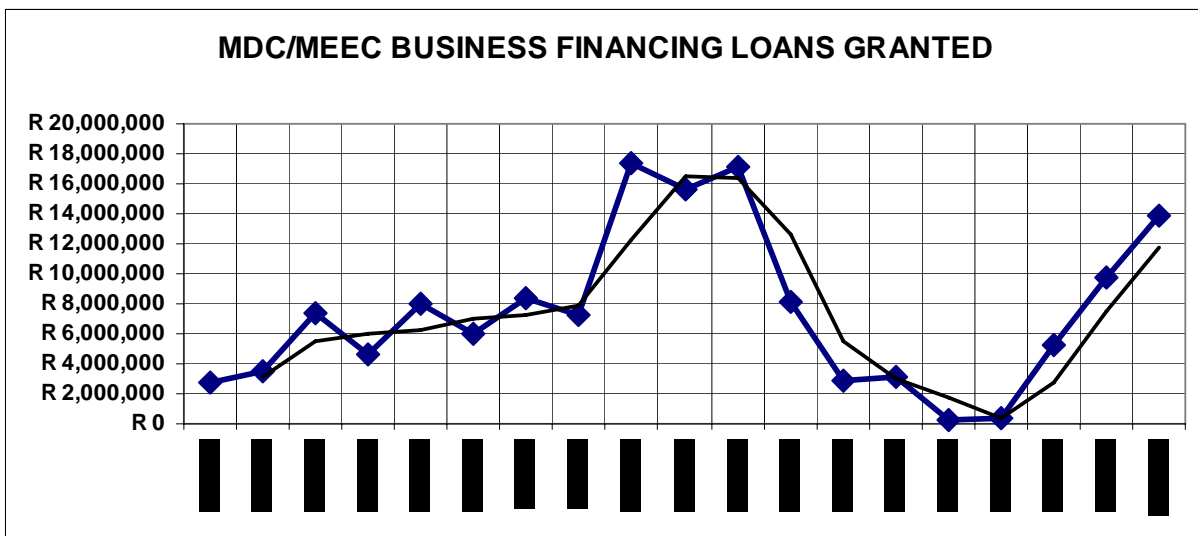


Figure 2: Financing portfolio – loans granted

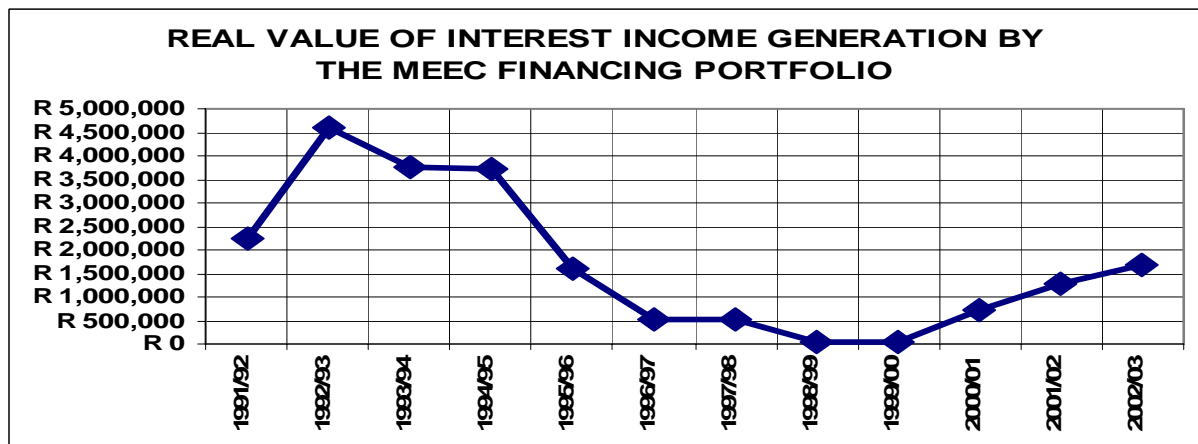


Figure 3: Financing portfolio – interest income (real value)

The above illustration indicates the extent to which the real value of interest income generated by the Corporation's financing portfolio suffered since 1994. Although not sufficient for a new organization, this demonstrated sufficient commitment on the part of the shareholder for this Program to succeed. This also overlaps with new political and macro-economic goals.

Due to the inconsistencies in reporting standards on the part of the Corporations, it was difficult to establish the correct figures on employment created by this Program in the first phase. The figures ultimately arrived at were based on an own extrapolation of the average loan financing disbursed per employment opportunity for the years for which data are available, and the actual loan finance disbursed.

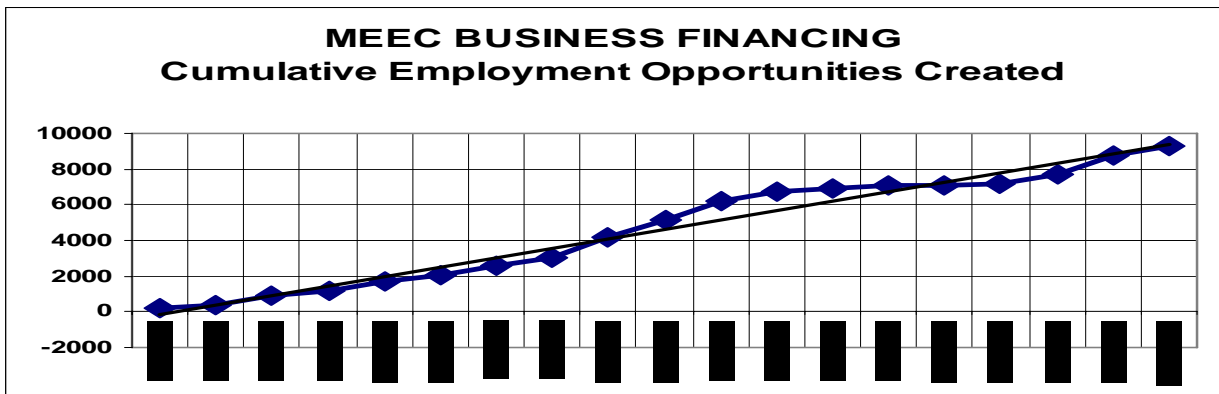


Figure 4: Financing portfolio – employment creation (cumulative)

Based on this, the average number of jobs created by this Program rose from about two hundred to four hundred each year until 1992. The years 1992 to 1994 witnessed a leap from 400 jobs to about 800 per year. The average annual number of jobs created during the period 1984 to 1994 was 514. The budget of this Program ballooned during this year. Political reasons may have played a part as this was before the first democratic elections in 1994.

There is no question that the Corporations did fund some businesses. The question though, is whether these businesses were sustainable or not. The fact is that it is rare to come across entrepreneurs who have managed to sustain their businesses after being assisted by the MDC. Even though there was no question that the Corporations did finance clients, it was not easy to find reliable records in this regard. In terms of the 1984 – 1994 debt book of the predecessor of the MDC it can be concluded that in the first few years the loan portfolio was run on a manual basis, but during the various restructuring processes which involved relocation of files, vital information was lost or destroyed.

The following variables were employed to assess the performance of the Program: return on investment, level of bad debt, cost to income ratio and cost to portfolio value ratio.

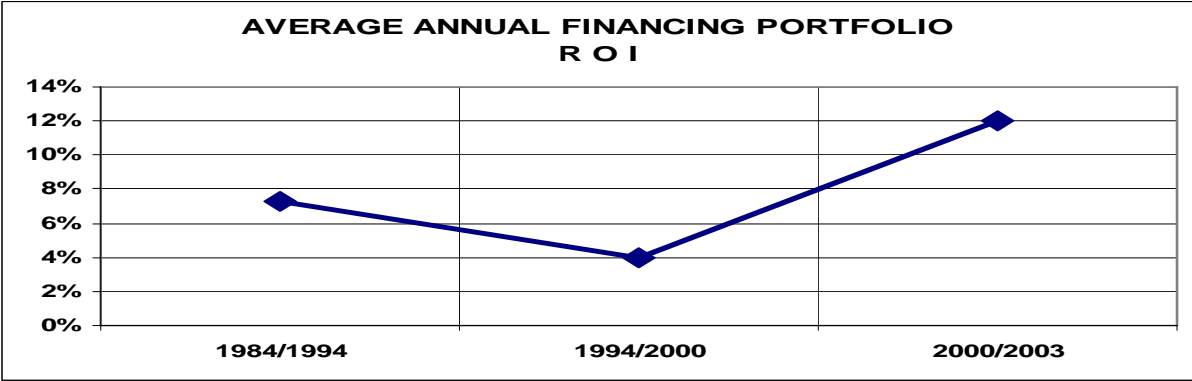


Figure 5: Financing portfolio – average annual ROI

The Return on Investment for the Program averaged 7% before 1994. This was about half the industry average of about 14%, nowhere near profitable enough.

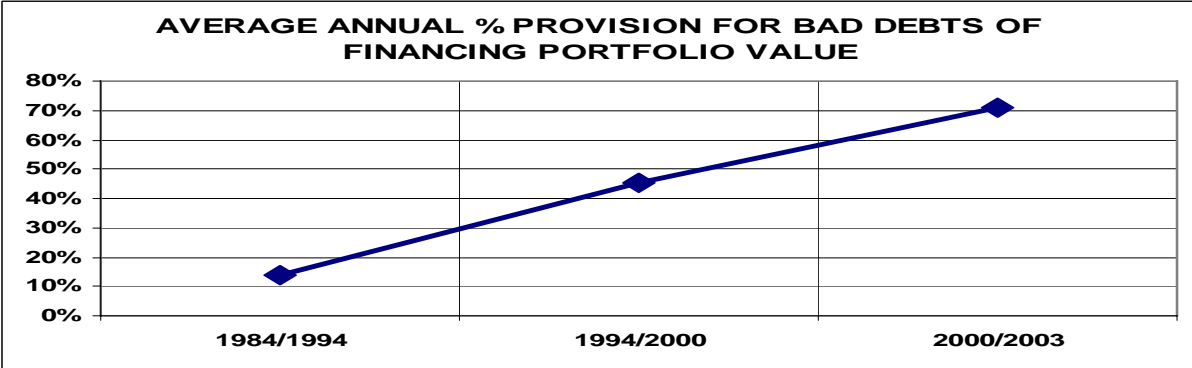


Figure 6: Financing portfolio – bad debts provision

The average annual bad debt provision was 14%. This was fairly optimistic for an organization funding micro enterprises with a high failure rate.

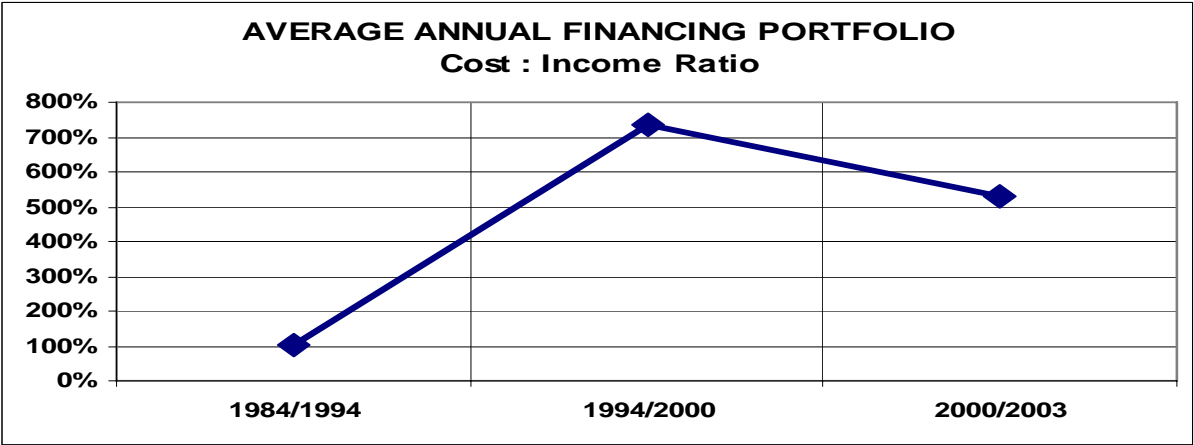


Figure 7: Financing portfolio – average annual cost/income ratio

The operating cost was 103% of operating income in the period 1984 to 1994. This meant that for every rand of income earned, the Corporation spent R1.03 in operating expenses.

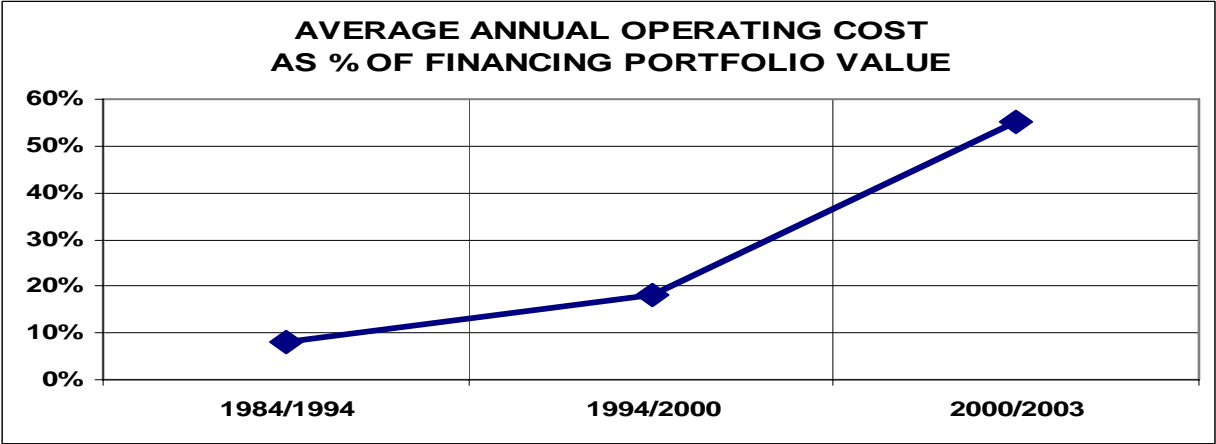


Figure 8: Financing portfolio – average annual operating cost %

The operating cost during this period was 8% of the financing portfolio value. The operating cost (including salaries and administrative expenses) amount to 8 cents in every rand disbursed, whilst the ROI (interest earnings) was only 7 cents to the rand.

The average annual percentage Rate of Returns, the average annual percentage provision for bad debts, the average annual Cost-to-Income ratio and the average annual Operating Cost as a percentage of the Financing Portfolio value, as reflected in this analysis, indicated that the Program started off relatively well in the first phase.

4.4. The Contractors' Support Program

The Contractors Support Program was a successful program. The Contractors Support Program was only established in the 1992 / 93 financial year in response to the demand by local contractors who won tenders for construction from state institutions. The Contractors Support Program had as its objectives the use of performance guarantees for working capital and provision of guarantees to the client of the contractor. To this end, the program had two main components: bridging finance and performance guarantees.

Of all the programs, the Contractor Support Program is one has been the most successful in the past. The following facts bear testimony to this:

- During the 11 years of the Program's existence, only 13 bridging finance guarantees were called up, reflecting 4,22% or less than 5% of the total exposure of the Program.
- The annual project value increased significantly during phase two, to reach a high of R 152,78 million during 1999/ 2000.
- The annual average value of performance guarantees issued increased significantly during phase two, to reach a high of R 29,2 million during 1999/ 2000.
- The average annual employment opportunities created through the Program increased significantly over the period to reach an annual average of 1,163.

Resources set aside in the first phase:

The Program was initiated during the 1992/ 1993 financial year.

During its first two years the Province allocated the following:

Bridging finance	R 7.5 million
Performance guarantees	R 3.3 million

Financial performance and profile of the Program

The following provides an indication of the financial performance of the Program:

Average annual number of projects assisted	32 projects
Average annual projects value	R 17.67m
Average annual Performance Guarantees values	R 1.66m
Average annual bridging finance provided	R 7.5m
Average annual number of jobs created	343 jobs

Bad debts: (According to records, only two guarantees were called up)

In the first year of its existence, the program created 160 jobs.

The above analysis implied that an average amount of R 21 865 Bridging Finance was disbursed to create one employment opportunity. This is slightly higher than in the average SMME venture. The Program had a low default rate at that stage. It was clear, therefore, in the beginning that the Program would be an important ingredient in the sustainability drive of the Corporation.

4.5. The restructuring phase: 1994 – 2000

With regards to the Industrial Development Program, a total financial investment set aside for this purpose. A limited amount of only R 9.0 million for financial investment was made available in this period. Consequently only limited industrial development could take place during this period.

The employment rate decreased dramatically during this period due to the relocation of industrialists from both the small industrial parks and Ekandustria. Ekandustria's employment rate dwindled by about 50 % compared to the first phase during 1984 / 94. Suppliers of inputs and other essential services to Ekandustria remained outside the Province due to the fact that there was no successful manufacturing base of small industrialists in the targeted areas. With no major movement at all on the development of the Industrial Program, the Corporation was only involved in maintaining existing factories.

The same variables as employed in the previous section were evaluated: i.e. rate of return, bad debts, cost to income ratio, and cost to property value ratio. Rates of return: The rates of return for this period stood at 11%; Bad debts: There was an astronomical average annual provisional for bad debts at 70%; Cost to income ratio: The operating cost in this period was 52% of operating income. Cost to property value ratio: The operating cost stood at 6% of the property value. It is very clear that by the end of the first phase, the Corporation's programs were not performing well. The average ROI of the period for the Corporation was -2%.

The period between 1994 and 2000 witnessed a dwindling rate of financial investment into the MDC / MEEC Corporation from the shareholder. The total investment in this phase amounted to R 31.0 million.

It must be pointed out, though, this was a period when various restructuring exercises took place. Government resources went into restructuring rather than to this program. This period witnessed a decrease in loan financing value per employment opportunity created.

There is no reliable data available regarding the number of clients financed during this period. The fact that in 1997, the MDC had to stop funding projects to concentrate on restructuring the Corporation, implied that there were little effort expended in the direction of developing entrepreneurs. This phase was characterized by political influence in the development of entrepreneurs.

- The Return on Investment: The Return on Investment was at its lowest ebb at 4%, almost fifty percent lower than the average for the previous period;
- Level of bad debt: At 45% the level of bad debt provision had gone up by more than 300%.
- Cost to Income ratio: The operating cost was 736% of operating income;
- Cost to portfolio value ratio: The operating cost was 18% of the Financing Portfolio value.

This program was clearly experiencing a downward trend in terms of performance.

• Average annual performance guarantee values	R 7.6m
• Average annual bridging finance provided	R 6.m
• Average number of jobs created jobs	1,201
• Total number of jobs created during this phase	7,203
• Total number of projects for this phase	273
• Total projects value for the period R381,5m	
• Total value of performance guarantees during this phase 45,67m	R
• Total value of bridging finance during this phase	R 36,8m

Based of the facts presented in this section it is very obvious that the only program that witnessed growth in this period was the contractor's support program. Both development finance and property development reached a record low in their performance.

4.6. Shift in Provincial Policy

The 2000 – 2003 period represents a significant change in the external environmental and situation of the Corporation. A second term of office for the ruling party had just begun. The Province had a new Premier but the Cabinet was more than 50% similar to the preceding Cabinet.

A team appointed to restructure the Corporation had submitted its report to both the outgoing Cabinet as well as the incoming Cabinet. There was no excuse why a firm decision on the future of the Corporation could not be taken. Consequently, the Corporation began changing.

In general, the post-1994 Government had acquired practical experience on policy implementation. The Reconstruction and Development Program was put to test but was not that easy to implement. GEAR was by then official government policy and it provided a framework for economic development. The Provincial Government of Mpumalanga, was

in this phase in a good position to change the role of the Corporation. This was reflected in its programs, as discussed below.

The value of the Property Portfolio grew with more than R30 million by the end of the 2003 financial year. For the first time since the last factories were built in 1989, the Provincial Government set aside an amount of R 35 million for the construction of a 2,200 m² factory in 2003. This happened more than 13 years after the old Industrial Development Program witnessed the construction of new factories. This constituted a significant development in the history of the Corporation and this signaled a demonstration on the part of Government of its appreciation of the role of industrial parks in job creation.

For the first time, the Company that won the tender for the construction of the factory was assisted by local people. Services such as earth moving were procured from local entrepreneurs. Technical expertise and other important inputs were brought in from outside the borders of the Province. A major renovation of the other factory, which involved R27 million, was also done by a local contractor: These two projects alone allocated work to more than ten local sub-contractors.

The factory was going to create an estimated 1,000 jobs in Ekandustria. This would constitute about 15% of the total employment in the area. By and large the employment rate in the area has been on a downward trend. The speedy reconstruction of a fire damaged factory resulted in more confidence in the area, with the result that more investors came to Ekandustria for factory space. This translated in fifty more jobs.

In the last phase under investigation there is evidence of increased shareholder commitment to support the Corporation and its clients. The funds set aside by the Government over and above the normal allocation to fund this Program constitute the main evidence of Government's commitment.

In the period of loan disbursements, the contribution to support prospective loanees was as follows:

- 2000 / 01 R 5,23 million

- 2001 / 02 R 9,7 million
- 2002 / 03 R 13,8 million

Figure 9 below demonstrates how this phase performed *vis-a-vis* the rest in respect of average annual loan disbursements. However it must be remembered that the data is expressed in nominal terms.

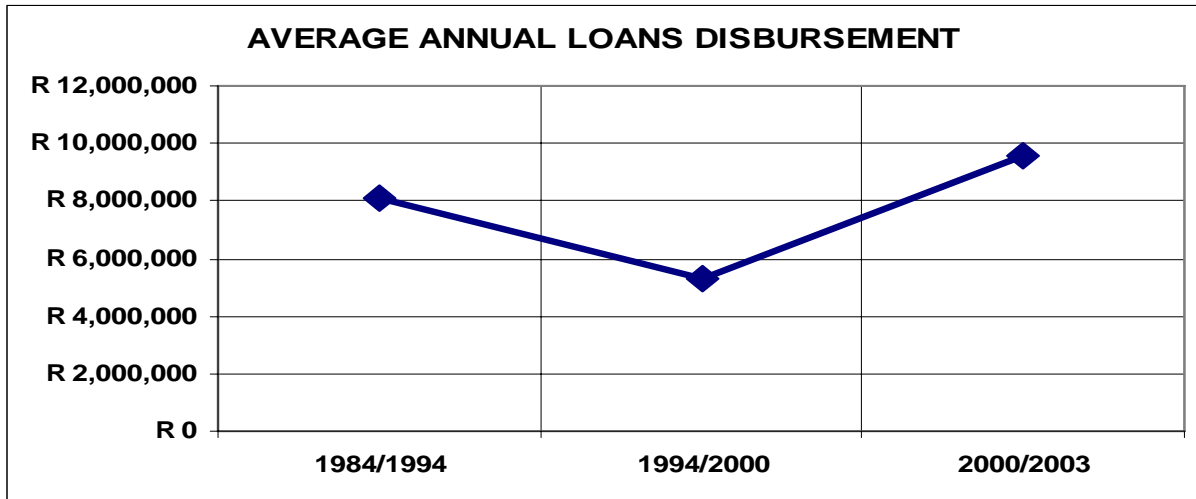


Figure 9: Financing portfolio – average annual loan disbursements

The level of funding, as reflected in the Annual Report of the MEEC for the 2002/2003 year, indicates the dwindling commitment of Government to support development corporations. The total grant for this financial year was just under R 44 million. The Development Finance Program was the most seriously affected program. The budget for Development Finance in the 2000 financial year stood at only R 5,2 million.

It remains to be seen whether businesses that were assisted with special programs during this period would be sustainable. Available data indicate that the repayment rate is growing worse. The fact that the bad debt provision has moved from 14% in the first phase to 71% in the third phase is an indication that entrepreneurs who are being assisted are not coping or are not repaying even though they might be in a position to do so.

The average number of jobs created in this phase is 715. This is the highest compared with totals of the first two phases. This can be attributed to the fact that clients in this phase were moving away from retail into other sectors that were more labour intensive.

The resources that were set aside for this program were as follows:

Total value of performance guarantees issued	R 9,15 m
Average annual performance guarantee values	R 3,05 m

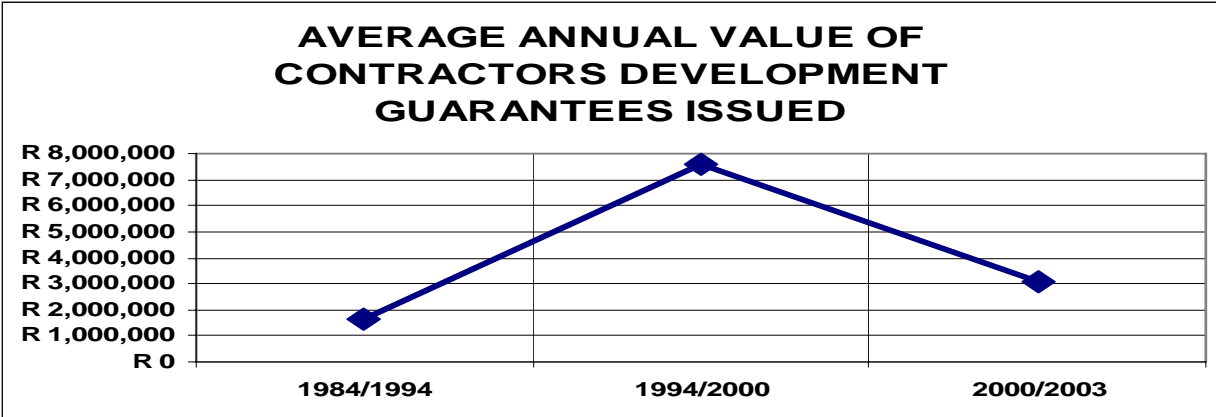


Figure 10: Contractors’ development portfolio

Average annual bridging finance provided	R 1,91 m
Total value of bridging finance provided	R 5,73 m

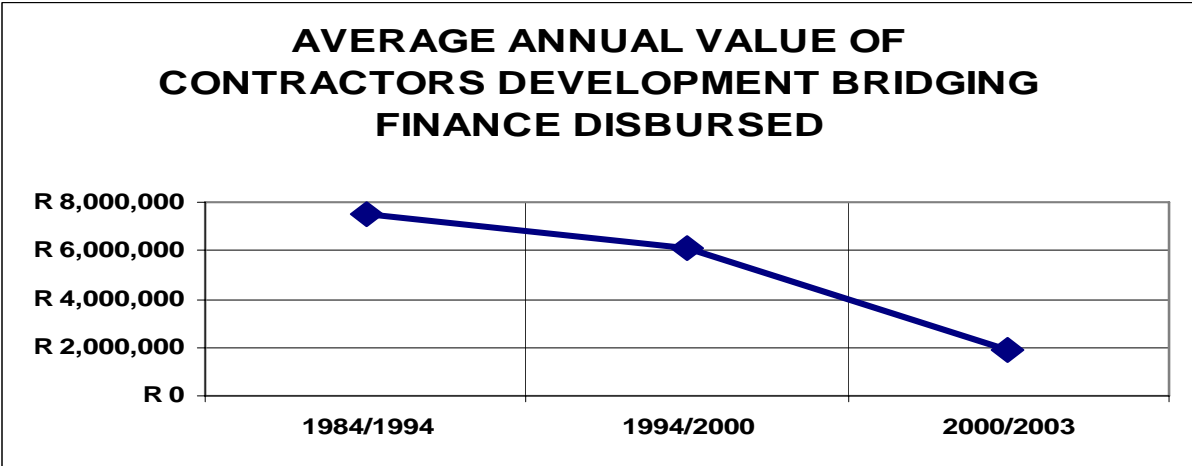
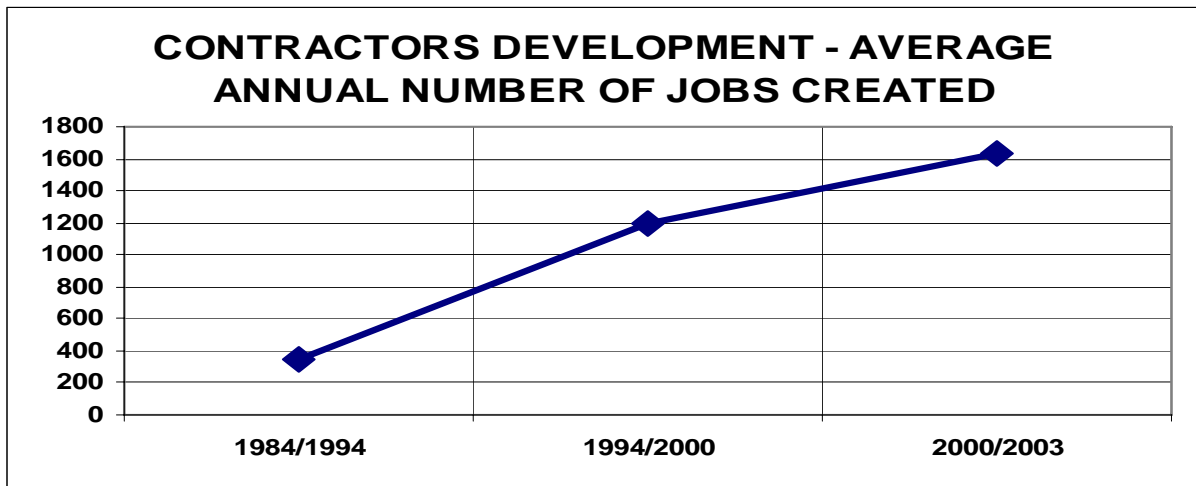


Figure 11: Contractors development portfolio – bridging finance

The job creation impact of the program is as follows:

- Total number of jobs created during the period 4,910 jobs
- Average annual number of jobs created 1,637 jobs

Figure 12: Contractors Development Portfolio- average annual job creation



Total number of entrepreneurs assisted	83
Total value of projects during the period	R 120,4m

The average annual budget value was R40,12 million. Clients were mentored by the Corporation's experts in construction and most of them have won tenders and completed projects for the Government. During the eleven years of the Program's existence, only 13 bridging finance guarantees were called up, reflecting 4,22% or less than 5% of the total Program exposure. This means that more and more contractors have become economically successful. The performance of the programs of the Corporation were characterized by very interesting trends from which we can clearly draw useful lessons.

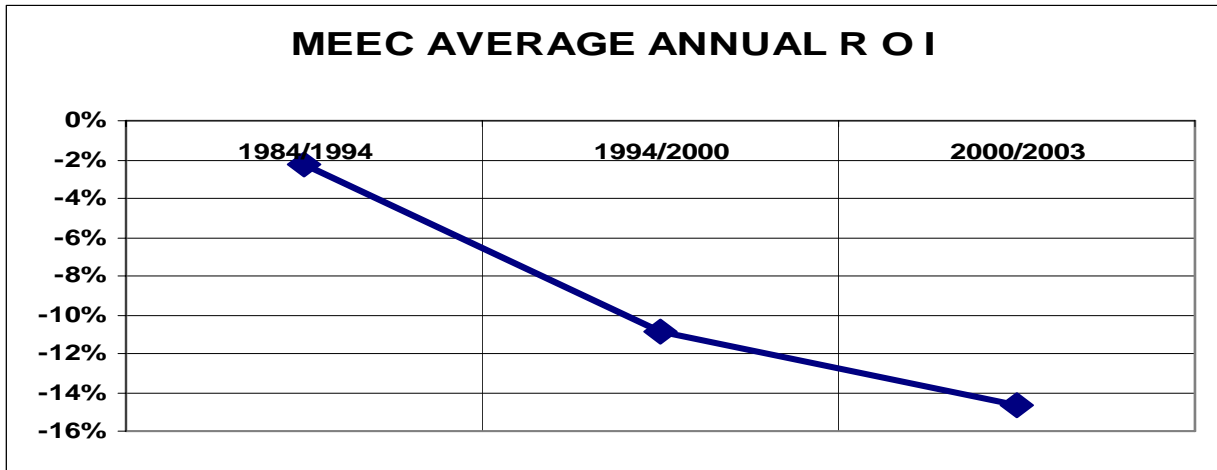


Figure 13: Average annual ROI

An even more interesting analogy can be drawn from the relationship between political developments and the level of financial support from the shareholder. The first phase of the Development Corporation witnessed political commitment on the part of both central Government and the governments of the respective self-governing territories to make the corporations live up to its mandate. This commitment translated into pouring financial resources into the development of industrial parks and into loan finance.

The second phase witnessed a skeptical approach towards the Development Corporations on the part of the shareholder. This resulted in the withholding of resources and an attempt to “dismantle” the Corporation. During this period the two main programs of the Corporation i.e. Industrial Development and Development Finance both suffered. The Contractors Support Program thrived, not because of Government support, but because it did need and had significant financial resources to negotiate performance guarantees. This is because, in the case of bridging finance, the Corporation could use its strong asset base as a guarantee for its clients in this portfolio. During the second period, Government set aside R 52 million for restructuring costs of the MDC. These funds went mainly to finance severance packages to the staff of the Corporation. Only some R 31 million was allocated for project financing in the period between April 1994 and April 1999. An illustration of funds committed for restructuring as opposed to business finance in this period is the following:

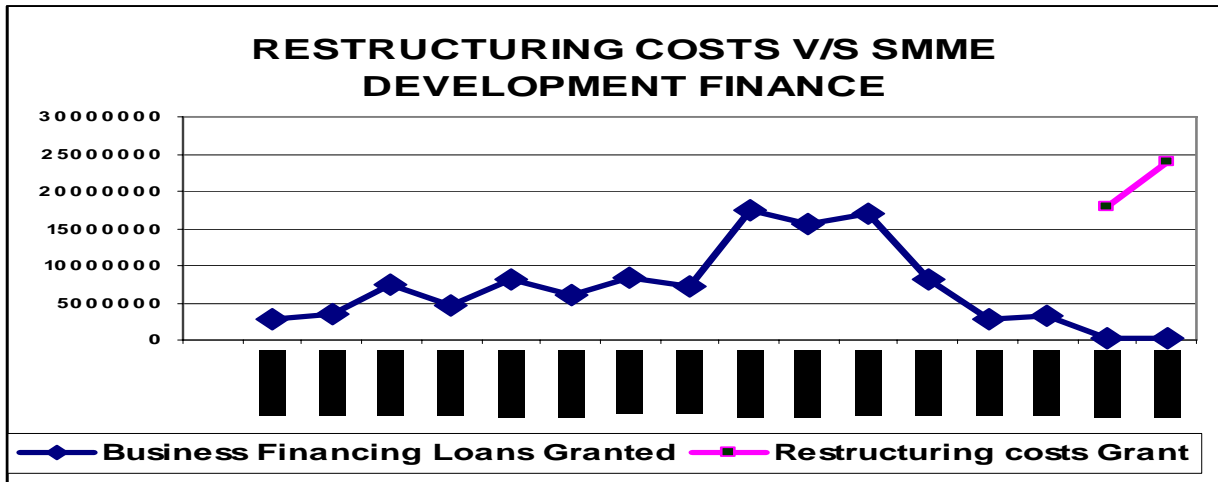


Figure 14: Restructuring cost compared with value of loan

It could be postulated that restructuring as a political act, has clear and negative effects on the number of loans granted.

An analysis of the performance of the various programs follows:

- There was a reduction in occupancy rate at the Industrial Park during the second phase of the Corporation’s life.
- Judging from the resources allocated, it is evident there has been no serious intervention since 1994 to further develop Industrial Parks. Instead the Corporation could not adequately maintain the existing Industrial Parks.
- The Corporation’s Property Portfolio experienced short-term improvements in respect of returns and unrealized interest charges during the year under review. These are at 8% and 16% respectively as opposed to 11% and 2% respectively in the previous phase.
- The efficiency of property administration remained almost constant over the longer term. However, a short-term trend of decreasing efficiency in terms of both operating cost as a percentage of rental income and the portfolio value is observed.

- The quality of the Property Portfolio was compromised by a high percentage of bad debt provisions, which by the 2002/2003 financial year stood at 95,6% of the budgeted value of rental income.
- The financial statements of the Corporation indicate a dwindling of the funds set aside for Business Finance since 1996.
- In 1995 the funds set-aside for new entrepreneurs was in the region of R 17 million. The following year, in 1996, this amount was almost halved to R 8 million. In 1997 it came down again to R 2,7 million, and to R 0,3 million 1998 and R 0,35 million in 1999.

The illustration below provides a picture of how the development finance program decreased during the period 1995 to 2000. After this, it increased possibly to the importance of political influence in the performance of the program.

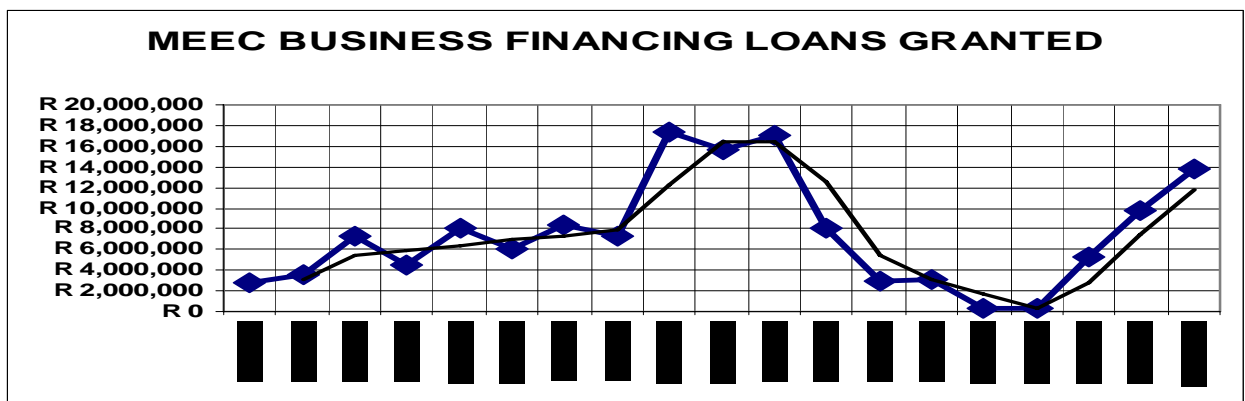


Figure 15: Value of loans granted

Lack of financial resources and other factors contributed to the under-performance of the Program. The following is evident:

- The bad debt provision for the whole period stood at 32,8%. This implies that the Corporation has written off more than 32 cents in every rand allocated. The bad debt provision for last phase was at 70%, which demonstrates a negative trend in this regard.

- The high cost-to-income ratio which is currently at 200%, though showing some improvement, is unacceptable. It was 100% in 1992, implying that it then costs a rand to generate a rand in income. The 1994 - 2000 era witnessed a situation where it cost R5 in operating expenses to generate one rand in operating income.
- In general, clients of the Corporation are mostly in a debt trap. Out of thirty clients interviewed, only 10% or 3 managed to pay off their loans.
- A total of 37,7% of clients are so debt ridden that the amounts they owe the Corporation far exceed the amounts borrowed.

It seems that the political influence was stronger than market forces. The implementation of the Public Finance Management Act has, however, halted this Program. Whilst there are isolated cases demonstrating how the Corporation has been able to assist entrepreneurs, in general, the Corporation's clients have been left with no credit available. This resulted in most of them becoming very skeptical of any effort on the part of any Development Finance Institution to support entrepreneurs. This could have far reaching implications in the future. Since there are insufficient records in the area of non-financial support, information was solicited through interviews and questionnaires on clients. This Program was implemented in various phases by the predecessor organizations of the current Corporation. In some cases officials responsible for after-care services were performing the role of debt collectors. The following observations concerning this Program need to be noted.

- In general, clients of the Corporation were not sufficiently educated to participate in an industrial development program. The average formal qualification of thirty clients interviewed was grade eleven.
- The Corporation did not sufficiently educate its clients on compliance issues. Only about 30% of those interviewed were knowledgeable on compliance issues.
- Only 10% of clients interviewed saw their mentors as per the agreed upon Program, implying that the After-Care Program was run in an un-coordinated way.
- About 40% of the clients were not given any after-care service. This is in spite of an average of 2½ weeks' business training of the Corporation's clients.

In the second phase, and the first two years of the third phase, no after-care service for the Corporation's clients was offered. It is in this period that the highest default rate was registered. The after-care service in the first phase, though faulty, was still able to ensure a relatively better repayment rate. This shows the importance of such an after-care program.

4.7. Other shortcomings

Based on the questionnaire distributed to a sample of thirty clients of the Corporation's Loan Portfolio, and on interviews with former and current officials and other stakeholders of the Corporation, the following shortcomings were noted:

- Systems, whether in the form of information or information technology or other monitoring mechanism, were generally inefficient. Until very recently the Corporation has been using an Information Technology system called the Pic system, which was basically an in-house product. The System was only mastered by two people, this was very unreliable and expensive to maintain. In the first phase the Corporation's records were processed and kept on a manual basis. More interesting is the fact that the Corporation never saw the need to employ any monitoring system such as Bank stop orders to ensure that clients paid regularly. Of the interviewed clients, only about 15 % were made to sign bank stop orders to service their loans.
- The average formal education the clients received was grade eleven. One of the many implications here is that those that did not make it to matric became the core of the Corporation's client base. What is even more intriguing is that the average period of business training received by the clients was only two and a half weeks, which is completely insufficient.
- There is no evidence that there was any concentrated effort to train local staff to be able to occupy the managerial positions of the Corporation. In 1998, for example, more than 80% of the managers in the Corporation were white males. It was only very recently that black staff were placed into various positions and programs to ensure that they are able to hold down managerial positions in the Corporation. In 2003, more than 85% of Managers were black, whilst about 25% were females.

In general, whilst the Corporation has in some cases fulfilled its stated objectives as enshrined in the various acts of parliament, the end result of these activities have not always benefited the target groups sufficiently. Whilst the Industrial Development Program has been fairly successful in so far as it created jobs, the Program itself has not proved to be sustainable. The SMME Loan's Program was an act of expediency and the fact that it has left more than 80% of the Corporation's clients in debt is a testimony that it was an unmitigated disaster. The program to realize the objective of promoting, planning, establishing and co-ordination and acquiring business ventures has been an absolute failure too. No subsidiary of the Corporation has proved to be sustainable to date.

4.8. Benchmarking with other Development Corporation

The performance of the Corporation was benchmarked with other development corporations which share a similar focus in terms of its mandate. These benchmarks were derived from Ithala in Kwazulu Natal, The Free State Development Corporation in the Free State, and the Botswana Development Corporation in Botswana. The mandates and origins of these institutions are not fundamentally different from those of the MDC/MEEC, save to note that the Botswana Development Corporation has no social engineering baggage. In the Table below the rate of investment, interest cover, the gearing ratio, bad debt provision and cost to income ratio's are used as variables to compare the performance of the Corporation with similar institutions.

The following observations can be made:

- The MDC has an unparalleled low gearing ratio.
- The MDC's cost-to-income ratio which was at 205% was an indication that the organization was not run on business principles.
- The bad debt provision at 76.5% is more than 6 times that of the best parastatal in the group. This is an indication that its loan portfolio will not lead to self-sufficiency of the organization.

Both the rates of return and interest cover are extremely low compared with the other corporations. Other observations on the profile of the MDC/MEEC *vis-a-vis* other Corporations are as follows:

- Other Corporation's were significantly capitalized in their initial years. The BDC and Ithala are outstanding examples. Ithala, for example, was capitalized by the former Kwazulu Government in the form of annual share capital transfers to the extent that it built an asset base of more that R2.5 billion as a basis for generating income. The Freestate Development Corporation received R1 billion capitalisation from Government in 2002/03 compared to the MEEC's R80,0 million.
- The Boards of all these Corporations consist of appropriately experienced members.
- There was in general sufficient government support for these institutions. This translates into material support. The capitalization of the Industrial Development Corporation (IDC) is a typical example.
- These institutions are run on strict business principles. Their performance reflected in Table 4 below is testimony of that.

Benchmark	MEEC	ITHALA	FDC	Botswana Development Corporation
ROI	- 22,5%	13,6%	13,5%	4,4%
Interest Cover	- 1 348%	15,8%	244,8%	228,5%
Gearing	18 %	51%	135%	31%
Bad Debt Provision	76,5%	12%	54,4%	27,4%
Cost-to-Income	205%	71,8%	69%	39,1%

Table 4: Comparison between development corporations

In conclusion, it must be noted that the MDC/MEEC has not performed well in terms of stated objectives and its mandate. However, this does not mean that the concept of a development corporation is uncalled for. Under different circumstances, the Corporation could have performed much better or, at the very least, performed very much like other similar institutions.

4.9. Political impact on performance

It is common practice for state institutions throughout the world to have state officials on their boards to ensure compliance with the state's mandate. German parastatals, where the affected departments always delegate a senior official to sit on the parastatal's board, is a typical example. This is one measure to ensure that the shareholder's interests are taken into account during the decision-making process. In the case of the Mpumalanga government and its relationship to the Corporation, evidence exists that political factors other than the need to ensure compliance with the mandate were at play in the case of the Corporation. They manifested themselves as follows:

Former employees of the Corporation talk about two sets of criteria for approving applications for project funding. One was criteria that related to the sustainability of a project and the other was called the "ringing telephone". The latter implied that when senior politicians called to recommend that certain applicants be given first preference in their applications for funding these requests need to be prioritised. More interesting is the classification of files by the Corporation. There were two main categories. The first one was a category called "M", standing for ministers, traditional leaders, members of parliament, and other influential members of society. The second was for the normal client requests. There was evidence of special treatment given to the first group. The "M" category has generally not performed any better. In fact the "M" category made debt collection almost impossible because of their power to lobby against any drastic debt collection efforts.

The Development Corporation spent about five years since 1995 not really focusing on its mandate but on various restructuring efforts. This led to the demoralization of staff, lack of attention to the Corporation's assets, including industrial properties, channeling funds that were supposed to be for on-lending activities to other non-core functions and a general lack of service to both existing and potential new clients.

After three restructuring and amalgamation exercises which were basically unsuccessful, the last restructuring team headed by a retired Auditor-general handed its report to the Cabinet in the middle of 1997. It was eventually adopted towards the end of 1998, and it was only fully implemented by a different Cabinet towards the end of 1999. In the process

aspects of the institutional memory of the Corporation and important documents were lost. The Corporation lost market share and failed to maintain its infrastructure.

The Boards of provincial parastatals, in general, are not expertise based. Appointments take into account issues such as regional spreading, chamber interests and gender representivity. Whilst these are legitimate issues, quite often this is done at the expense of the sustainability of the Corporation. In some situations board appointments were no more than political gestures. The Benchmarking exercise in Chapter Four with other Institutions such as, amongst others, the Botswana Development Corporation, indicates that best practice in the industry is to attract appropriate expertise to the boards of corporations. Issues such as representivity must be weighed against the need for Board members to add value. The current provision for the Corporation is to have only five Board members, which makes it difficult to attract the necessary expertise from a variety of appropriate areas of skills.

The financing of the Corporation did not escape the negative attitudes of politicians and bureaucrats towards it. In situations where the politicians did not support the existence of the Corporation or its senior officials, funding dwindled. Former senior officials interviewed asserted that one of the reasons why the funding levels dwindled was the bad relationship between the shareholder and the Corporation. This is evident in the second phase of the Development Corporation.

4.10. Legislative framework

Whilst, in general, legislation gave the Development Corporation latitude to perform almost every function it may wish, it has several weaknesses, which make it difficult for the Corporation to be sustainable in the long-term. The following are to be noted:

- In terms of the current Act governing the Corporation, the Corporation cannot always procure goods and services beyond a certain minor amount unless it goes through the Provincial Tender Board. It is very clear that the current Act was drafted with the objective of reducing the Corporation to a government department or a section in a department. This defeats the objective of the Corporation's existence. Fortunately this limitation was overruled by the Public Finance Management Act recently.

- The Public Finance Management Act does not allow the Corporation to continue with performance guarantees, an important component of the contractor development program. Unfortunately this was the only Program that was sustainable and has led to the Corporation losing its market share and consequently decreasing its chances of sustainability.

4.11. Skills and performance

There is no evidence among the Corporation's staff of sufficient skills in the various phases of its business to execute all facets of the mandate. The client's skills levels, as explained in the last chapter, left much to be desired. There is also no evidence of a program to ensure that the skills profile of staff matches the requirements of the Corporation. In an organization operating in the development finance industry, one would expect staff to be trained in related fields or recruitment activities to reflect this challenge.

Records show that neither the recruitment activities of the Corporation nor the training profile of the Corporation point in this direction. Instead the Corporation was no more than an employment agency. The fact that in 2003 it could function with only 84 members as opposed to more than 250 in 1999 attest to the fact that skills were not a big issue as such, but employment of as many people as possible was.

4.12. Beneficiation of performance

The beneficiaries constitute one of the biggest challenges of the Corporations in that:

- They generally have a culture of entitlement. The Corporation's resources are, in their opinion, State resources that do not have to be collected in an aggressive way. This partially explains the debt book problem. The Corporation records indicate that there was a committee set up in 2001 to address the debt collection problem. This was based on a response that political upheavals in the 1980s have led to failure on the part of the clients to service their debts. The peaceful situation after the upheaval did not yield better results for the debt book.

- The majority of those who would like to access the assistance of the Corporation's programs are resident in deep rural areas where there are limited available business opportunities leading to unsustainable businesses.
- As a result, the beneficiaries become basically survivalists, whose businesses are unlikely to be sustainable. As a state institution the Corporation will always face subtle pressure to ensure demographic correctness in its lending activities. However, sometimes demographic correctness compromises the principle of project sustainability.

4.13. Government policy

One of the programs whose performance relates strongly to government policy is the industrial development program. In the pre-1994 era, when the South African Government offered incentives for industrialists to operate in economically depressed areas, the occupancy rate at Ekandustria was more than 90%. In the small industrial parks the occupancy rate also averaged around 90%. With the change in government policy in this regard, the occupancy rate at Ekandustria plummeted to 70% in the mid-1990s and to about 40% in the small industrial parks. The contractor's support program is one other example of how government policy can lead to the underperformance of a program.

CHAPTER FIVE: CONCLUSIONS AND RECOMMENDATIONS

5.1. Introduction

Whilst there is an acknowledgement that, in general, all development corporations' performance suffered severe setbacks even before 1994, what is of concern is the reality that benchmarked against other corporations with the same background and focus: the MDC/MEEC is lagging behind in performance. Given the resource base of the Province, with coal resources that produce more than 80% of the country's electricity, with water in the region at more than 20% of the country's total water resources, with more than 30% of the country's plantations and more than 20% of the country's arable land and the proximity of some of its towns to Gauteng (the industrial nerve center of South Africa and gateway to the world), the MDC/MEEC and its clients were expected to perform better.

There are mitigating factors, though, that have contributed to the under-performance of the Corporation. These factors will be discussed in this chapter will refer to political, legislative, skills level and policy related factors.

5.2. Conclusion

The homeland economies where development Corporations operated were based on false economic principles as there was no way the resource bases of those areas would be able to play a key role in a major stimulation of economic activities. Whilst there were exceptions, they were very few indeed. The MDC/MEEC did not operate in an area with such subsidized national resources.

This did not stop the then unitary government from committing funds for SMME development and development of new industrial parks to these areas. When the new provincial government was established in 1994 many civil servants moved from the self-governing territory capitals to Nelspruit. The income from these civil servants had over the years accounted for the relative success of some of the small businesses in the self-governing territories. With this new development the client base of the SMME's funded by the Corporation dwindled, so did their profit margins.

In conclusion it must be emphasized that the Corporation had some successes against many odds. Whilst they were expected to achieve success in an environment which negated the basics of the business and many other external factors contributed to defeat the objectives of their operations, they struggled successfully to keep afloat and to limit employment totals from more than 1,200 to less than 100 in recent years. Expenses on salaries were thus substantially reduced, but this did not, unfortunately lead to more effective, efficient and economical services to their existing and potential client base.

5.3. Summary

There is no doubt that the Corporation as it stands cannot measure up to the key features which constitute best practice for successful development Corporations throughout the world. In most cases, its conduct goes against best practice. The unfortunate result is that if this continues, it cannot live up to its mandate.

If the Corporation seeks to live up to its mandate, there are some key measures that should be implemented as soon as possible. These are as follows:

Development corporations are not only peculiar to South Africa. Most countries throughout the world have development finance institutions with sole mandates to propel economic participation and the consequent economic development of the target community. Some of the world's advanced economies were beneficiaries of development finance assistance and still maintain development finance institutions at national and provincial level. Germany is one outstanding case in this regard. Italy with its development finance concept called the

Mezzogiomo, whose mandate is to assist entrepreneurs in poor parts of the country, is another example. All these institutions across the world are basically responding to market failure and addressing the need to stimulate business activities and economic growth in poorer areas. The development finance institutions in South Africa have had their share of challenges and failures and successes out of which certain lessons could be learnt. Out of these lessons, the best practice for ensuring that our development finance institutions meet their stated objectives has slowly been taking shape.

5.4. Limitation of the Study

Mpumalanga Province is a rural province, and there are not so many SMMEs that are managed professionally. A lot of references that the study made was based on national legislation. This could have restricted the researcher in expressing a more accurate view in as far as the Province is concerned.

5.5. Ethical considerations

It was important to appreciate that any business operates within a certain set of values to which all employees should adhere. In turn any individual adheres to his own set of values. The researcher ensured that these principles are respected.

5.6. Recommendation

The following are the recommendations, which also constitute some of the key pillars of best practice :

Adequate initial capitalization

For the DFI's to be successful they need adequate resources to invest in both their clients and in systems which will make it possible for them to earn adequate returns and serve their clients better. The Botswana Development Corporation is a good example of how a development finance Institution should be funded in its initial years. Until 1999 the Botswana Development Corporation was funded to the tune of an amount equivalent to R320 million, with a further capitalization of R310 million in the year 2000. The Botswana Development Corporation also has specific funding mechanisms which compliment the capitalization by its shareholders, namely the issuing of redeemable non-voting preference shares.

Back home, the Industrial Development Corporation and the Land Bank provide outstanding examples of other alternatives to ensure adequate initial capitalization of development financial Institutions. They were funded and financially supported in such a way that the latter institution did not require any funding since 1959.

The MEEC never enjoyed funding close to the examples mentioned above, neither during the pre-1994 era, nor during the post -1994 era.

The above corporations operate in a market environment where some key stakeholders may be private sector organizations. They will expect an attractive balance sheet and sufficient liquidity for healthy business dealings. Initial adequate capitalization played a key role in ensuring that this happens – if extended to businesses such as development finance institutions, the chances of these becoming more self-sustainable will be appreciably enhanced.

Expertise-based Boards

Whilst there is no disrespect for factors such as gender and regional representation, successful corporations have boards that are structured to accommodate appropriate expertise in its ranks. The Board of Ithala, the Free State Development Corporation and the Botswana Development Corporation are structured in a manner which accommodate experts and stakeholders who will add value to the Corporation's mandate.

Ithala has always insured that one of its major funders, the Development Bank of Southern Africa, has a representative sitting on its Board, whilst the others will include financial and legal experts and even retired academics with a wealth of knowledge on issues of development. They would involve experts from the private sector thus reinforcing the private sector orientation of the development finance institution.

Long term institutional sustainability should not be compromised

In most cases development finance institutions are expected to be self-sustainable within a given time. For the past five years, the Botswana Development Corporation was not receiving any annual funding from Government. The same can be said of national development finance institutions such as the IDC and the Land Bank. The Land Bank received its last capitalization more than forty years ago.

One of the reasons why these institutions are self-sufficient is because they fund loans on the basis of sustainability and not sentiments. This ensures long-term sustainability. The willingness of government to allow these institutions to operate with business principles ensures long-term sustainability. With this in place assisting the poor is not executed at the expense of long-term institutional sustainability.

The capacity of the clients to run businesses requires more careful analysis

One of the reasons why clients of development corporations were unable to service their debts is due to the fact that they have had no basic training to run a business nor are they motivated to be entrepreneurs.

A majority of them would have business plans drafted by consultants. They would not be in a position to defend the details enshrined in the business plans even though these formed the basis on which they are being funded.

Successful development finance institutions consider the capacity of their clients to run businesses as an important variable in determining the sustainability of any loan request for a project.

Commitment of the client to the project

It is almost standard practice in the industry to ensure that a client to whom a loan will be granted demonstrates a reasonable degree of commitment. This is usually measured by the client's willingness to pay a deposit equivalent to a certain percentage of his or her loan. The Industrial Development Corporation whose commitment to empowering small and medium enterprises has been emphasized again and again in their press statements and annual reports, have a facility where new entrants can part with a deposit as low as 2% of the value of a project applied for. Other institutions would generally be happy with a deposit of 10% of the total loan amount.

Implementing a Mentorship Program

That the mentorship program during the first phase of the Corporation was not well designed is an issue that has already been discussed extensively in our study. The fact is that there is a major difference in terms of the loan repayment rate when there was some form of after-care service compared to where there was none. The last period when there was no Mentorship Program witnessed the worst repayment rate, which was more than 70% as compared to 45% during the first phase of the Corporation. The nature of the terrain in which the Corporation is operating, necessitates an effective mentorship program which should take into account the following factors:

- The skills level of the beneficiaries;
- The need to ensure that the compliance issues are respected;
- Respect for loan repayment conditions; and
- The reality that new entrepreneurs who partner with established business persons are not as exposed to losing their investment due to lack of knowledge of business dynamics as would otherwise be the case.

Creating an appropriate legislative framework

The current legislative framework is by and large friendly for the Corporation to conduct its work. There are sections, of this legislative framework that are neither in line with the Public Finance Management Act nor with best practice. These include i.a. severe limitations on procurement procedures. The Public Management Finance Act should be amended to create greater flexibility for the Corporations to conduct business. Also, the Public Finance Management Act must create an environment for the Corporation to continue with programs such as contractor finance development, where guarantees are an integral part of its operations.

Governance

The shareholder must ensure that strict governance principles are observed. To this end, competent boards should be appointed and should be given the latitude to run the affairs of the Corporation without the interference in the day-to-day management of the Corporation. As argued earlier on, there is evidence of political interference in the Corporations operations and decision-making during various phases of the process. This does not only de-focus the Corporation, but it renders the Corporation unable to work in terms of its own program. What will also be important for Government's comfort is the signing of a shareholder's compact between the Board and Government. A shareholder's compact will define what the government expects of the Board and vice-versa. A code of conduct for the Board may be useful to ensure that there will be speedy action taken in the case of unethical behavior.

Capacitating the Corporation

The Corporation will not be in a position to follow the route of other corporations such as Botswana Development Corporation if there is no major intervention to increase its capacity to meet its mandate.

According to the Corporation's records, in a recent quantification of the immediate needs of its industrial parks, which would include renovations and ensuring that the Corporation's factories comply with the current legislative requirements on buildings, a figure of R130 million was arrived at as appropriate for this purpose. This program has

better potential to lead towards greater sustainability of the Corporation than, for instance, the loans program. Government should be encouraged to allocate adequate regular financial resources on a phased basis for the Industrial Development Program, the loans program, mentorship and contractors' support.

Political Support

As argued earlier, development finance institutions which have been successful, have experienced massive injections of funds from the State at national level. The Industrial Development Corporation is one such example. Massive financial resources are not sufficient without a human capital base to employ the financial resources in a manner that will benefit the Corporation and its clients. The two go hand in hand. The level of culture of entitlement is such that the politicians must stand behind the Corporation to ensure that irresponsible clients "toe the line".

The political support that the Corporation needs should translate into financial commitment from Government and willingness by Government to publicly discourage loan and rental defaulters. There must be political support to provide resources to develop the human capital base of the Corporation.

Skilling Beneficiaries

As indicated earlier, on average, the average educational qualification for the Corporation's client's base was grade eleven. There is no way in which the Corporation can create a new class of entrepreneur with this kind of client base. A program needs to be put in place to address this issue. In the year 2000, the government started a program involving a two week period of training to entrepreneurs. This was basically generic business training and, on its own, cannot be adequate. A program which appreciates the required skills levels of the beneficiaries and promotes technical training in financial management with specific focus on those sectors whose activities have a bearing on the Province's comparative advantage, should be established.

Ensuring that the clients are committed to the project applied for

The Corporation's clients must demonstrate a level of commitment to the business they are receiving funding for. The mentality that the Corporation's funds are in any case "tax payer" money which does not have to be paid back can be eliminated when clients know they must carry the risks associated with the projects for which they are being assisted. During the research, in profiles of the businesses funded by the Corporation, instances were discovered where some clients did not even bother continuing with the businesses after receipt of funding.

The client should amongst others, commit a certain amount of their own financial resources to the project. In situations where clients do not have sufficient financial resources to commit, their capacity as clients to run a business must be ascertained and the mentorship program should evaluate their willingness to commit their time and effort for the projects.

In conclusion it must be emphasized that the fact that Corporations have in general failed to meet their mandates does not mean there is no need for them. In fact the inability of the private sector to meet the interest of new entrepreneurs is on its own a strong reason why wholly owned or partially owned state institutions should be available to address this challenge. Like many other Corporations, the institution under investigation has not lived up to the shareholder nor the client's expectations. Not only is there a need for it to exist, but it has a potential to become one of the best development finance institutions in the world.

The Province in which it is situated provides a perfect setting for testing the impact of a development finance institution in empowering entrepreneurs. The non-homeland part of the Province has high quality infrastructure and other resources, which have formed a strong base for industries such as mining, tourism, energy generation and agricultural processing. These are present on a scale that make a significant impact on the gross domestic product of the country. For the facilitation and generation of more economic activities in the Province, there is a need for previously disadvantaged people to be mentored into doing business in this Province.

A well structured, sufficiently resourced and focused development finance institution would be well placed to facilitate this. The Mpumalanga Development Corporation has a very important role to play in the economic development of the province. To be in a position to fulfill this role, the Corporation must avoid the mistakes of the past and embrace best practise in executing its mandate.

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CHAPTER ONE : BACKGROUND

Introduction

Mpumalanga Economic Development Corporation (MEEC) was established to focus on the development and financial support of SMME in Mpumalanga. It has been a trend throughout the world to establish development institutions to take care of the development needs of a nation. Even some of the world's most industrialized countries still have development institutions which facilitate the entry and sustenance of new entrepreneurs and ensure that a country or a region's comparative advantage is exploited for further development.

Small Medium and Micro Enterprises (SMMEs) on the other hand play a vital role in economic development by enabling people to meet their basic needs for survival. (Department of Trade and Industry, 2002: 33). Moreover it has been proven in many parts of the world that the SMME sector stimulates economic growth, redistributes wealth and creates jobs. Whether this scenario can play itself in the lives of the young people will still need to be established.

According to the report by National Manpower Commission (Development Southern Africa, 1982: 223), a small business firm can be regarded as an independent economic unit. Its aim is to account profitability for the capital and risk attached thereto. The firm manifests distinctive characteristics such as independent ownership, independent management, a simple organisational structure and a relatively small influence on the market; and whose owners can be identified with the entrepreneurs, the part suppliers of capital, the management of the business, the decision-makers and those you share in the profits.

1.2. Problem Statement

Small and medium enterprises face many constraints, such as lack of credit, which hinder them from reaching their job-creating potential. Banks have reservations towards small

enterprise, especially regarding start-up projects. They often require collateral that is beyond the means of potential borrowers and are unwilling to bear the costs of examination of numerous small loans applications.

The SMME sector is growing and constitutes the largest group of vulnerable entrepreneurs in the labour market. The study will explore the problems faced by the sector with regards to the credit/loan facilities. Banking facilities for people lacking access to them and wanting to be self-employed should be investigated more closely in South Africa, to give access to credit to the poor and simultaneously make productive use of loans.

The rise of development finance institutions is not a development that is only peculiar to South Africa. It is a trend that has assumed global proportions, the prominence of which can be attributed to the impact of the Bretton Woods Conference on the reconstruction of post World War II Europe. Since then various development finance institutions have been established, both in highly industrialized countries and in the developing world. Whilst they all have a common objective of economic development, their ways of operation constitute a response to their particular economic and social environments. Their approach to facilitating development therefore differs (Porter: 1992: 63)

1.3. Motivation

The SMME sector is important in the South Africa market. It is constituted by previously disadvantaged individuals (PDI), which by definition require some financial assistance.

The restructuring of financial assistance to the informal sector is however essential for improving the income earning of people involved in the sector (Wilkins, 1998). The main bulk of the informal sector lies in consumer services, but the current emphasis on the manufacturing SMMEs does not address the most vulnerable groups, which are found in services, these SMME development programmes are aimed at economic growth and not at addressing poverty.

This study will explore the problems faced by the sector with regards to the credit/loan facilities. The study will argue that for a corporation to be successful there is a need to observe best practice in the industry and for the following measures to be in place:

- A mentorship program for the loan finance clients with the purpose of ensuring that the clients receive both monitoring and training on the fundamentals of running a business.
- Creation of a legislative framework, which allows a corporation to have the flexibility to do business beyond that of the red tape of a government department.
- Ensuring that there is sufficient political support, which should translate into appropriate budgetary allocations and communicating to clients the need to service their debts with the corporation.
- Ensuring that the corporation respects best practice in terms of government measures.
- Creating opportunities for the beneficiaries to be capacitated even before the mentoring process commences.

Whilst the general context will be on development corporations in South Africa, the focus of this study will be on the Mpumalanga Economic Empowerment Corporation (MEEC).

The area which will be investigated will be financial and non-financial support for small and medium enterprises and the various programs which were put in place to support SMME's. The programs will include the following: industrial development, contractors' support, development finance and non-financial support.

Due to the lack of records from one of the MEEC's predecessors, namely the Mpumalanga Development Corporation, Kangwane Economic Development Corporation (KEDC), the pre-1994 analysis of the Corporation will be based on the performance of its other predecessor, the KwaNdebele National Development Corporation (KNDC).

1.4. Aims of the Study

The study starts from the premise that development corporations in South Africa have not lived up to their mandates. Neither the main shareholder (state or provinces) nor the target groups (client base) has derived any satisfaction from the operations of the development corporations. This study will therefore focus on the following areas:

- Investigate the performance of development corporations in South Africa, with particular reference to the Mpumalanga Economic Empowerment Corporation (MEEC);
- Isolate the factors which have contributed to unsatisfactory performance or under-performance of the Corporation;
- Identify best practice for the management of development corporations;
- Recommend an appropriate framework to ensure that development corporations meet their mandates; and
- Develop a practical guide for the management of development corporations.

1.5. Objectives

The area, which will be investigated, will be financial and non-financial support for small and medium enterprises and the various programs, which were put in place to support SMME's. These programs will include the following:

Industrial and Commercial Development

The main objective of the industrial development programmes is to contribute to job creation and eradication of poverty by encouraging the development of local industry. Providing world-class commercial and industrial premises to investors and emerging entrepreneurs. The industrial development program was aimed at the creation of industrial parks in targeted areas. The following were features of this program:

- Encouragement of product manufacturing;
- Ensuring that the industries are labour intensive;
- Attracting foreign and local industrialists to KwaNdebele; and
- Importing foreign technology into South Africa.

Financial services

The provision of financial services has always been one of the key objectives of development corporations. To this end the development corporations had set itself an objective of mobilizing financial resources from the private sector and formation of a financial company with a bank to satisfy short- term financing needs of clients.

Infrastructure Development

In this regard the Corporation has the following objectives:

- Establishment of an electricity utility; and
- Plan schemes to ensure the availability of water.

Training

This is aimed at developing a new class of black entrepreneurs, focusing on the following:

- Initiating a Technical Training Center;
- Formation of a small business advisory service; and
- On the job training related to development projects

1.6. Research questions

Questions that will be addressed include the following:

- i) What financial products and services are offered by MEEC?
- ii) What are the literacy levels of the MEEC clients?
- iii) Does the Corporation render an effective induction program for its clients?
- iv) What is the impact of an after-care program (or its absence)?
- v) What are the perceptions of MEEC clients towards the Corporation? What are the reasons for non-performance of these clients? To what extent in MEEC contributing to the development of SMMEs?

1.7. Significance of the study

It is very important that all players in the economy have a good understanding of the dynamics of the small business sector if they are to make a meaningful intervention in helping and assisting SMMEs. Also government has prioritised the youth in ensuring that they enter into the mainstream of the economy.

However the challenges facing them are enormous. This study will therefore attempt to deal with both issues of the SMME sector and the youth development. It will also serve as a valuable resource for policy makers, academics and business people.

1.8. Definition of selected concepts

Bad debt percentage: The percentage of money due to be paid by debtors to the MEEC (debtors are clients who owes the MEEC money for services rendered or loans advanced), which could / cannot be collected compared to total debts outstanding. Such monies are regarded as not-recoverable and are to be written off (Smith, 1999).

Bridging finance: Business loans for a relative short period (3 to 6 months), during which period a business experiences a cash flow situation of more outflow than inflow of funds. Mostly experienced in the contracting industry, and referring specifically to the period leading up to the receipt of the first progress payment.

Bretton Woods Institutions: DFI's that were established for the purpose of, amongst others, the reconstruction of post-World War 2 Europe, e.g. the World Bank (WB) and the International Monetary Fund (IMF).

Business Finance: Loan funding granted to a business to purchase assets, stock, or defray operating expenses

Commercial Development: Various forms of financial and non-financial support to emerging /SMME businesses and disadvantaged communities aimed at establishing commercial facilities (e.g. shopping centers and other trade facilities) and commercial opportunities (e.g. access to contracts and markets).

Contractor Support: Assistance to civil and building contractors in the form of loans, guarantees and advice with the aim of providing such businesses with access to contacts, finance, and skills to increase their competitiveness and stimulate their growth.

Cost-to-income ratio: The ratio between operating cost (e.g. cost of salaries and other administrative expenses) and operating income (e.g. income derived from the rental of facilities and interest on loans). If the ratio is more than 1, it costs the institution more than one rand in terms of salaries and other administrative expenses to generate one rand in income.

Cost-to-investment ratio: The ratio between operating cost (e.g. cost of salaries and other administrative expenses) and the value of MEEC's investment (including investment in buildings at historic cost, and loans disbursed).

Cost-to-portfolio ratio: The ratio between operating costs (e.g. cost of salaries and other administrative expenses) and the value of MEEC's respective programs (e.g. industrial property portfolio value, or business finance loan book value).

Development Corporation: DFI's instituted by an Act of the National of provincial parliament, with a specific focus in respect of the economic sector (e.g. agriculture / small business) and / or geographic area (e.g. National or a particular province).

Development Finance: Various forms of financial assistance (including equity-, loan- and bridging finance) provided to emerging / SMME businesses at subsidised terms and conditions (e.g. lower security and own contribution requirements than demanded by commercial finance institutions).

Development Finance Institutions (DFI's): Institutions providing any combination of development finance and non-financial support to emerging / SMME businesses for the

reason of overcoming the market inadequacies such emerging businesses are subjected to (e.g. access to finance, -markets, -advice and consulting services, and business facilities). Market failures are mostly the result of past policies of the previous regime (e.g. it was not possible for PDI's to own land and thereby accumulate securities to offer financiers in order to access finance). Because of the concessionary terms and conditions at which such services are provided, DFI's are normally government / donor supported and controlled.

Equity Finance: Loan finance granted to purchase shares in a business.

Equity Investment : Taking up of a shareholding in a business by injecting money / assets or other means of production into a business

Gearing: The ratio between: borrowed funds (e.g. monies borrowed from banks); and own capital (e.g. monies received from shareholders and through profits). A high gearing ratio is not always bad, provided the Company generates a net profit that is higher than the interest payments on such borrowed funds.

Industrial Development: Assistance to manufacturing businesses in the form of loans, equity, advice, training and factory building rentals with the aim of providing such businesses with access to finance, manufacturing facilities, information and skills to increase their competitiveness.

Interest cover: The extent to which a company is able to pay interest on loans, from the profit generated through using (e.g. on-lending to small businesses and / or rental of buildings) such borrowed monies.

Non – financial support : Various forms of assistance at subsidised terms to emerging / SMME businesses that are not in the form of rands / cents, including training, business advice, mentoring, business information and consulting.

Nominal terms : The actual rand / cent value of an investment in the year which the investment is made

Performance guarantee: Guarantee issued on behalf of a business, guaranteeing that performance will be according to time and quality specifications. Should performance not comply with the contract specifications, the authority who awarded the contract can call up the guarantee (draw payments from the guarantor) to make good any losses incurred as a result of non-performance by the contractor. A guarantee issued by a financier (e.g. Standard Bank) is normally backed by an investment / deposit equal or higher than the guarantee amount. If the guarantee is called up due to non-performance, the depositing / investor institution stands to lose part or the entire amount deposited.

Real terms: The value of an investment if the escalation effect of inflation is discounted to a base year of, e.g. 1984. If the inflation-effect is eliminated, R 1-00 today has the same purchasing power than approximately 15 cents in the year 1984.(MEEC, 2001)

ROI: The return on investment is the ratio of profit generated by an investment (e.g. a machine) after costs (e.g. costs associated with operating and maintaining the machine) has been deducted.

Summary

The role of Development Finance agencies is central to the development of small enterprises more especially in a development state. The legislative environment through which they operate should ensure that they assist in the provision of development finance, more pertinently where the commercial banks may not take risks. The next chapter seeks to establish the trends and patterns of the Development in Southern Africa.

CHAPTER TWO: DEVELOPMENT FINANCE IN SOUTH AFRICA

2.1. Introduction

This chapter is premised on the fact that the objectives of provincial development corporations cannot be divorced from international trends in the industry. Indeed, the whole concept of development corporations bears close resemblance to regional development institutions in many parts of Europe and North America. Institutions such as Business Link in England and the German Development Bank in Germany are typical

examples: If these institutions were not a cardinal variable in economic development, they would not be such a common feature around the globe.

In defining the role of these institutions, Borkey (1959: P 3) argues that they are *“intended not only to provide capital for the private industrial sector, but also to mobilize savings, enterprise and skills for productive investment, and also to mobilize savings, enterprise and skills for productive investment in that sector, largely a post World War II creation”*. Borkey’s definition of the role of development corporations is important in that it represents a view on development finance institutions less than 15 years after the formation of the Bretton Woods institutions and before the world’s development finance institutions started playing a major role in the reconstruction of developing economies.

There is no doubt that homeland development corporations and, indeed, the establishment of the Development Bank of Southern Africa (DBSA) were influenced by a post World War II philosophy, which assumed that the Marshall Plan would also be applicable to the developing world.

The chapter will address the following: Current thinking on development finance institutions, the stated objectives of the MEEC, its predecessors and successor, the operational objectives of the MDC, its predecessors and its successor and will present a framework for the evaluation of the institution’s performance.

2.2. Development finance institutions

One of the key debates after the 1994 democratic election was the nature of institutions that were supposed to be put in place to support the development and thriving of small and medium enterprises. Prior to the 1994 elections, the African National Congress (which party was destined to win the elections) developed a document called the Reconstruction and Development Program (RDP), which was meant to provide a framework for post-1994 development in South Africa. However, the RDP document was silent on the role of development corporations. Whether this implied a lack of recognition of the role of these institutions or a determination on the part of the government in waiting to phase out the institutions, is a key question.

Whilst the first two years after the advent of a new government was characterized by a debate on whether development corporations should continue to exist, this debate soon developed to focus on how they should be structured, as opposed whether there was any justification for their existence at all.

The following constituted development corporations and their area of focus before 1994:

Table 1: Development Corporations (Pre-1994)

Institution	Area where they operated	Areas of focus
Ciskei Agricultural Bank	Ciskei	Financial support for farmers
Ulimo-Corporation	Ciskei	Non-financial support for farmers
Transkei Development Corporation	Transkei	Industrial development, -renting and maintenance of properties, SMME financing, farmer and availing other non-financial support services
Transkei Agricultural Development Corporation	Transkei	Financial support for farmers
Kwazulu Finance and Development Corporation	KwaZulu Natal	Industrial development, renting and maintenance of properties, SMME financing farmers and other non-financial support services
Transkei Bank	Transkei	Rural banking, SMME development
Bophuthatswana National Development Corporation	Bophutatswana	Industrial development, renting and maintenance of properties, SMME financing, farmer and other non-financial support services
Kwandebele National Corporation	KwaNdebele	Industrial development, renting and maintenance of properties, SMME financing, farmer and availing other non-financial support services
Agricor	Bophuthatswana	Financing and non-financial support for farmers
Kangwane Economic Development Corporation	Kangwane	Property development, -renting and maintenance, financing and non-financial support for SMME's
Agriwane	Kangwane	Financing and non-financial support for farmers
Gazankulu Development Corporation	Gazankulu	Industrial development, renting and maintenance of properties, SMME financing, farmer and other non-financial support services
Lebowa Development	Lebowa	Industrial development, renting and

Institution	Area where they operated	Areas of focus
Corporation		maintenance of properties, SMME financing, farmer and other non-financial support services
Lebowa Agricultural Development Corporation	Lebowa	Financial and non-financial support for farmers
Venda National Development Corporation	Venda	Industrial development, renting and maintenance of properties, SMME financing, farmer and other non-financial support services
Qwaqwa National Development Corporation	Qwaqwa	Industrial development, renting and maintenance of properties, SMME financing, farmer and other non-financial support services

What should be observed is that all the development corporations of the homeland era have since been replaced by provincial-based development finance institutions. They have all undergone a restructuring or re-engineering process, and are characterized by the following features:

Downsizing: Before 1994 the average development corporation used to employ about one thousand two hundred (1,200) people. To date the staff complement of development corporations is about eighty-six (86). This represents nearly a 93% decrease in staff members since the 1994 democratic transition.

Geographical areas of operation: The development corporations which were ethnically based have since come to operate within the confines of provincial borders.

The client base: The client base of development corporations has since changed to include business persons residing or working outside the borders of the former homelands. This had major implications for financial resources.

Profile of management: The profile of the management of development corporations has changed considerably. One illustration is that in 1994 all development corporations had white CEO's at the helm of their management structures. The situation has changed considerably. All development corporations throughout the

country, by 2000, are being led by black CEO's. The management structures have also changed considerably in favour of black managers. In 1994, for example, 95% of the members of the MDC were white males. In 2003 90% of the managers of the MEEC were black executives, with 25% of the total management structure constituted by women.(Mpumalanga Economic Empowerment Corporation,2001:4)

The spread of development corporations: They all exist in those provinces which had homelands or self-governing territories within their former borders. The Gauteng Province, the Northern Cape and the Western Cape do not have development corporations. Whilst some of these provinces may have development institutions, these institutions do not resemble the profile of the development corporations in the other provinces. The latter were characterized by the presence of homelands or self-governing territories. For example, the Gauteng Province has a development institution called Gauteng Economic Development Agency (GEDA), which encourages investment.

The following constitute the new development corporations since 1994, which focus on SMME financial and non-financial support:

Table 2: Development Corporations (Post –1994)

Corporation	Province	Focus
Limpopo Development Corporation (Limdev)	Limpopo	Property Management, SMME finances and running projects on behalf of Government
North West Development Corporation (NWDC)	North West	Property Management, SMME finances and running projects on behalf of Government
Mpumalanga Economic Empowerment Corporation (MEEC)	Mpumalanga	Property Management, SMME finances and running projects on behalf of Government
Eastern Cape Development Corporation (ECDC)	Eastern Cape	Property Management, SMME finances and running projects on behalf of Government
Ithala Development and Finance Corporation Ltd	Kwazulu-Natal	Rural Banking, Housing development, Property Management, SMME finances and running projects on behalf of Government
Freestate	Freestate	Property Management, SMME finances and

Corporation	Province	Focus
Development Corporation (FDC)		running projects on behalf of Government

Although development finance institutions all have certain similarities in their goals, one of which is to propel economic growth in their targeted area of operation, they will always have different ways of conducting their business and different sectoral emphases. This will be influenced by the environment in which these organizations operate, in particular the comparative advantage of the area and the general socio-political culture in the area of operation. There are general trends, though, in the industry. These trends constitute a framework for current thinking in the industry.

This framework is informed by, among others, the following factors:

- The need to increase the level of accountability on the part of executives of the institutions;
- The need to avoid political interference;
- The need to develop the beneficiaries; and programmes
- The need to ensure that programmes to be funded give rise to a long-term economic impact.

The following factors characterize current thinking on the management control and operations of development finance institutions:

One of the challenges development finance institutions have faced in the developing world in particular, is the inability to be self-sustainable. They have either continuously depended on donor funding or on Government statutory allocations. In emphasizing this challenge, Thomas (1992: 8) asserts:

“All over the world, parastatals in pursuit of development promotion, be it a sector, an industry, a number of programs or broad based bodies, have been discredited because of their inherent tendency towards loss-making, often in astronomic magnitudes”.

In arguing for performance and sustainability for one of the world’s best known development agencies, the Bangladesh Rural Advancement Committee (RCP), Khalily and Khandker (1996: XV) argue:

“Although the loan recovery rate has been consistently around 90%, the transaction costs of delivering social and human development inputs are quite high. Nevertheless, the BRAC strategy of providing self-sustaining bank services for the poor is built on its program design, as evident in the creation of the RCP. The RCP branches are financially viable.”

The sustainability of the institutions and indeed these programs funded by the institutions, have assumed a significant focus in current thinking on the management of development finance institutions.

Development finance institutions are not unaffected by developments throughout the world on good governance, nor by the need to ensure adequate accountability in their own geographic areas of operation. The collapse of Enron in the United States has unleashed a debate on stricter measures for good governance that no institution can ignore.

German institutions notably the German Development Bank, in reacting to the culture that led to the World Wars, have been characterized by strictness on accountability to an extent that some development institutions have two chief executive officers who run the organization jointly.

In South Africa, the Public Finance Management Act (Act 1 of 1999) provides a framework for greater accountability on the part of development finance institutions in the country.

Development finance institutions are moving away from accessing their financial requirements from one source only, be it donors or Government. The trend is to access funds from other sources as well, including the private sector. In South Africa, development corporations have been largely funded by Government or by government designated financial institutions. The need to access funds from sources other than Government has major implications for the strategic positioning of these institutions.

Whilst development finance Institutions are a product of both state and market failure, there is a growing thinking to call upon these institutions to recognize the role of the

markets in their operations. Regional bodies such as the European Union have in recent times subtly demonstrated their resolve to get regional agencies to observe the flow of markets. *“In the common market of Europe, a further dimension of control enters the regional development sphere through the role played by the Brussels Commission in the monitoring and shaping of market orientated regional development agencies. All over the European Union the Commission will increasingly question interventionist policies at national or regional level of member countries, stressing the need for an evolution to more competitive, non-interventionist development patterns”* Thomas (1992:10)

Commercial banks are willing to co-operate with development finance institutions on condition that the markets are respected.

2.3. The need for Development Corporations

It has been a trend throughout the world to establish development institutions to take care of the development needs of a nation (see objectives on page 13 and 14). Even some of the world's most industrialized countries still have development institutions which facilitate the entry and sustenance of new entrepreneurs and ensure that a country or a region's comparative advantage is exploited for further development.

The existence of the German Development Bank in Germany and the Mezzogiorno in Italy are indications of the need for government intervention to facilitate development. Eastern Europe has a number of development finance institutions that were aimed at addressing the development of entrepreneurs to enable them to participate in the economies of those countries after the cold war. The developing world in general has many institutions that are meant to support entrepreneurs.

The Mezzogiomo in Italy is a development institution which was tasked with the responsibility of stimulating economic activities in the south of Italy, which is compared to the northern part of the country, a relatively depressed area economically. The fact that this institution is focused on a particular population living in an economically depressed geographical area is lesson enough for South Africa.

In general the following constitute the reasons why there is a need for development finance institutions:

Market failure

There is no doubt that market forces, on their own, can be a source of economic development. The fact though is that market forces do not always take into account the long-term developmental needs of a nation. In the financing sector commercial banks are an outstanding example of how the private sector will not accept short-term losses in the interest of long-term sustainability. Those that do not have assets for financial guarantees usually cannot access bank finance, regardless of their potential to be good entrepreneurs.

State failure

The state on its own has a poor record of propelling economic growth and the establishment and sustenance of entrepreneurs. These defects all contribute to the need for an environment for growth and the establishment of entrepreneurs. Development finance institutions should borrow the best from the market and the state.

Need to develop entrepreneurs

Porter (1990:125) identifies entrepreneurship as a key condition to enhance national competitive advantage. Van Aardt et al (1999:5) take this further by arguing that entrepreneurship holds the promise of growth, expansion, and long-term financial gain. They further assert that a small business aimed only at the survival of its owner is not an entrepreneurial venture.

With an economy like ours, which in growth terms is not performing satisfactory, there is a need for the development of entrepreneurs. Development corporations can offer a useful tool in this regard.

Need to sustain the development of entrepreneurs

Whilst conventional finance institutions will assist new entrepreneurs only if they come forward and the bank can delink their relationship at the end of the project, development finance institutions have the latitude and flexibility to approach entrepreneurship as a

program. They can therefore make major investments in developing entrepreneurship in communities even if the results are long-term.

In terms of Bantu Development Act, no 86 of 1965, the objects of a development corporation *“shall be to plan and to promote in all spheres the economic development of Bantu homeland in respect of which it has been established and the general welfare and advancement of such Bantu homelands and its population”*. The beneficiaries of the activities of the development corporations were targeted tribes. This only changed after 1994 with the advent of a new dispensation. The stated objective has, until the second half of the 1990's, been too broad. Except for the former Bophutatswana and Lebowa, the stated objectives normally covered areas which included industrial development, training, agricultural development, commercial development and entrepreneurial development. The stated objectives were generally too mechanistic. While they are quite clear on how the target groups should be assisted, there is no reference to the appreciation of local knowledge or inputs.

Interesting enough in its first strategic document of June 1984, the Kwandebele National Development Corporation recognizes, inter alia, the following as its weak points: limited knowledge of the environment and publics, limited knowledge of socio-cultural traditions, limited knowledge of politics. The document goes on to appreciate that the new corporation had a poor image due to the fact its predecessor is known to have been prescriptive in its assistance to people.

In general the stated objectives of development corporations as reflected in their founding acts, were identical throughout the country. This explains their origins, i.e. the policy of separate development.

As indicated earlier the stated objectives of development corporations are generally similar. One striking feature of the Mpumalanga Economic Empowerment Corporation is the similarity of its stated objectives to that of both its predecessors (the Kangwane Economic Development Corporation and the Kwandebele Development Corporation) and its successor, the Mpumalanga Economic Development Corporation. (Strategic Planning in Mpumalanga, 1996:9)

Until very recently, the Mpumalanga Economic Development Corporation's stated aims covered areas which ranged from industrial development to training of entrepreneurs. The following constitutes a summarized version of the stated objectives of the Corporation as reflects in The Mpumalanga Economic Empowerment Corporation Act, Act No. 5 of 1999, of the Mpumalanga Provincial Government:

Promotion, planning, establishment, financing, co-ordination, and acquiring business ventures. To engage in projects of whatever nature as long as they would assist in the development of the Province. To extend loan finance to emerging entrepreneurs. To extend guarantee facilities to entrepreneurs who had won tenders from Government or other public sector institutions. To engage in training activities of its officials and clients; and to take up shares in public or private companies.

Whilst the stated objectives of the Corporations were enshrined in the relevant acts of parliament, the operational objectives of the institutions can be found in their business plans.

The business plans of the Kwandebele National Development Corporation in its early years provide an indication of the operational objectives of the Corporation. The challenge, though, is that whilst they are fairly clear on what the objectives are, they are unable to quantify the operational objectives of that Corporation. Recent business plans (from 1998 - 2003) have demonstrated a shift from merely stating the operational objectives, to making serious efforts to quantify these objectives.

The first strategic plan of Kwandebele National Development Corporation of June 1984 provides the key operational objectives of the Corporation. To a very great extent the operational objectives of the Corporation in successive years and under different phases of legislation were influenced by these initial objectives.

It must be emphasized, though, that there is no evidence of a culture of quantification of operational objectives in the business plans of the Corporation before the 1990's. Some quantification of the strategic objectives would have provided guidelines on the turnover the Corporation sought to achieve. There is, furthermore, no evidence of the desired rates of return of projects that were supposed to be established.

For the purposes of this study, the operational objectives were divided into six areas:

- Industrial development
- Commercial development
- Financing and on-lending activities
- Non-financial support of small business
- Publicity and promotional activities
- Infrastructure development

The industrial development program was aimed at the creation of industrial parks in targeted areas. The following were features of this program:

- Encouragement of product manufacturing;
- Ensuring that the industries are labour intensive;
- Attracting foreign and local industrialists to KwaNdebele; and
- Importing foreign technology into South Africa.

Among the steps that were going to be taken in pursuit of these objectives were the following:

- Complete construction of nine factory buildings and to find tenants;
- Complete four industrial plants;
- Complete Ekandustria infrastructure;
- Resolve problems at the existing bakery; and
- Commercial development.

These referred to the establishment of commercial centers to co-ordinate the informal sector, the establishment of marketing channels for dispersed individuals to access markets and sorghum beer distribution. Shopping center establishment was the key objective. In this regard the completion of shopping centers at Tweefontein and Nkangala were prioritized.

The provision of financial services has always been one of the key objectives of development corporations. To this end the development corporations had set itself an

objective of mobilizing financial resources from the private sector and formation of a financial company with a bank to satisfy short- term financing needs of clients.

In this regard the Corporation had the following objectives:

- Establishment of an electricity utility; and
- Plan schemes to ensure the availability of water.

This was aimed at developing a new class of black entrepreneurs. To this end the following were the main areas of focus:

- Initiate a Technical Training Center;
- Formation of a small business advisory service; and
- On the job training related to development projects

2.4. Development Corporations in SA

The two most prominent finance institutions established in South Africa already decades ago are the Land and Agricultural Bank of South Africa and the Industrial Development Corporation in 1922 and 1940 respectively. The former was meant to support agricultural development and the latter industrial development in South Africa. Both played prominent roles in the development of agricultural co-operatives and capital-intensive projects such as SASOL.

The advent of apartheid's policies since the late 1940s implied crafting policies to sustain the separate development of various ethnic groups. For this reason, exactly eleven years after the victory of the National Party, the 1959 Bantu Investment Act was passed which resulted in the establishment of the Bantu Investment Corporation in 1965. This was followed by the establishment of various development corporations throughout South Africa.

The first development corporation to be established in the homelands was the Transkei Development Corporation, established in 1964. Soon after this, the 1965 Bantu Development Corporation Act was passed providing a framework for the establishment of ethnic-based development corporations. By 1984, every black ethnic group in South

Africa which had its own homeland or self-governing territory, had a development corporation.

One of the areas of difference between development corporations in South Africa and the rest of the world is the fact that these corporations were supposed to be instruments to perpetuate the policy of separate development. In observing this peculiarity Thomas (1992:4) asserts:

“Unfortunately, the early history of these development corporations was already contaminated by prevalence, if not total dominance, of the apartheid principle of fundamental criteria for virtually all aspects of their operation. It determined the geographical boundary of their operation - a homeland, a prospective homeland territory or a (black / colored / indian) group area, the defined circle of ultimate beneficiaries (even though the bulk of the more immediate benefits in many cases reached white operations), the control structure, the scope of activities allowed, and many more aspects.”

2.5. Objectives of the MEEC

The area, which will be investigated, will be financial and non-financial support for small and medium enterprises and the various programs, which were put in place to support SMME's. These programs will include the following:

Industrial and Commercial Development

The main objective of MEEC is to contribute to job creation and eradication of poverty by encouraging the development of local industry. Providing world-class commercial and industrial premises to investors and emerging entrepreneurs. The industrial development program was aimed at the creation of industrial parks in targeted areas. The following were features of this program:

- Encouragement of product manufacturing;
- Ensuring that the industries are labour intensive;
- Attracting foreign and local industrialists to KwaNdebele; and
- Importing foreign technology into South Africa.

Financial services

The provision of financial services has always been one of the key objectives of development corporations. To this end the development corporations had set itself an objective of mobilizing financial resources from the private sector and formation of a financial company with a bank to satisfy short- term financing needs of clients.

Infrastructure Development

In this regard the Corporation has the following objectives:

- Establishment of an electricity utility; and
- Plan schemes to ensure the availability of water.

2.6. Evaluation of Performance

The performance of the Corporation will be evaluated against its stated objectives. As indicated earlier, the stated objectives were fairly wide, ranging from infrastructure development to financial and non-financial support to small, micro and medium-sized enterprises. The performance tool employed, though, took into account a number of features characterizing the environment in which the development corporation has always operated. They are as follows:

- Development corporations are Government tools to address market imperfections in the developmental and financial sphere;
- Over the years these institutions have accumulated a vast number of clients who have experiences to share on the impact of development corporations;
- Empowerment of SMME's and infrastructure development requires immense skilling and reskilling programs of the human capital of the agency itself; and of the beneficiaries.
- For institutions of this nature to be efficient in respect of their mandate, there is a need for appropriate systems.

The Corporation, as indicated earlier, can be located within the broader family of financial institutions. The temptation of employing a traditional financial model to assess its performance is very appealing indeed. Financial reports would be one practical example of following this route.(Development Strategy, 1996:5)

This study has gone beyond the pitfalls of using financial reports as the main yardstick to measure the performance of the organisation.

The disadvantages of using traditional accounting models to evaluate a company's performance lead to the following:

It focuses more on tangible assets as opposed to appreciating the company's intangible and intellectual assets. The sustainability of business organizations depends on, among others, client satisfaction. Financial statements have no method of measuring this, and, in the process a key determinant of the success of a business is being left out. The traditional accounting system does not appreciate the dynamics of the market and the fact that the organisation needs to continuously adapt to new market conditions. It is more interested in measuring history as if history unfolds in a vacuum.

The organization under investigation is more than an ordinary financial institution. Its objectives went beyond conventional financial results and the shareholder's evaluation of its impact would include, among others, customer satisfaction. In evaluating the performance of the organization, factors beyond the financial performance were included. These factors included but are not limited to the following:

In this regard the investigation focused on two main areas i.e. client satisfaction and whether clients were developed in line with the mandate of the organisation.

In this regard an analysis of the human capital *vis-a-vis* the mandate will be made to determine whether the human capital base and -structure was in line with the mandate of the organisation. Systems, in particular information technology, will be evaluated against the expected output of the organisation.

The post 1994 situation resulted in the development of new trends in business and the emergence of new markets, both inside and outside the country. Any organisation responsible for entrepreneurial development has to adapt to new reality and conceptualize their activities accordingly. The efforts by the organisation to adapt will be evaluated. Also the relevance of information technology for the need to provide an efficient service will be evaluated.

In asserting the effectiveness of a Balanced Scorecard in measuring the performance of an institution, Kaplan and Norton (1996: 21) argue: *“The balanced score card retains financial measurement and business performance, but it highlights a more general and integrated set of measurements that link current customer, internal process, employee and systems performance to long term financial successes”*.

The areas of emphasis include the following:

Financial Performance

In this area, the following items will be examined: Revenue management, Cash flow management, Asset management, Capital management and Funding Management. All these factors are evaluated against the mandate of the organisation and the need for development in the targeted area.

Servicing the Customer

The following are some of the areas that are examined: Marketing Service, Accessibility Services, Effects of awareness on the Corporation’s service, and Customer satisfaction.

Human Capital and Internal Systems

The Balanced Score Card is used to examine the following: Funding criteria, Human capital base, State of information technology, Service quality.

Innovation and Learning

Most of the factors mentioned above are being evaluated with the objective of observing the overall performance of the Corporation apart from its financial results.

Summary

The Development Finance corporations are integral to the development of the local economy. Much as their character and form are shaped by the internal trends, the local conditions under which they operate cannot be overemphasized. Chapter three looks at the methodology that is used to measure the impact of the Development Corporations, with specific references to Mpumalanga Economic Empowerment Corporation.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1. Introduction

As evident in the first two chapters, the nature of the subject under investigation is such that no single research project would be sufficient. By and large, the nature and role of development corporations is under-researched in South Africa. In developing a research methodology for this study, the following assumptions were taken into account:

Evaluating Development Corporations financial performance cannot be the only factor considered in assessing its nature and role. That political variables can best be examined by in-depth interviews. The institution constituting the case study holds a wealth of documents in the form of reports and other strategic planning documents, which reflect the challenges and the direction the organizations sought to follow during its various phases. These are not accessible, and it might be possible to gain access to this information through abovementioned key informants.

Research Design

Against this background, this study employed both qualitative, and, to a limited extent, quantitative research methods to achieve its objectives. It was possible to gauge to what extent political influence, sometimes from political leadership of the day, interfered with the MEEC. This is interesting on its own, but illustrates to what extent interference with the MEEC affects performance.

The origin of development corporations was a political initiative. The Bantu Investment Corporation Act, Act No. 34 of 1959, (Republic of South Africa, 1959) which ultimately gave birth to various homeland-based sets of legislation, was a product of a particular political ideology and constituted the first indication of constant political intervention in the establishment and sustenance of development corporations.

Questionnaires, internal documents and published works would not be sufficient to explain political variables that influenced the performance of the Corporation. Against this background, there was a need to conduct in-depth interviews with political and administrative officials of the provincial government and the Corporation.

At the initial stages of this exercise a literature survey was conducted with the following main objectives:

Determination of best practice – To conceptualize the specific objectives of the case study, there was a need to establish both current thinking and best practice on development institutions. To this end literature relevant to the need was carefully perused. This covered both international and local trends.

Development corporations in our case are creations of Government and as such they are part of the bigger family of State institutions. In investigating their practices, the role of the main shareholder, in this case the State, has to be analysed. This can only be done after all the theoretical issues have been determined.

The determination of current status of development corporations: Development corporations have undergone great changes in recent times. It is important to scan available literature for more familiarity on the current status of these institutions.

3.3. Area of study

There study focused on the Nkangala District Municipality, where there are a number of entrepreneurs that have been funded by MEEC.

3.4. Population

The MEEC clients who received both the financial and the non-financial support were the population that participated during the study.

Sampling Methods

Using the list of clients for Nkangala District, a stratified random sampling was utilized during the selection process of the participants. MEEC has regional database through which the random selection was made possible. A 20% sampling fraction produced 20 clients.

Choice of instruments

Although the Corporation has information in the form of annual reports and a variety of internal correspondences and records, questionnaires were also employed to test certain variables. These variables included the following:

- The literacy levels of clients
- Whether the Corporation renders an effective induction program for its clients
- The impact of an after-care program (or its absence)
- Perception of clients towards the Corporation
- Reasons for non-performance

Data collection Methods and Procedures

Although the Corporation has information in the form of annual reports and a variety of internal correspondences and records, questionnaires were also employed to test certain variables. These variables included the following:

The interviews were very conversational in nature. Although there were basic objectives the exercise was meant to address, the individuals interviewed were given sufficient scope to analyse the performance of the Corporation, to indicate what they consider had gone wrong or right, and to advise on how the wrongs can be remedied. There were also follow-up interviews on important elements of views gathered during the interviews. After a while I gained a thorough, if somewhat personal view of the MEEC and its politics. This is reflected in this study.

Facets of the research methodology linked very well and provided a basis upon which further appropriate information on how the Corporation worked was secured. For example, due to the fact that the people interviewed were senior government officials and the Corporation's own executives, quite often they would link certain developments in the Corporation to documents they would still have a recollection of. In the end I had to peruse additional literature to be informed what these interviews meant and vice-versa.

It must be emphasized that the various tools employed in this study, i.e. analysis of appropriate literature on the subject, investigating how similar corporations are

functioning, soliciting beneficiaries opinions and experience in their relationship with the Corporation, and conversation with both administrators and political heads, provided a sound basis of information to determine what is best practice to render Development Finance Corporations effective.

Three other development finance institutions were investigated, with the purpose of establishing what lessons can be learnt for rendering development finance institutions more effective.

The following categories of development institutions were identified:

One development finance institution in South Africa, considered to be fairly successful, is Ithala in KwaZulu-Natal. One development finance institution in South Africa which has succeeded in restructuring itself and operates differently from its predecessors: The Free State Development Corporation fits this description; and

A development corporation in the South African development region, which is considered successful. The Botswana Development Corporation was chosen as an appropriate candidate.

Summary

The clients that were interviewed clearly demonstrated areas of concern with regards to the current funding model of MEEC. The role or the lack thereof, as played by Management is very crucial in the sustainability of the funded enterprises, as research has shown. The subsequent chapter address the performance issue arising from the intervention programs of the Mpumalanga Economic Empowerment.

CHAPTER FOUR: ANALYSIS OF PERFORMANCE

4.1. Introduction

The programs of the Corporation had very noble objectives, which included, inter-alia, job creation, development of new entrepreneurs, stimulating economic activities in the targeted homelands, and attracting new technology. The results of these efforts, though, were not what the champions of a development corporation would have preferred to witness. In addition analyse the reasons behind the failure of the program. In this Chapter, the various programs of the Corporation are assessed. The key objectives of the program are tested against both the efforts put in by the corporation and the results achieved. The reasons behind failure are identified. It must be emphasized that vast amounts of financial resources were set aside to facilitate, amongst others entrepreneurial development and employment creation.

To this end, the following have been analysed: The financial resources allocated and spent on the various programs. Where appropriate this will be done in nominal and in real terms. The employment impact of the various programs through the different phases of the Corporation's activities. Financial performance of individual programs: which includes assessing variables, such as the rates of return, provisions for bad debts, and other efficiency related variables. The extent to which entrepreneurs were developed. This will be going beyond merely financial support to after-care services such as mentorship and related activities.

4.2. Tribal Development Institution: Pre-2004

The analysis focuses on the three phases:

The Pre – 1994 Period: This ranges from 1984 when the Kwandebele National Development Corporation was established to 1993. However, where information for certain years' operations is unavailable, this will be indicated in the analysis.

The 1994 – 2000 Period: This will constitute the first five years of the democratic Government. Although the first five years ended in 1999, part of the 2000 financial year's budget was determined in 1999.

The 2000 – 2003 Period: The significance of this period is that this was a second term of the Provincial Government of Mpumalanga and its Cabinet had by now started settling. It has been argued earlier that the Central or Provincial governments had until 2000 not given any clear direction of its support to the Corporation, which makes this period significant.

In some cases, real (1984) value figures are reflected, based on the following STATS SA derived figures:

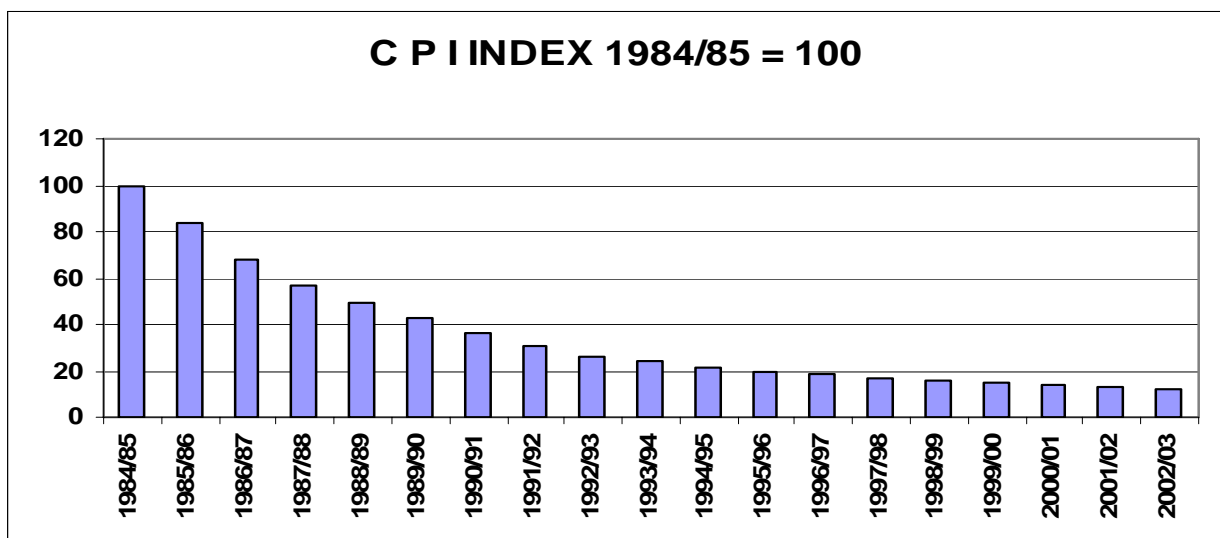


Figure 1: Consumer Price Index 1984 TO 2003

(Throughout this document, reference is made of the term “Real terms”, which refers to the above CPI index. This graph clarifies that an investment of R100 million today has the same value as approximately R15 million in 1984 .

The programs, which will be assessed for all these phases are as follows: industrial development, development finance, contractor support and non-financial support programs.

The Industrial Development Program was the most important initiative period in the conception and implementation of the industrial development strategy program. For one thing, the Development Corporations were established in that period. For another, the major programs of the Development Corporation were conceived and implemented in that period.

In assessing the performance of this portfolio at that time, the following variables were employed: the financial investment set aside for this purpose; employment impact of the program; multiplier effects of the program; and efficiency aspects of the program.

a). Total Financial Investment set aside for this Program:

About R 116 million was set aside between 1984 and 1989 to develop a number of industrial parks in both the Kwandebele and the Kangwane homelands. The real (1984) value of these amounts in 1998 would be R 48 million.

These investments were done in respect of the following area:

Development of the Ekandustria Industrial Park in Kwandebele;

Development of the Kabokweni Industrial Park in the Lowveld (in the former Kangwane self-governing territory);

Development of the Siyabuswa Industrial Park;

A string of small industrial parks on the Highveld; and

A string of small industrial parks in the Lowveld.

Investments in these programs were as follows:

Total investment in nominal value: R 191.6 million

Total investment in real (1984) value in 2003: R 23.05 million

Judging from the above efforts, there is no doubt that this program was implemented with vigor and commitment.

b) **Employment impact of the program**

During this period, the programs created a total of 5,140 employment opportunities. The bulk of employment opportunities created over the lifespan of the corporations were at Ekandustria, which had created a total of more than 7,680 job opportunities. This constituted more than 85% of the total employment opportunities created by the whole Portfolio. The small industrial parks created only 633 jobs. (Annual Reports 2003)

c) **Multiplier effects of the program:**

By creating more than 7,313 jobs, the Industrial Development Program made a significant impact on the livelihoods of the targeted communities. In fact, other than in government, there is no evidence of employment opportunities created on such a scale elsewhere in KwaNdebele.

This impact translated into 32,500 indirect employment opportunities and benefited an estimated 162,500 family members. This is arrived at by employing a dependency ratio of 5:1. However it must be mentioned that whilst factors of production in the form of labour were purchased from the targeted community, other important factors of production such as machinery and related inputs were sourced from areas outside the targeted homelands. The multiplier effects were therefore felt more in areas other than the targeted ones.

d) **Efficiency aspects of the program**

In this respect, the following variables are analysed: the Return on Investment (ROI), bad debt ratios, the cost to income ratio and the cost to investment value (see definition of selected concepts).

The analysis of these variables provide a general picture of the efficiency aspects of the portfolio during this period.

The rate of return on properties stood at 8%. This is less than the average cost of capital which was at 10%. If maintenance costs are taken into account, it becomes very clear that the rate of return was very low.

Bad debts: This is based on the quality of the administration of this portfolio as expressed in terms of the percentage of bad debt provision to rental income. In terms of this formula the average annual bad debts provision of the portfolio during this phase was 10%.

Cost to income ratio: This ratio refers to the value of operating expenses incurred in an effort to generate R1.00 in operating income. The operating cost in this phase amounted to 60% of the operating income. This meant that it cost the Corporations 60 cents of operating expenses to generate R1.00 in rental income.

Cost to property value ratio: This is calculated as a percentage of the operating cost to the historic property value. In terms of this ratio operating costs was 5% of the portfolio value. Combined with the cost of capital it burdens the performance of the portfolio.

4.3. The Development Finance Program

The Development Finance Program constitutes the core of the MEEC's mandate. When the mandate of the Corporation is under scrutiny, what receives most attention is the Development Finance Program. When the Premier of the Province in the second phase of the existence of the Corporation explained the reason for his Government's desire to dismantle the MEEC, he singled out the under-performance of the loan portfolio as one of the key reasons.

In assessing the Development Finance Program over time, the following were identified as key variables: financial investment set aside for the Program; the impact of it on job creation; extent to which entrepreneurs were developed; and the financial performance of the Program.

Financial investments

Between the establishment of the KEDC / KNDC and 1994 a total of R 80.9 million was set-aside for this Program. In real (1984) terms this amounts to only R44,43 million. The illustration below provides an indication of how government provided more and more resources, year after year, since 1984.

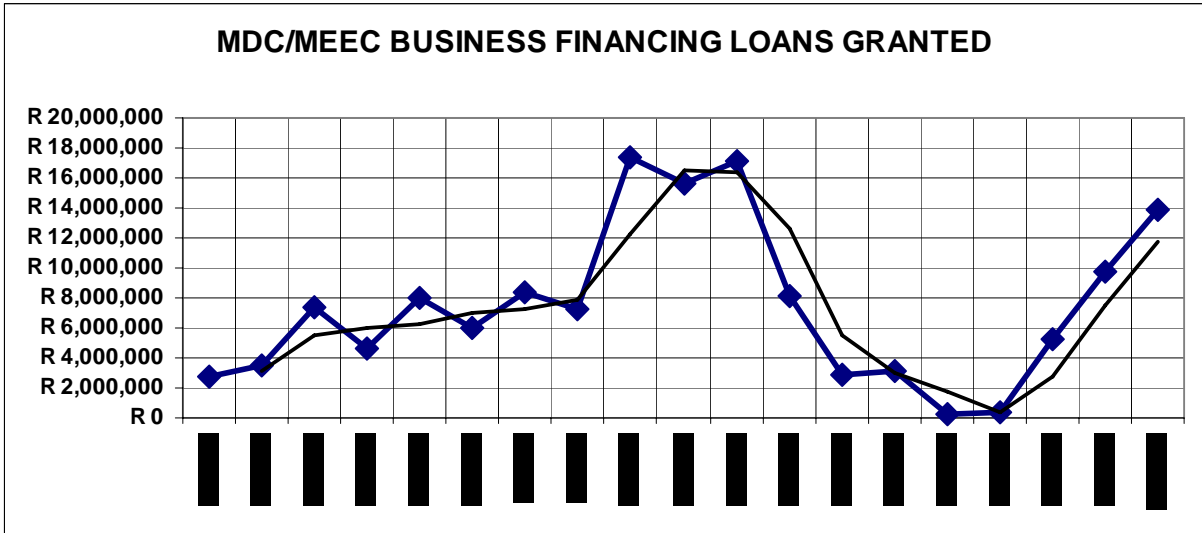


Figure 2: Financing portfolio – loans granted

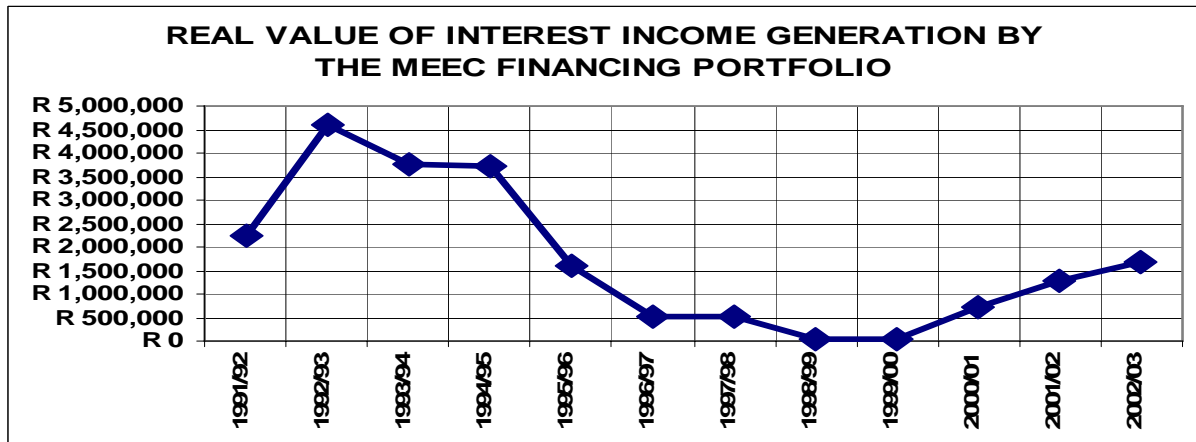


Figure 3: Financing portfolio – interest income (real value)

The above illustration indicates the extent to which the real value of interest income generated by the Corporation's financing portfolio suffered since 1994.

Although not sufficient for a new organization, this demonstrated sufficient commitment on the part of the shareholder for the program to succeed. This also overlaps with new political and macro-economic goals.

Due to the inconsistencies in reporting standards on the part of the Corporations, it was difficult to establish the correct figures on employment created by this Program in the first phase. The figures ultimately arrived at were based on an own extrapolation of the average loan financing disbursed per employment opportunity for the years for which data are available, and the actual loan finance disbursed.

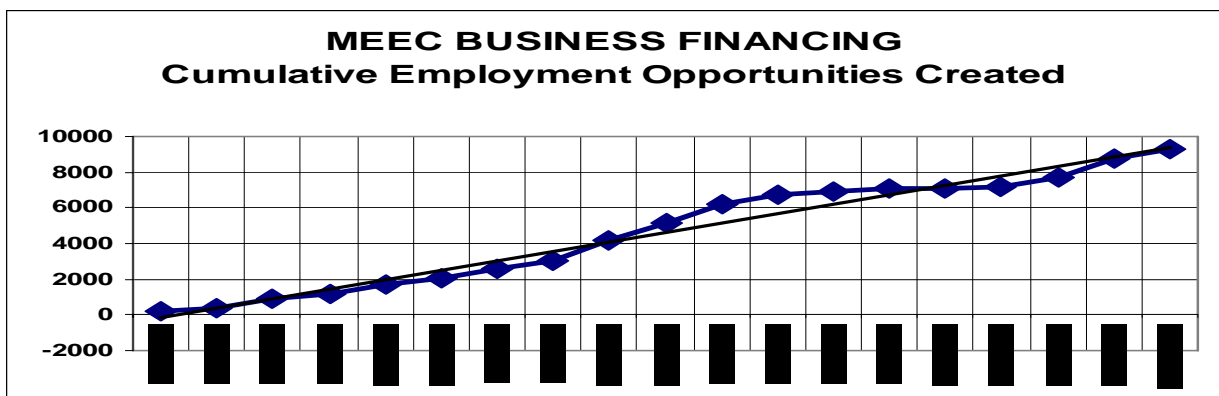


Figure 4: Financing portfolio – employment creation (cumulative)

Based on this, the average number of jobs created by this Program rose from about two hundred to four hundred each year until 1992. The years 1992 to 1994 witnessed a leap from 400 jobs to about 800 per year. The average annual number of jobs created during the period 1984 to 1994 was 514. The budget of this Program ballooned during this year. Political reasons may have played a part as this was before the first democratic elections in 1994.

There is no question that the Corporations did fund some businesses. The question though, is whether these businesses were sustainable or not. The fact is that it is rare to come across entrepreneurs who have managed to sustain their businesses after being

assisted by the MDC. Even though there was no question that the Corporations did finance clients, it was not easy to find reliable records in this regard. In terms of the 1984 – 1994 debt book of the predecessor of the MDC it can be concluded that in the first few years the loan portfolio was run on a manual basis, but during the various restructuring processes which involved relocation of files, vital information was lost or destroyed.

The following variables were employed to assess the performance of the Program: return on investment, level of bad debt, cost to income ratio and cost to portfolio value ratio.

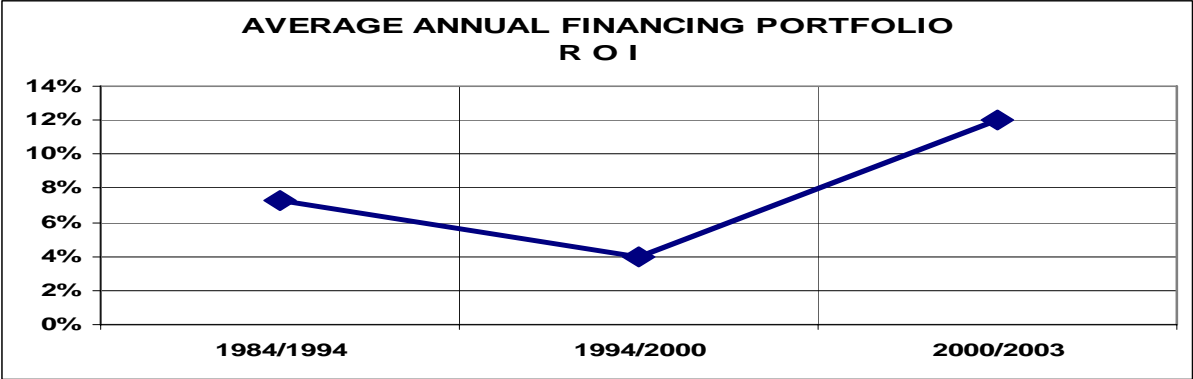


Figure 5: Financing portfolio – average annual ROI

The Return on Investment for the Program averaged 7% before 1994. This was about half the industry average of about 14%, nowhere near profitable enough.

The operating cost was 103% of operating income in the period 1984 to 1994. This meant that for every rand of income earned, the Corporation spent R1.03 in operating expenses.

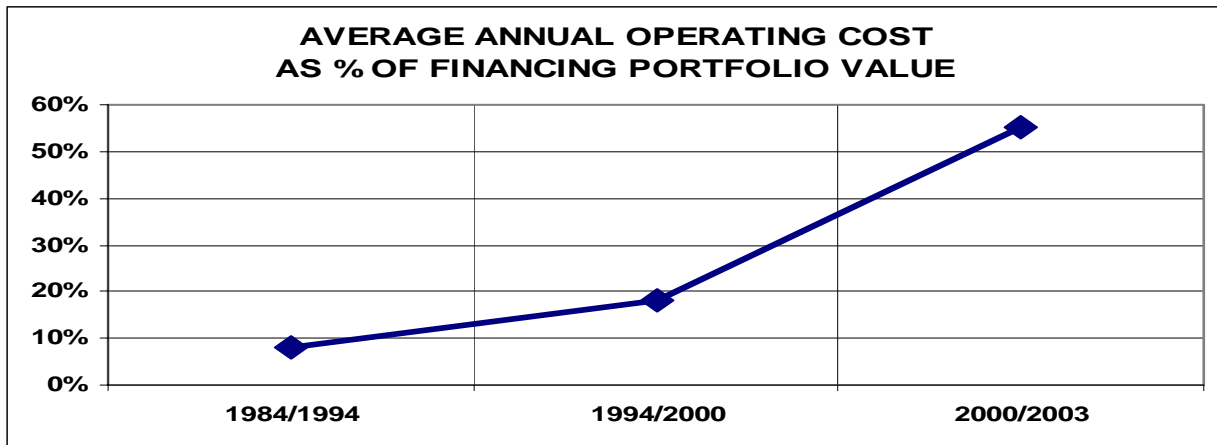


Figure 8: Financing portfolio – average annual operating cost %

The operating cost during this period was 8% of the financing portfolio value. The operating cost (including salaries and administrative expenses) amount to 8 cents in every rand disbursed, whilst the ROI (interest earnings) was only 7 cents to the rand.

The average annual percentage Rate of Returns, the average annual percentage provision for bad debts, the average annual Cost-to-Income ratio and the average annual Operating Cost as a percentage of the Financing Portfolio value, as reflected in this analysis, indicated that the Program started off relatively well in the first phase.

The Contractors' Support Program

The Contractors Support Program was a successful program. The Contractors Support Program was only established in the 1992 / 93 financial year in response to the demand by local contractors who won tenders for construction from state institutions. The Contractors Support Program had as its objectives the use of performance guarantees for working capital and provision of guarantees to the client of the contractor. To this end, the program had two main components: bridging finance and performance guarantees.

Of all the programs, the Contractor Support Program is one has been the most successful in the past. The following facts bear testimony to this:

During the 11 years of the Program's existence, only 13 bridging finance guarantees were called up, reflecting 4,22% or less than 5% of the total exposure of the Program. The

annual project value increased significantly during phase two, to reach a high of R 152,78 million during 1999/ 2000. The annual average value of performance guarantees issued increased significantly during phase two, to reach a high of R 29,2 million during 1999/ 2000. The average annual employment opportunities created through the Program increased significantly over the period to reach an annual average of 1,163.

Resources set aside in the first phase:

The Program was initiated during the 1992/ 1993 financial year.

During its first two years the Province allocated the following:

Bridging finance	R 7.5 million
Performance guarantees	R 3.3 million

Financial performance and profile of the Program

The following provides an indication of the financial performance of the Program:

Average annual number of projects assisted	32 projects
Average annual projects value	R 17.67m
Average annual Performance Guarantees values	R 1.66m
Average annual bridging finance provided	R 7.5m
Average annual number of jobs created	343 jobs
Bad debts: (According to records, only two guarantees were called up)	

In the first year of its existence, the program created 160 jobs.

The above analysis implied that an average amount of R 21 865 Bridging Finance was disbursed to create one employment opportunity. This is slightly higher than in the average SMME venture. The Program had a low default rate at that stage. It was clear, therefore, in the beginning that the Program would be an important ingredient in the sustainability drive of the Corporation.

The restructuring phase: 1994 – 2000

With regards to the Industrial Development Program, a total financial investment set aside for this purpose. A limited amount of only R 9.0 million for financial investment was made available in this period. Consequently only limited industrial development could take place during this period.

The employment rate decreased dramatically during this period due to the relocation of industrialists from both the small industrial parks and Ekandustria. Ekandustria's employment rate dwindled by about 50 % compared to the first phase during 1984 / 94.

Suppliers of inputs and other essential services to Ekandustria remained outside the Province due to the fact that there was no successful manufacturing base of small industrialists in the targeted areas. With no major movement at all on the development of the Industrial Program, the Corporation was only involved in maintaining existing factories.

The same variables as employed in the previous section were evaluated: i.e. rate of return, bad debts, cost to income ratio, and cost to property value ratio. Rates of return: The rates of return for this period stood at 11%; Bad debts: There was an astronomical average annual provisional for bad debts at 70%; Cost to income ratio: The operating cost in this period was 52% of operating income. Cost to property value ratio: The operating cost stood at 6% of the property value. It is very clear that by the end of the first phase, the Corporation's programs were not performing well. The average ROI of the period for the Corporation was -2%.

The period between 1994 and 2000 witnessed a dwindling rate of financial investment into the MDC / MEEC Corporation from the shareholder. The total investment in this phase amounted to R 31.0 million.

It must be pointed out, though, this was a period when various restructuring exercises took place. Government resources went into restructuring rather than to this program. This period witnessed a decrease in loan financing value per employment opportunity created.

There is no reliable data available regarding the number of clients financed during this period. The fact that in 1997, the MDC had to stop funding projects to concentrate on

restructuring the Corporation, implied that there were little effort expended in the direction of developing entrepreneurs. This phase was characterized by political influence in the development of entrepreneurs.

The Return on Investment: The Return on Investment was at it's lowest ebb at 4%, almost fifty percent lower than the average for the previous period;

Level of bad debt: At 45% the level of bad debt provision had gone up by more than 300%.

Cost to Income ratio: The operating cost was 736% of operating income;

Cost to portfolio value ratio: The operating cost was 18% of the Financing Portfolio value.

This program was clearly experiencing a downward trend in terms of performance.

▪ Average annual performance guarantee values	R 7.6m
▪ Average annual bridging finance provided	R 6.m
▪ Average number of jobs created	1,201 jobs
▪ Total number of jobs created during this phase	7,203
▪ Total number of projects for this phase	273
▪ Total projects value for the period	R381,5m
▪ Total value of performance guarantees during this phase	R 45,67m
▪ Total value of bridging finance during this phase	R 36,8m

Based of the facts presented in this section it is very obvious that the only program that witnessed growth in this period was the contractor's support program. Both development finance and property development reached a record low in their performance. (MDC:1995)

4.6. Shift in Provincial Policy

The 2000 – 2003 period represents a significant change in the external environmental and situation of the Corporation. A second term of office for the ruling party had just begun. The Province had a new Premier but the Cabinet was more than 50% similar to the preceding Cabinet. (MEEC:2003)

A team appointed to restructure the Corporation had submitted its report to both the outgoing Cabinet as well as the incoming Cabinet. There was no excuse why a firm decision on the future of the Corporation could not be taken. Consequently, the Corporation began changing.

In general, the post-1994 Government had acquired practical experience on policy implementation. The Reconstruction and Development Program was put to test but was not that easy to implement. GEAR was by then official government policy and it provided a framework for economic development. The Provincial Government of Mpumalanga, was in this phase in a good position to change the role of the Corporation. This was reflected in its programs, as discussed below.

The value of the Property Portfolio grew with more than R30 million by the end of the 2003 financial year. For the first time since the last factories were built in 1989, the Provincial Government set aside an amount of R 35 million for the construction of a 2,200 m² factory in 2003. This happened more than 13 years after the old Industrial Development Program witnessed the construction of new factories. This constituted a significant development in the history of the Corporation and this signaled a demonstration on the part of Government of its appreciation of the role of industrial parks in job creation.

For the first time, the Company that won the tender for the construction of the factory was assisted by local people. Services such as earth moving were procured from local entrepreneurs. Technical expertise and other important inputs were brought in from outside the borders of the Province. A major renovation of the other factory, which involved R27 million, was also done by a local contractor. These two projects alone allocated work to more than ten local sub-contractors.

The factory was going to create an estimated 1,000 jobs in Ekandustria. This would constitute about 15% of the total employment in the area. By and large the employment rate in the area has been on a downward trend. The speedy reconstruction of a fire damaged factory resulted in more confidence in the area, with the result that more investors came to Ekandustria for factory space. This translated in fifty more jobs.

In the last phase under investigation there is evidence of increased shareholder commitment to support the Corporation and its clients. The funds set aside by the Government over and above the normal allocation to fund this Program constitute the main evidence of Government's commitment.

In the period of loan disbursements, the contribution to support prospective loanees was as follows:

2000 / 01	R 5,23 million
2001 / 02	R 9,7 million
2002 / 03	R 13,8 million

Figure 9 below demonstrates how this phase performed *vis-a-vis* the rest in respect of average annual loan disbursements. However it must be remembered that the data is expressed in nominal terms.(MEEC,2003)

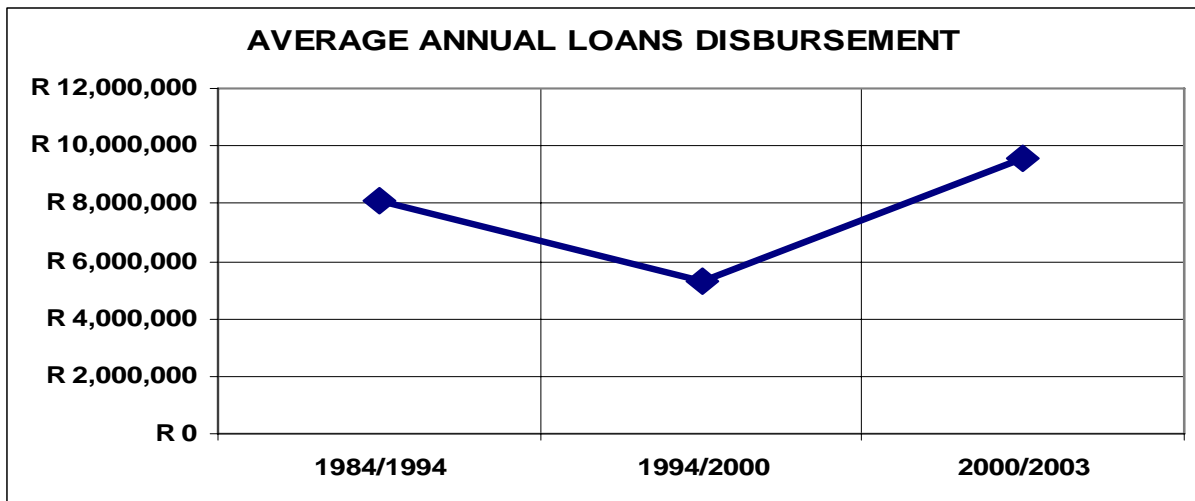


Figure 9: Financing portfolio – average annual loan disbursements

The level of funding, as reflected in the Annual Report of the MEEC for the 2002/2003 year, indicates the dwindling commitment of Government to support development corporations. The total grant for this financial year was just under R 44 million. The Development Finance Program was the most seriously affected program. The budget for Development Finance in the 2000 financial year stood at only R 5,2 million.

It remains to be seen whether businesses that were assisted with special programs during this period would be sustainable. Available data indicate that the repayment rate is growing worse. The fact that the bad debt provision has moved from 14% in the first phase to 71% in the third phase is an indication that entrepreneurs who are being assisted are not coping or are not repaying even though they might be in a position to do so.

The average number of jobs created in this phase is 715. This is the highest compared with totals of the first two phases. This can be attributed to the fact that clients in this phase were moving away from retail into other sectors that were more labour intensive.

The resources that were set aside for this program were as follows:

Total value of performance guarantees issued	R 9,15 m
Average annual performance guarantee values	R 3,05 m

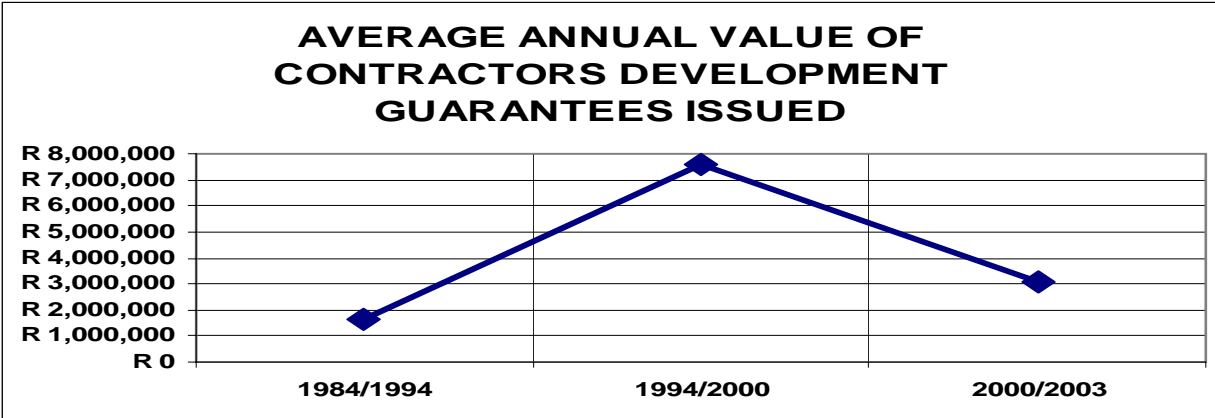


Figure 10: Contractors' development portfolio

Average annual bridging finance provided	R 1,91 m
Total value of bridging finance provided	R 5,73 m

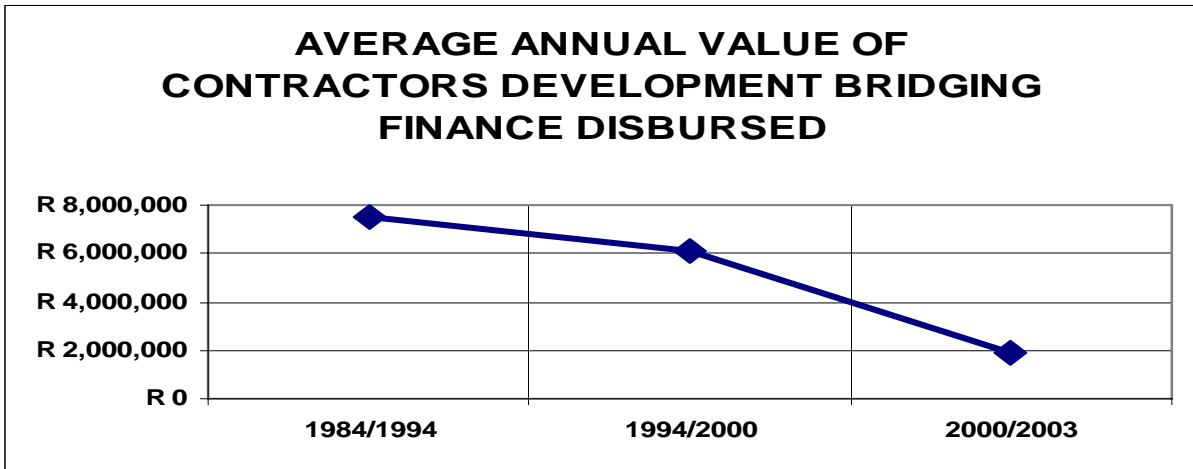


Figure 11: Contractors' development portfolio – bridging finance

The job creation impact of the program is as follows:

Total number of jobs created during the period	4,910 jobs
Average annual number of jobs created	1,637 jobs

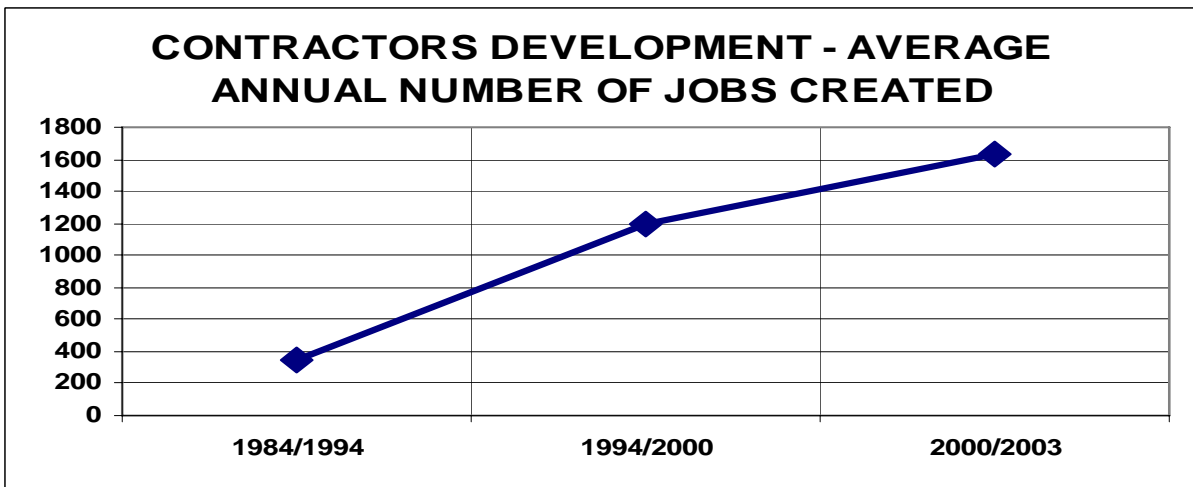


Figure 12: Contractors' Development Portfolio- average annual job creation

Total number of entrepreneurs assisted	83
Total value of projects during the period	R 120,4m

The average annual budget value was R40,12 million. Clients were mentored by the Corporation's experts in construction and most of them have won tenders and completed

projects for the Government. During the eleven years of the Program's existence, only 13 bridging finance guarantees were called up, reflecting 4,22% or less than 5% of the total Program exposure. This means that more and more contractors have become economically successful. The performance of the programs of the Corporation were characterized by very interesting trends from which we can clearly draw useful lessons.

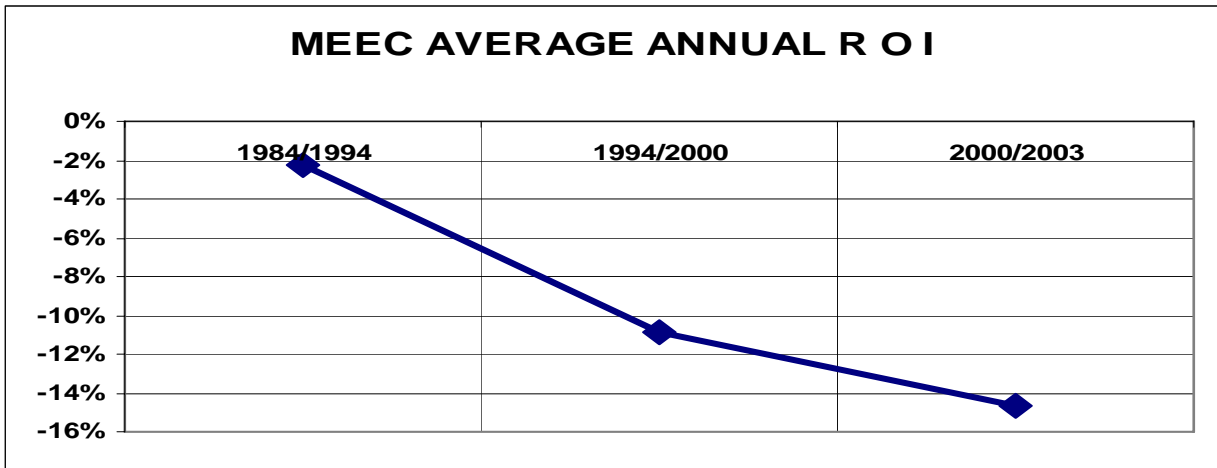


Figure 13: Average annual ROI

An even more interesting analogy can be drawn from the relationship between political developments and the level of financial support from the shareholder. The first phase of the Development Corporation witnessed political commitment on the part of both central Government and the governments of the respective self-governing territories to make the corporations live up to its mandate. This commitment translated into pouring financial resources into the development of industrial parks and into loan finance.

The second phase 1994 – 2000 witnessed a skeptical approach towards the Development Corporations on the part of the shareholder. This resulted in the withholding of resources and an attempt to “dismantle” the Corporation. During this period the two main programs of the Corporation i.e. Industrial Development and Development Finance both suffered. The Contractors Support Program thrived, not because of Government support, but because it did need and had significant financial resources to negotiate performance guarantees. This is because, in the case of bridging finance, the Corporation could use its strong asset base as a guarantee for its clients in this portfolio. During the second period, Government set aside R 52 million for restructuring costs of the

MDC. These funds went mainly to finance severance packages to the staff of the Corporation. Only some R 31 million was allocated for project financing in the period between April 1994 and April 1999. An illustration of funds committed for restructuring as opposed to business finance in this period is the following:

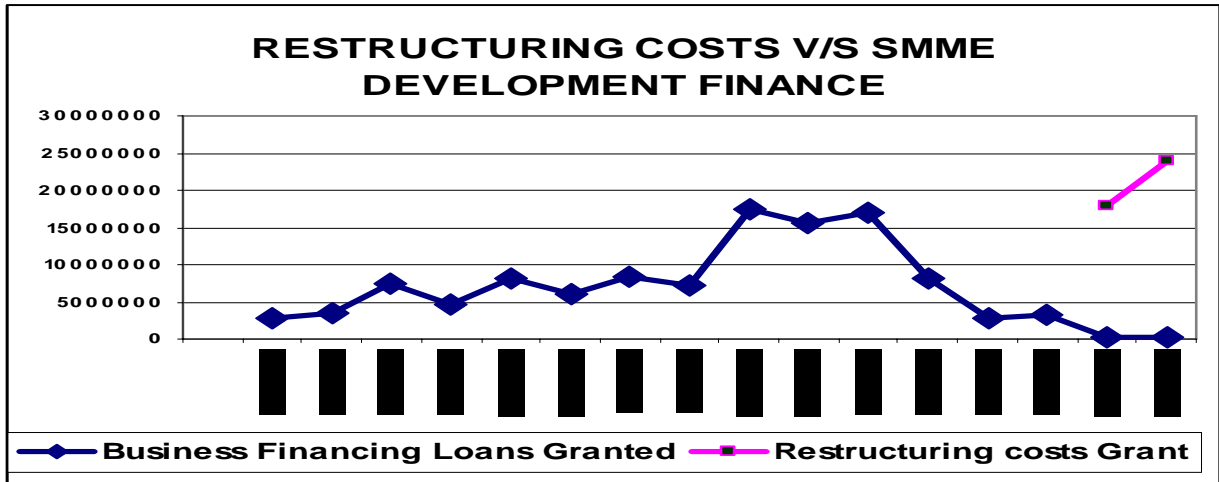


Figure 14: Restructuring cost compared with value of loans

It could be postulated that restructuring as a political act, has clear and negative effects on the number of loans granted.

An analysis of the performance of the various programs follows:

There was a reduction in occupancy rate at the Industrial Park during the second phase of the Corporation's life. Judging from the resources allocated, it is evident there has been no serious intervention since 1994 to further develop Industrial Parks. Instead the Corporation could not adequately maintain the existing Industrial Parks.

The Corporation's Property Portfolio experienced short-term improvements in respect of returns and unrealized interest charges during the year under review. These are at 8% and 16% respectively as opposed to 11% and 2% respectively in the previous phase.

The efficiency of property administration remained almost constant over the longer term. However, a short-term trend of decreasing efficiency in terms of both operating cost as a percentage of rental income and the portfolio value is observed.

The quality of the Property Portfolio was compromised by a high percentage of bad debt provisions, which by the 2002/2003 financial year stood at 95,6% of the budgeted value of rental income.

The financial statements of the Corporation indicate a dwindling of the funds set aside for Business Finance since 1996.

In 1995 the funds set-aside for new entrepreneurs was in the region of R 17 million. The following year, in 1996, this amount was almost halved to R 8 million. In 1997 it came down again to R 2,7 million, and to R 0,3 million 1998 and R 0,35 million in 1999.

The illustration below provides a picture of how the development finance program decreased during the period 1995 to 2000. After this, it increased possibly to the importance of political influence in the performance of the program.



Figure 15: Value of loans granted

Lack of financial resources and other factors contributed to the under-performance of the Program. The following is evident:

The bad debt provision for the whole period stood at 32,8%. This implies that the Corporation has written off more than 32 cents in every rand allocated. The bad debt provision for last phase was at 70%, which demonstrates a negative trend in this regard.

The high cost-to-income ratio, which is currently at 200%, though showing some improvement, is unacceptable. It was 100% in 1992, implying that it then costs a rand to generate a rand in income. The 1994 - 2000 era witnessed a situation where it cost R5 in operating expenses to generate one rand in operating income.

In general, clients of the Corporation are mostly in a debt trap. Out of thirty clients interviewed, only 10% or 3 managed to pay off their loans.

A total of 37,7% of clients are so debt ridden that the amounts they owe the Corporation far exceed the amounts borrowed.

It seems that the political influence was stronger than market forces. The implementation of the Public Finance Management Act has, however, halted this Program. Whilst there are isolated cases demonstrating how the Corporation has been able to assist entrepreneurs, in general, the Corporation's clients have been left with no credit available. This resulted in most of them becoming very skeptical of any effort on the part of any Development Finance Institution to support entrepreneurs. This could have far reaching implications in the future. Since there are insufficient records in the area of non-financial support, information was solicited through interviews and questionnaires on clients. This Program was implemented in various phases by the predecessor organizations of the current Corporation. In some cases officials responsible for after-care services were performing the role of debt collectors. The following observations concerning this Program need to be noted.

In general, clients of the Corporation were not sufficiently educated to participate in an industrial development program. The average formal qualification of thirty clients interviewed was grade eleven.

The Corporation did not sufficiently educate its clients on compliance issues. Only about 30% of those interviewed were knowledgeable on compliance issues. Only 10% of clients interviewed saw their mentors as per the agreed upon Program, implying that the After-Care Program was run in an un-coordinated way. About 40% of the clients were not given any after-care service. This is in spite of an average of 2½ weeks' business training of the Corporation's clients.

In the second phase, and the first two years of the third phase, no after-care service for the Corporation's clients was offered. It is in this period that the highest default rate was registered. The after-care service in the first phase, though faulty, was still able to ensure a relatively better repayment rate. This shows the importance of such an after-care program in all financing contracts with clients.

Other shortcomings

Based on the questionnaire distributed to a sample of thirty clients of the Corporation's Loan Portfolio, and on interviews with former and current officials and other stakeholders of the Corporation, the following shortcomings were noted:

Systems, whether in the form of information or information technology or other monitoring mechanism, were generally inefficient. Until very recently the Corporation has been using an Information Technology system called the Pic system, which was basically an in-house product. The System was only mastered by two people, this was very unreliable and expensive to maintain. In the first phase the Corporation's records were processed and kept on a manual basis. More interesting is the fact that the Corporation never saw the need to employ any monitoring system such as stop orders to ensure that clients paid regularly. Of the interviewed clients, only about 15 % were made to sign stop orders to service their loans.

The average formal education the clients received was grade eleven. One of the many implications here is that those that did not make it to matric became the core of the Corporation's client base. What is even more intriguing is that the average period of business training received by the clients was only two and a half weeks, which is completely insufficient.

There is no evidence that there was any concentrated effort to train local staff to be able to occupy the managerial positions of the Corporation. In 1998, for example, more than 80% of the managers in the Corporation were white males. It was only very recently that black staff were placed into various positions and programs to ensure that they are able to hold down managerial positions in the Corporation. In 2003, more than 85% of Managers were black, whilst about 25% were females.

In general, whilst the Corporation has in some cases fulfilled its stated objectives as enshrined in the various acts of parliament, the end result of these activities have not always benefited the target groups sufficiently. Whilst the Industrial Development Program has been fairly successful in so far as it created jobs, the Program itself has not proved to be sustainable. The SMME Loan's Program was an act of expediency and the fact that it has left more than 80% of the Corporation's clients in debt is a testimony that it was an unmitigated disaster. The program to realize the objective of promoting, planning, establishing and co-ordination and acquiring business ventures has been an absolute failure too. No subsidiary of the Corporation has proved to be sustainable to date.

Benchmarking with other Development Corporation

The performance of the Corporation was benchmarked with other development corporations which share a similar focus in terms of its mandate. These benchmarks were derived from Ithala in Kwazulu Natal, The Free State Development Corporation in the Free State, and the Botswana Development Corporation in Botswana. The mandates and origins of these institutions are not fundamentally different from those of the MDC/MEEC, save to note that the Botswana Development Corporation has no social engineering baggage. In the Table below the rate of investment, interest cover, the gearing ratio, bad debt provision and cost to income ratio's are used as variables to compare the performance of the Corporation with similar institutions.

The following observations can be made:

The MDC has an unparalleled low gearing ratio.

The MDC's cost-to-income ratio which was at 205% was an indication that the organization was not run on business principles. The bad debt provision at 76.5% is more than 6 times that of the best parastatal in the group. This is an indication that its loan portfolio will not lead to self-sufficiency of the organization.

Both the rates of return and interest cover are extremely low compared with the other corporations. Other observations on the profile of the MDC/MEEC *vis-a-vis* other Corporations are as follows:

Other Corporation's were significantly capitalized in their initial years. The BDC and Ithala are outstanding examples. Ithala, for example, was capitalized by the former Kwazulu Government in the form of annual share capital transfers to the extent that it built an asset base of more that R2.5 billion as a basis for generating income. The Freestate Development Corporation received R1 billion capitalisation from Government in 2002/03 compared to the MEEC's R80,0 million.

The Boards of all these Corporations consist of appropriately experienced members. There was in general sufficient government support for these institutions. This translates into material support. The capitalization of the Industrial Development Corporation (IDC) is a typical example.

These institutions are run on strict business principles. Their performance reflected in Table 4 below is testimony of that.

Benchmark	MEEC	ITHALA	FDC	Botswana Development Corporation
ROI	- 22,5%	13,6%	13,5%	4,4%
Interest Cover	- 1 348%	15,8%	244,8%	228,5%
Gearing	18 %	51%	135%	31%
Bad Debt Provision	76,5%	12%	54,4%	27,4%
Cost-to-Income	205%	71,8%	69%	39,1%

Table 3: Comparison between development corporations

In conclusion, it must be noted that the MDC/MEEC has not performed well in terms of stated objectives and its mandate. However, this does not mean that the concept of a development corporation is uncalled for. Under different circumstances, the Corporation could have performed much better or, at the very least, performed very much like other similar institutions.

Political impact on performance

It is common practice for state institutions throughout the world to, members of board of directors, have state officials on their boards to ensure compliance with the state's mandate. German parastatals, where the affected departments always delegate a senior official to sit on the parastatal's board, is a typical example. This is one measure to ensure that the shareholder's interests are taken into account during the decision-making process. In the case of the Mpumalanga government and its relationship to the Corporation, evidence exists that political factors other than the need to ensure compliance with the mandate were at play in the case of the Corporation. They manifested themselves as follows:

Former employees of the Corporation talk about two sets of criteria for approving applications for project funding. One was criteria that related to the sustainability of a project and the other

was called the "ringing telephone". The latter implied that when senior politicians called to recommend that certain applicants be given first preference in their applications for funding these requests need to be prioritised. More interesting is the classification of files by the Corporation. There were two main categories. The first one was a category called "M", standing for ministers, traditional leaders, members of parliament, and other influential members of society. The second was for the normal client requests. There was evidence of special treatment given to the first group. The "M" category has generally not performed any better. (MDC:1995). In fact the "M" category made debt collection almost impossible because of their power to lobby against any drastic debt collection efforts.

The Development Corporation spent about five years since 1995 not really focusing on its mandate but on various restructuring efforts. This led to the demoralization of staff, lack of attention to the Corporation's assets, including industrial properties, channeling funds that were supposed to be for on-lending activities to other non-core functions and a general lack of service to both existing and potential new clients.

After three restructuring and amalgamation exercises which were basically unsuccessful, the last restructuring team headed by a retired Auditor-general handed its report to the Cabinet in the middle of 1997. It was eventually adopted towards the end of 1998, and it was only fully implemented by a different Cabinet towards the end of 1999. In the process

aspects of the institutional memory of the Corporation and important documents were lost. The Corporation lost market share and failed to maintain its infrastructure.

The Boards of provincial parastatals, in general, are not expertise based. Appointments take into account issues such as regional spreading, chamber interests and gender representivity. Whilst these are legitimate issues, quite often this is done at the expense of the sustainability of the Corporation. In some situations board appointments were no more than political gestures. The Benchmarking exercise in Chapter Four with other Institutions such as, amongst others, the Botswana Development Corporation, indicates that best practice in the industry is to attract appropriate expertise to the boards of corporations. Issues such as representivity must be weighed against the need for Board members to add value. The current provision for the Corporation is to have only five Board members, which makes it difficult to attract the necessary expertise from a variety of appropriate areas of skills.

The financing of the Corporation did not escape the negative attitudes of politicians and bureaucrats towards it. In situations where the politicians did not support the existence of the Corporation or its senior officials, funding dwindled. Former senior officials interviewed asserted that one of the reasons why the funding levels dwindled was the bad relationship between the shareholder and the Corporation. This is evident in the second phase of the Development Corporation.

Legislative framework

Whilst, in general, legislation gave the Development Corporation latitude to perform almost every function it may wish, it has several weaknesses, which make it difficult for the Corporation to be sustainable in the long-term. The following are to be noted:

In terms of the current Act governing the Corporation, the Corporation cannot always procure goods and services beyond a certain minor amount unless it goes through the Provincial Tender Board. It is very clear that the current Act was drafted with the objective of reducing the Corporation to a government department or a section in a department. This defeats the objective of the Corporation's existence. Fortunately this limitation was overruled by the Public Finance Management Act recently.

The Public Finance Management Act does not allow the Corporation to continue with performance guarantees, an important component of the contractor development program. Unfortunately this was the only Program that was sustainable and has led to the Corporation losing its market share and consequently decreasing its chances of sustainability.

Skills and performance

There is no evidence among the Corporation's staff of sufficient skills in the various phases of its business to execute all facets of the mandate. The client's skills levels, as explained in the last chapter, left much to be desired. There is also no evidence of a program to ensure that the skills profile of staff matches the requirements of the Corporation. In an organization operating in the development finance industry, one would expect staff to be trained in related fields or recruitment activities to reflect this challenge.

Records show that neither the recruitment activities of the Corporation nor the training profile of the Corporation point in this direction. Instead the Corporation was no more than an employment agency. The fact that in 2003 it could function with only 84 members as opposed to more than 250 in 1999 attest to the fact that skills were not a big issue as such, but employment of as many people as possible was.

Beneficiation of performance

The beneficiaries constitute one of the biggest challenges of the Corporations in that: They generally have a culture of entitlement. The Corporation's resources are, in their opinion, State resources that do not have to be collected in an aggressive way. This partially explains the debt book problem. The Corporation records indicate that there was a committee set up in 2001 to address the debt collection problem. This was based on a response that political upheavals in the 1980s have led to failure on the part of the clients to service their debts. The peaceful situation after the upheaval did not yield better results for the debt book.

The majority of those who would like to access the assistance of the Corporation's programs are resident in deep rural areas where there are limited available business opportunities leading to unsustainable businesses.

As a result, the beneficiaries become basically survivalists, whose businesses are unlikely to be sustainable. As a state institution the Corporation will always face subtle pressure to ensure demographic correctness in its lending activities. However, sometimes demographic correctness compromises the principle of project sustainability.

Government policy

One of the programs whose performance relates strongly to government policy is the industrial development program. In the pre-1994 era, when the South African Government offered incentives for industrialists to operate in economically depressed areas, the occupancy rate at Ekandustria was more than 90%. In the small industrial parks the occupancy rate also averaged around 90%. With the change in government policy in this regard, the occupancy rate at Ekandustria plummeted to 70% in the mid-1990s and to about 40% in the small industrial parks. The contractor's support program is one other example of how government policy can lead to the underperformance of a program.

Summary

The challenges faced by MEEC are fundamental and reflect serious gaps in the financing system of the Corporation. The failure rate on the repayment of loans has led to the failure of the Corporation to achieve a sustainability levels. The after care support, or the lack of it has somewhat spiraled to unabated levels. The state of helplessness of its clients has worsened in recent years. In the last chapter, Chapter 5, clear recommendations are therefore proposed to remedy the situation.

CHAPTER FIVE: CONCLUSIONS AND RECOMMENDATIONS

5.1. Introduction

Whilst there is an acknowledgement that, in general, all development corporations' performance suffered severe setbacks even before 1994, but what is of concern is the reality that benchmarked against other corporations with the same background and focus: the MDC/MEEC is lagging behind in performance. Given the resource base of the Province, with coal resources and production of more than 80% of the country's electricity, with water in the region at more than 20% of the country's total water resources, with more than 30% of the country's plantations and more than 20% of the country's arable land and the proximity of some of its towns to Gauteng (the industrial nerve center of South Africa and gateway to the world), the MDC/MEEC and its clients were expected to perform better.

There are mitigating factors, though, that have contributed to the under-performance of the Corporation. These factors are discussed in this chapter with reference to political, legislative, skills level and policy related factors.

5.2. Conclusion

The homeland economies where development Corporations operated were based on false economic principles as there was no way the resource bases of those areas would be able to play a key role in a major stimulation of economic activities. Whilst there were exceptions, they were very few indeed. The MDC/MEEC did not operate in an area with such subsidized national resources.

This did not stop the then unitary government from committing funds for SMME development and development of new industrial parks to these areas. When the new provincial government was established in 1994 many civil servants moved from the self-governing territory capitals to Nelspruit. The income from these civil servants had over the years accounted for the relative success of some of the small businesses in the self-governing territories. With this new development the client base of the SMME's funded by the Corporation dwindled, so did their profit margins.

In conclusion it must be emphasized that the Corporation had some successes against many odds. Whilst they were expected to achieve success in an environment which negated the basics of the business and many other external factors contributed to defeat the objectives of their operations, they struggled successfully to keep afloat and to limit employment totals from more than 1,200 to less than 100 in recent years. Expenses on salaries were thus substantially reduced, but this did not, unfortunately lead to more effective, efficient and economical services to their existing and potential client base.

5.3. Summary

There is no doubt that the Corporation as it stands cannot measure up to the key features which constitute best practice for successful development Corporations throughout the world. In most cases, its conduct goes against best practice. The unfortunate result is that if this continues, it cannot live up to its mandate.

If the Corporation seeks to live up to its mandate, there are some key measures that should be implemented as soon as possible. These are as follows:

Development corporations are not only peculiar to South Africa. Most countries throughout the world have development finance institutions with sole mandates to propel economic participation and the consequent economic development of the target community. Some of the world's advanced economies were beneficiaries of development finance assistance and still maintain development finance institutions at national and provincial level. Germany is one outstanding case in this regard. Italy with its development finance concept called the

Mezzogiomo, whose mandate is to assist entrepreneurs in poor parts of the country, is another example. All these institutions across the world are basically responding to market failure and addressing the need to stimulate business activities and economic growth in poorer areas. The development finance institutions in South Africa have had their share of challenges and failures and successes out of which certain lessons could be learnt. Out of these lessons, the best practice for ensuring that our development finance institutions meet their stated objectives has slowly been taking shape.

Limitation of the Study

Mpumalanga Province is a rural province, and there are not so many SMMEs that are managed professionally. A lot of references that the study made was based on national legislation. This could have restricted the researcher in expressing a more accurate view in as far as the Province is concerned.

Ethical considerations

It was important to appreciate that any business operates within a certain set of values to which all employees should adhere. In turn any individual adheres to his own set of values. The researcher ensured that these principles are respected.

5.6. Recommendation

The following are the recommendations, which also constitute some of the key pillars of best practice :

Adequate initial capitalization

For the DFI's to be successful they need adequate resources to invest in both their clients and in systems which will make it possible for them to earn adequate returns and serve their clients better. The Botswana Development Corporation is a good example of how a development finance Institution should be funded in its initial years. Until 1999 the Botswana Development Corporation was funded to the tune of an amount equivalent to R320 million, with a further capitalization of R310 million in the year 2000. The Botswana Development Corporation also has specific funding mechanisms which compliment the capitalization by its shareholders, namely the issuing of redeemable non-voting preference shares.

Back home, the Industrial Development Corporation and the Land Bank provide outstanding examples of other alternatives to ensure adequate initial capitalization of

development financial Institutions. They were funded and financially supported in such a way that the latter institution did not require any funding since 1959.

The MEEC never enjoyed funding close to the examples mentioned above, neither during the pre-1994 era, nor during the post -1994 era.

The above corporations operate in a market environment where some key stakeholders may be private sector organizations. They will expect an attractive balance sheet and sufficient liquidity for healthy business dealings. Initial adequate capitalization played a key role in ensuring that this happens – if extended to businesses such as development finance institutions, the chances of these becoming more self-sustainable will be appreciably enhanced.

Expertise-based Boards

Whilst there is no disrespect for factors such as gender and regional representation, successful corporations have boards that are structured to accommodate appropriate expertise in its ranks. The Board of Ithala, the Free State Development Corporation and the Botswana Development Corporation are structured in a manner which accommodate experts and stakeholders who will add value to the Corporation's mandate.

Ithala has always insured that one of its major funders, the Development Bank of Southern Africa, has a representative sitting on its Board, whilst the others will include financial and legal experts and even retired academics with a wealth of knowledge on issues of development. They would involve experts from the private sector thus reinforcing the private sector orientation of the development finance institution.

Long term institutional sustainability should not be compromised

In most cases development finance institutions are expected to be self-sustainable within a given time. For the past five years, the Botswana Development Corporation was not receiving any annual funding from Government. The same can be said of national development finance institutions such as the IDC and the Land Bank. The Land Bank received its last capitalization more than forty years ago.

One of the reasons why these institutions are self-sufficient is because they fund loans on the basis of sustainability and not sentiments. This ensures long-term sustainability. The willingness of government to allow these institutions to operate with business principles ensures long-term sustainability. With this in place assisting the poor is not executed at the expense of long-term institutional sustainability.

The capacity of the clients to run businesses requires more careful analysis

One of the reasons why clients of development corporations were unable to service their debts is due to the fact that they have had no basic training to run a business nor are they motivated to be entrepreneurs.

A majority of them would have business plans drafted by consultants. They would not be in a position to defend the details enshrined in the business plans even though these formed the basis on which they are being funded.

Successful development finance institutions consider the capacity of their clients to run businesses as an important variable in determining the sustainability of any loan request for a project.

Commitment of the client to the project

It is almost standard practice in the industry to ensure that a client to whom a loan will be granted demonstrates a reasonable degree of commitment. This is usually measured by the client's willingness to pay a deposit equivalent to a certain percentage of his or her loan. The Industrial Development Corporation whose commitment to empowering small and medium enterprises has been emphasized again and again in their press statements and annual reports, have a facility where new entrants can part with a deposit as low as 2% of the value of a project applied for. Other institutions would generally be happy with a deposit of 10% of the total loan amount.

Implementing a Mentorship Program

That the mentorship program during the first phase of the Corporation was not well designed is an issue that has already been discussed extensively in our study. The fact is that there is a major difference in terms of the loan repayment rate when there was some form of after-care service compared to where there was none. The last period when there was no Mentorship Program witnessed the worst repayment rate, which was more than 70% as compared to 45% during the first phase of the Corporation. The nature of the terrain in which the Corporation is operating, necessitates an effective mentorship program which should take into account the following factors:

The skills level of the beneficiaries;

The need to ensure that the compliance issues are respected;

Respect for loan repayment conditions; and

The reality that new entrepreneurs who partner with established business persons are not as exposed to losing their investment due to lack of knowledge of business dynamics as would otherwise be the case.

Creating an appropriate legislative framework

The current legislative framework is by and large friendly for the Corporation to conduct its work. There are sections, of this legislative framework that are neither in line with the Public Finance Management Act nor with best practice. These include i.a. severe limitations on procurement procedures. The Public Management Finance Act should be amended to create greater flexibility for the Corporations to conduct business. Also, the Public Finance Management Act must create an environment for the Corporation to continue with programs such as contractor finance development, where guarantees are an integral part of its operations.

Governance

The shareholder must ensure that strict governance principles are observed. To this end, competent boards should be appointed and should be given the latitude to run the affairs of the Corporation without the interference in the day-to-day management of the Corporation. As argued earlier on, there is evidence of political interference in the Corporations operations and decision-making during various phases of the process. This does not only de-focus the Corporation, but it renders the Corporation unable to work in

terms of its own program. What will also be important for Government's comfort is the signing of a shareholder's compact between the Board and Government. A shareholder's compact will define what the government expects of the Board and vice-versa. A code of conduct for the Board may be useful to ensure that there will be speedy action taken in the case of unethical behavior.

Capacitating the Corporation

The Corporation will not be in a position to follow the route of other corporations such as Botswana Development Corporation if there is no major intervention to increase its capacity to meet its mandate.

According to the Corporation's records, in a recent quantification of the immediate needs of its industrial parks, which would include renovations and ensuring that the Corporation's factories comply with the current legislative requirements on buildings, an estimated figure of R130 million was arrived at as appropriate for this purpose. This program has better potential to lead towards greater sustainability of the Corporation than, for instance, the loans program.

Government should be encouraged to allocate adequate regular financial resources on a phased basis for the Industrial Development Program, the loans program, mentorship and contractors' support.

Political Support

As argued earlier, development finance institutions which have been successful, have experienced massive injections of funds from the State at national level. The Industrial Development Corporation is one such example. Massive financial resources are not sufficient without a human capital base to employ the financial resources in a manner that will benefit the Corporation and its clients. The two go hand in hand. The level of culture of entitlement is such that the politicians must stand behind the Corporation to ensure that irresponsible clients "toe the line".

The political support that the Corporation needs should translate into financial commitment from Government and willingness by Government to publicly discourage loan and rental defaulters. There must be political support to provide resources to develop the human capital base of the Corporation.

Skilling Beneficiaries

As indicated earlier, on average, the average educational qualification for the Corporation's client's base was grade eleven. There is no way in which the Corporation can create a new class of entrepreneur with this kind of client base. A program needs to be put in place to address this issue. In the year 2000, the government started a program involving a two week period of training to entrepreneurs. This was basically generic business training and, on its own, cannot be adequate. A program which appreciates the required skills levels of the beneficiaries and promotes technical training in financial management with specific focus on those sectors whose activities have a bearing on the Province's comparative advantage, should be established.

Ensuring that the clients are committed to the project applied for

The Corporation's clients must demonstrate a level of commitment to the business they are receiving funding for. The mentality that the Corporation's funds are in any case "tax payer" money which does not have to be paid back can be eliminated when clients know they must carry the risks associated with the projects for which they are being assisted. During the research, in profiles of the businesses funded by the Corporation, instances were discovered where some clients did not even bother continuing with the businesses after receipt of funding.

The client should amongst others, commit a certain amount of their own financial resources to the project. In situations where clients do not have sufficient financial resources to commit, their capacity as clients to run a business must be ascertained and the mentorship program should evaluate their willingness to commit their time and effort for the projects.

In conclusion it must be emphasized that the fact that Corporations have in general failed to meet their mandates does not mean there is no need for them. In fact the inability of the private sector to meet the interest of new entrepreneurs is on its own a strong reason why wholly owned or partially owned state institutions should be available to address this challenge. Like many other Corporations, the institution under investigation has not lived up to the shareholder nor the client's expectations. Not only is there a need for it to exist, but it has a potential to become one of the best development finance institutions in the world.

The Province in which it is situated provides a perfect setting for testing the impact of a development finance institution in empowering entrepreneurs. The non-homeland part of the Province has high quality infrastructure and other resources, which have formed a strong base for industries such as mining, tourism, energy generation and agricultural processing. These are present on a scale that make a significant impact on the gross domestic product of the country. For the facilitation and generation of more economic activities in the Province, there is a need for previously disadvantaged people to be mentored into doing business in this Province.

A well structured, sufficiently resourced and focused development finance institution would be well placed to facilitate this. The Mpumalanga Development Corporation has a very important role to play in the economic development of the province. To be in a position to fulfill this role, the Corporation must avoid the mistakes of the past and embrace best practise in executing its mandate.

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