

**Investigating the Causes and Effects of Weak Corporate Governance that
Hinder successful performance of African National Development Banks:
“A Case Study of Development Bank of Zambia”**

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“Development depends upon good governance. That is the ingredient which has been missing in far too many places, for far too long. That is the change that can unlock Africa’s potential. And that is a responsibility that can only be met by Africans.”

-Barack Obama, President of the United States of America

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ABSTRACT

Corporate Governance in African National Development Banks is critical to their success or failure. These Banks have complex corporate governance structures with hierarchies comprising both national government representatives and in some cases the private sector. By focusing on election years this study aimed to show how external interventions from the owners of the Banks (governments) can unduly influence their performance and sustainability. Two causes of weak governance were identified, these were non-independence of the board and broad and unclear mandates. The study shows an increase in lending during election years, suggesting evidence of non-independence of the board signifying undue political influence and wide mandates leading to “mission creeps” usually encouraged by politicians. Non independence has its effects, these were identified as crowding out of the private sector, misallocation of funds and low profitability. A positive correlation was found between the African National Development Bank lending and private bank lending an indication that the African National Development Banks compete with the private banks instead of performing their counter cyclical role, this in turn leads to crowding out the private banks. Misallocation of funds is demonstrated by an increase in lending during election years followed by an increase in bad debts two years after the election year, an indication that loans were given to unviable projects. Lastly the study proves the low profitability effect by showing that loans given out are negatively correlated to the Banks profitability, showing a reduction in Bank profitability as more loans are advanced and vice versa. The findings suggest that non-independent boards and wide and broad mandates weaken African National Development Banks corporate governance, negatively affecting their performance and preventing them from executing their mandates effectively.

Key words: National Development Banks, Corporate Governance, Non independent Boards, Broad Mandates, Political Influence

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1 INTRODUCTION

1.1 Research Area

1.1.1 National Development Banks as Financial Intermediaries

The Global financial crisis of 2008 ignited fresh discussions on the role of the state in the financial sector, this put a spot light on development finance institutions (DFIs) and how policymakers can utilize them in times of financial turbulence (Calice, 2013).

Lazzarini et al (2014) states that these development banks are financial intermediaries specialized in long term credit, mostly subsidized to stimulate industrialization or infrastructure projects. These banks are controlled by the national government and normally have a mandate to support local enterprises. Development Finance Institutions play a counter cyclical role in many countries during times of financial instability; this is in response to private banks restricting lending during recessions and financial volatility.

National Development Banks (NDBs) are created by governments to play a significant role in combating the problem of market failures in the financial sector, by providing development finance to bridge the gap and provide financing to those enterprises and infrastructure projects that are unable to access financing from commercial banks and other private financial institutions. This helps support economic growth both in developed and developing countries, but more so in developing economies such as Zambia. La Porta et al. (2002) points out that Government ownership of Banks is universal and has significant influence on financial and economic development. Thorne (2011) supports this notion by stating that development banks are used as a form of Government intervention in a country's financial system, with a goal of tackling market failures in regards to the provision of finance. The author continues by stating that development banks provide finance in areas of the financial market that are not well serviced by the financial system, these areas include financing for long term projects, projects that produce social benefits more than commercial benefits, including those projects that are considered high risk, such as those located in remote areas, projects with new technologies including new and small projects that are unable to provide collateral for their borrowing.

Doctor (2015) adds to this view by stating that both policy and academic literature put fourth an argument that NDB activities must be focused on developing priority sectors, these include infrastructure, education, science and technology, rural development and the environment. This is further supported by Banda (2014) who points out that DFIs play a counter-cyclical role to economic growth as they reduce the impact of various market failures prevalent in developing economies, namely failures in infrastructure finance, agriculture finance, housing finance and small and medium enterprise (SME) finance.

However regardless of their importance in the financial sector NDBs have not been successful at achieving their objectives. Rudolph (2009) highlights that the Banks over the past few decades have had controversial imperial evidence found on their role in the economy. As the evidence suggests that State Financial Institutions (SFIs) which includes NDBs have under-performed, negatively impacting economic growth.

A number of various researchers find that government ownership of Banks is associated with a negative impact on the economy with limited contribution to development. This is evidenced by La Porta et al (2002) who find that governments owning banks is associated with “lower subsequent economic growth” and state that government officials use NDBs to enhance their political ambitions. Barth et al (1999) add to this view by providing empirical evidence that government ownership is linked to low level financial development; Beck and Levine (2002) have contributed to this negativity by failing to find a positive effect on government ownership of banks and economic growth. Caprio and Martinez Peria (2002) provide findings that NDBs are linked to a higher degree of a “banking crises” (Rudolph, 2009).

Dinc (2005) finds that State Financial Institutions show increased lending patterns during election years and provide further evidence that in developing countries these banks fund the government to a higher level compared to private banks.

Therefore from the evidence found by the researchers highlighted above this is an indication that numerous state financial institutions around the world are marred by a lack of managerial skills and are open to government intervention in areas of credit decision making (Rudolph, 2009).

The researcher continues that the mismanagement of resources by these banks is commonly associated with the following, i) a weak board of directors and management; ii) political interference; iii) and the absence of a clearly defined mission.

Luna-Martinez and Vicente (2012) state that countless problems commonly associated with State Financial Institution can be related to or attributed directly to weak corporate governance. These problems are namely, financial problems, weak performance, broad mandates, unjust competition with the private sector and being captured by interest groups.

1.1.2 Corporate Governance in National Development Banks

Corporate Governance as described by Scott (2014) states that “corporate governance refers to the process and structure for overseeing the direction and management of a corporation so that it carries out its mandate and objectives effectively.” The researcher adds as mentioned above that numerous problems associated with Government owned financial institutions can be attributed to weak corporate governance practices. Luna-Martinez and Vicente (2012) adds that good corporate governance is crucial to the success of Development Banks.

Good corporate governance is relevant for both state financial institutions and for private enterprises. However governance in NDBs tends to be more challenging than in private financial institutions. This is because the structure of a Development Bank is more complex involving the government, the legislator and one or numerous government ministries. This complicates the execution of the ownership function and is at risk of political interferences in the light of exercising ownership (Scott, 2007).

Addressing the areas of governance and management is a difficult undertaking, because the structure of NDBs significantly varies; as there is a wide and diverse ownership structure in the developed and developing world. Nonetheless the cases of failure amongst the NDBs in previous decades gone by, tend to have similar causes. Some of these causes are highlighted in the World Economic and Social Survey (2005), these are mismanagement, inadequate cost-benefit analysis appraisal of projects and high arrears. These have frequently been the cause of bringing regional and national public banks to the verge of collapse. Therefore it is recommended that the issues of ownership, management and good

governance of development banks are adequately addressed (United Nations Department of Economic and Social Affairs, 2005).

Government interferences is one of the key causes of problems in NDBs. To reduce on these interferences good corporate governance provides a solution to avoiding government intervention in credit decision making. This is because it creates a clear distinction in regards to the rights and responsibilities amongst the stakeholders of the NDB, which includes the management, board of directors and shareholders (Gutierrez et al, 2011).

The researcher continues that to achieve efficiency NDBs must be organised as corporations, which includes management, board of directors and shareholders. The NDB needs to have a well-defined legal form; the law under which it is created must provide for the appointment of board of directors with a separate management and distinct well defined responsibilities and roles. The law must state the regulatory and supervisory function that is independent of the management, board of directors and shareholders. The inclusion of the private sector participation in the ownership structure of the NDB is able to provide assurances on implementing good corporate governance practices. However the selection of private partners must be given serious consideration and priority given to “Smart money” investors that share the objectives of the NDBs. Private sector participation must be seen as a means of increasing corporate governance standards and technology transfer and not as a mechanism of increasing the NDBs capital.

It appears that the only way to develop an efficient institutional framework, NDBs need to be governed by good corporate governance separate from political interferences. As highlighted in the United Nations Department of Economic and Social Affairs (2005) *“Good governance is essential for sustainable development; Corruption is a serious barrier to effective resource mobilization and allocation, and diverts resources away from activities that are vital for poverty eradication and economic and sustainable development”*

The general success stories of government owned banks are not different, some of these banks have succeeded by achieving their objectives whilst preserving their financial sustainability. This effectiveness has been aligned to a number of factors such as having a well-defined mandate; identifying and mitigating market failures; using innovative

instruments to adapt to an evolving environment and the practice of good corporate governance (Gutierrez et al, 2011).

The researcher continues by mentioning that having a clear mandate including have a target sector and financial sustainability helps the NDB remain focused and avoids drifting into carrying out roles meant for private commercial banks. Luna-Martinez and Vicente (2012) add that when the mandate is broad and generally stated the government has room to influence the activities and direction of the NDB, unless its institutional framework is solid enough to withstand political pressure it becomes susceptible to political interference and interests groups may pressure it to offer reduced interest rates on its credit facilities.

Both Gutierrez et al (2011) and Yeyati et al (2004) point out that having a narrow and clear mandate prevents deviating from the goal and objective of the NDB and prevents “mission creeps” from the Government.

It is essential to understand how successful NDBs obtained their ability to remain efficient from a development prospective whilst maintaining a positive financial position. This understanding will help transfer best practice to other NDBs more especially those in developing economies that are failing to carry out their objectives.

1.1.3 Government Ownership of Banks

As stated by Luna-Martinez and Vicente (2012), historically National Development Banks have been recognised as a vital instrument to governments around the world, specifically to promote economic growth through providing much needed credit, including providing advisory services and capacity building initiatives to “households, small and medium enterprises and large private corporations, whose financial needs are not sufficiently served by private commercial banks or local capital markets”.

When governments control bank assets directly, their role as Government in finance becomes wider than merely regulatory and enforcement functions that it is usually confined to (Dinc, 2005).

They gain the ability to direct funds to projects that have social developmental benefits and positive externalities for economic growth. However government also have the power when banks are nationalised to promote projects that have more of a political objective than social benefit.

There are two broad views related to government ownership of banks, the first is the “developmental” view, it is essentially optimistic and is associated with Alexander Gerschenkron (1962). The researcher points out the need of financial development to foster economic growth. Gerschenkron states that private commercial banks have played the critical role of channelling savings into the industries of numerous industrialising countries around the world in the second half of the nineteenth century more especially in Germany. However in some countries “economic institutions were not sufficiently developed for private banks to play the crucial development role”, an example of this occurrence is in Russia during the 1890s (La Porta, 2002).

The view of Gerschenkron (1962) was associated with a “broader sentiment in development economics” which encouraged government ownership of enterprises in the “strategic economic sectors” (Shleifer, 1998). Numerous researchers in history advocated for nationalisation of banks, Hawtrey (1926) finds that there lies a strategic advantage in the idea of nationalising banks along with other areas of the economy including coal mines, utilities and education. Other researchers such as Lewis (1950) openly supports nationalisation of banks in association with the “commanding heights” method which allows the government to develop selected strategic industries using “direct ownership and control over finance”. This phenomenon was taken on by most countries around the world, in the 1960s and 1970s when governments began to convert the existing private commercial banks into government owned banks in Africa, Latin America and Asia (La Porta, 2002).

The second view is the “political” view where government participation in the financial sector is seen as politicians taking control of investments in enterprises but accentuating political motives rather than social goals. Therefore in this particular view the government obtains enterprises and financial institutions as a means of providing subsidies, employment including other benefits to their supporters who in turn provide political contributions, votes and in some cases bribes, this is according to Kornai (1979); Shleifer and Vishny (1994) (La Porta, 2002).

This type of action is prevalent in nations with financial systems that are underdeveloped and inadequately protected property rights as the government has no competition from private banks. This view of government ownership of enterprises is reinforced by substantial evidence highlighting the inefficiencies of government owned institutions, the political intentions behind the provision of public services and the advantages of privatisation Frydman et al (1999); Megginson et al (1994); Lopez-de-Silanes et al (1997); La Porta and Lopez-de-Silanes (1999); Barberis et al (1996) (La Porta, 2002).

However Gerschenkron (1962) sees this view differently he admits that in the case of Russia's industrialisation the government's role was not efficient and far from perfect. As it was accompanied by corruption, incompetence and bureaucracy was rife; the waste accompanying the process was formidable. Regardless of this occurrence the researcher regards the government's financial role in the industrialisation of Russia an overwhelming success (La Porta, 2002).

The government can be involved in the financing of enterprises in a number of ways: it is in a position to provide subsidies directly; it can enable private banks to lend to politically desired projects through regulation; or the government may own financial institutions partially or completely. The advantage of owning financial institutions outright in comparison to regulating banks or owning projects in full is that ownership gives the government considerable control over the types of projects being funded whilst the implementation of the projects is left to the private sector. Therefore ownership of banks encourages the government's goals in both views, the "development" and the "political" theories. In the development view government ownership gives the government the ability to collect savings and also direct them towards long-term projects that are usually shunned by private banks. Through this type of project finance the government removes institutional failures "undermining private capital markets, and creates aggregate demand including other externalities which in turn foster economic growth" (La Porta, 2002).

In regards to the political theory government ownership of financial institutions allows the government to fund inefficient but politically desired projects. In both views the government finances projects that would not be attractive to private financial institutions. "In the development theories, these projects are socially desirable. In the political theories, they are not" (La Porta, 2002).

Nonetheless, numerous development banks continue to be owned by the government today, in 2002 there was merely 11 privately owned development banks. The reason for this minute number is because the number of successful state-owned NDBs in existence today contradict the belief that NDBs owned by the government are naturally inefficient. Government ownership of banks can be efficient and enhanced when certain conditions are attached to them. This is further proved by successful national development banks in developed countries such as Germany, France and Spain as stated by Aghion (1999), (United Nations Department of Economic and Social Affairs, 2005).

1.1.4 African National Development Banks

Towards the end of the 1980s, development finance in Africa was provided almost exclusively by National Development Banks. During this period, African NDBs existed under a protected environment as was the case in most other developing countries. They enjoyed privileged access to government financial resources and held special relationships with the international donor institutions. They were not confined to the regulatory requirements imposed on private commercial banks as they functioned outside the financial regulatory frameworks of their countries (Banda, 2014).

The African continent is faced with widespread market failure in the provision of agriculture finance, housing finance, infrastructure finance including small and medium enterprise (SME) finance and therefore this leaves a strong rationale for the presence of well-functioning Development Finance Institutions. Therefore the immediate challenge is how to guarantee that NDBs are effectively used in Africa as counter-cyclical policy instruments while at the same time ensuring that they play a vigorous role in the provision of financial access (Calice, 2013).

The continent holds more than 140 Development Finance Institutions (DFIs) these are made up of a wide spectrum of institutions, which include government owned deposit taking and non-deposit taking development banks, insurance companies, plus guarantee funds only to name a few. Their common feature is in the form of a policy mandate to “foster economic development” in the areas in which they operate (Calice, 2013).

The researcher further adds that African DFIs are in a position to make important contributions to lengthening maturities in the financial industry and gather resources for the underserved in various segments of their economies.

In Africa like in most other emerging markets long term credit finance is not easily accessed, as private commercial banks are unwilling to take on the extra risk of financing long term projects because of the information asymmetry that exists between the borrower and lender. Diamond (1991) states that if full information existed in regards to the creditworthiness of companies, banks would most probably not exist. As all finance would consequentially be “direct finance” because lenders would fund enterprises directly with no need for banks (United Nations Department of Economic and Social Affairs, 2005).

Most countries in Africa do not have developed capital markets that would act as an alternative from private commercial banks to finance infrastructure and long term projects, especially socially viable projects that do not possess any profitability potential. Hence the important need to have fully operational NDBs on the continent that are sustainable and Profitable.

Mullineux and Murinde (2014) have contributed to the body of literature supporting development finance institutions in Africa by stating that multilateral and national development banks can assist by filling finance gaps in the financial sector in Africa. The gaps emanate from market failures and are eventually filled by the development of the financial sector. The authors go on to add that development banks can contribute to the development of the economy by providing finance for infrastructural development, but advise that development banks should progressively withdraw their financing, as the gaps close and the equity and bond markets develop.

Mullineux and Murinde (2014) continue by stating that whilst awaiting the development of domestic capital markets, NDBs continue to play an important role to help fund infrastructure projects and long-term investments. The researcher’s further point out that governments in developing countries will continue to use the development banks to access international capital flows by engaging in co-financing facilities prior to the development of fully functioning capital flows. Mullineux and Murinde (2014) also state that as providing long-term finance to large enterprises reduces in importance as a result of access

to capital market increases the NDBs should adjust their mandates according to the changing environment.

Literature on African DFIs is limited, according to Calice (2013) “to the best of our knowledge there is no specific assessment of the African DFI landscape. In particular, very little is known about the corporate governance arrangements and risk management systems of African DFIs”. It is vital that the areas that hinder the performance of DFIs are studied intensely as Calice (2013) continues by stating that existing research points to the fact that weaknesses in these areas are the chief causes of historically poor performance of these banks.

Corporate Governance as mentioned above has been found to be responsible for most of the problems and challenges faced by NDBs, therefore it is vital that in-depth studies are carried out in this area, more so in Africa where limited studies have been conducted in the area. Rudolph (2009) and Luna-Martinez and Vicente (2012) and Scott (2007) have carried out studies that include some African National Development Banks, but these also encompass NDBs from other parts of the world and not specifically focused only on Africa.

Some researchers have pointed out the reasons behind the failures of African NDBs such as De Aghion (1993) who associates failures of African NDBs to extremely high Non-performing loans (NPLs) which is aligned to poor cost-benefit evaluation and worsened by misplaced Government Intervention (Thorne, 2011).

1.2 Problem Statement

The study seeks to investigate the causes and effects of Weak Corporate Governance that hinder the successful performance of African National Development Banks. Ownership of Development Banks is virtually dominated by the National Government with some private sector shareholding and are usually susceptible to governance interferences. According to Calice (2013) an estimated 33 percent of African National Development Banks constitute a board of directors composed of a majority of government representatives and the author further adds that 42 percent do not have an established transparent board nomination process ensuring the directors have the technical ability to perform their roles. Banda (2014) states that 71% of African NDBs have broad mandates, which are easily influenced by the national government. According to Gutierrez et al (2011) and Yeyati et al (2004) having a clear and narrow mandate keeps NDBs focused on their goals and prevents “mission creeps” from the government.

The Board is responsible for credit decisions and therefore needs to have the capacity to make decisions that contribute to the profitability and sustainability of the Bank. However a majority of African NDBs have non-performing loans above the 15% standard threshold specified by the Association of African Development Finance Institutions (AADFIs) (Asfaw et al, 2016). This financial under performance is aligned to poor cost-benefit analysis and worsened by Government interferences. As a result the NDBs are not profitable and struggle to efficiently deliver on their policy mandates. This in turn leads to Banks that underperform, are unsuccessful at fore filling their social and developmental goals resulting in unsustainable development banks.

It is important to understand what causes African National Development Banks to underperform from a Corporate Governance view point which has been found to be the root cause of the major challenges encountered by numerous NDBs.

The preceding pages gave the contextual background to the research area and brought out the problem, as summarised below:

- National Development Banks play an intermediary role in the financial sector by performing two main functions, providing long term finance to enterprises and infrastructure projects and in doing so prevent market failures to those sectors in the

economy that have limited access to finance. Secondly they play a counter cyclical role in times of financial volatility. These roles allow them to foster financial and economic development.

- Research finds that the NDBs tend to be associated with negative impacts on the economy with limited contributions to development. However there are a number of successful NDBs that defy this finding as they are able to perform their developmental functions as well as remain profitable.
- Weak Corporate Governance is identified as the main cause of underperformance in NDBs causing problems such as the mismanagement of resources; political interference; and the absence of a clearly defined mission. Other problems identified are inadequate cost-benefit appraisal of projects, high Non-performing loans, financial problems, weak performance, broad mandates, unjust competition with the private sector and the NDB being captured by interest groups.
- Governance in NDBs is usually more challenging than in private banks, this is as a result of the structure of Development Banks being more complex in nature as it involves a larger number of stakeholders which includes the government, legislator and includes one or more government ministries.
- Government interferences is one of the key causes of problems in NDBs. This can be mitigated by establishing good corporate governance which in essence prevents the government from influencing credit decision making.
- NDBs operate through two broad views, a development view which aims to foster economic growth through the financing of social developmental projects and the political view which is seen as politicians controlling NDBs to promote their own political motives instead of social goals.
- NDBs should be organized as corporations and include private sector participation to increase corporate governance standards. The Banks need to be created under a well-defined law and must appoint board of directors with a separate management. The law must state a regulatory function that is independent of management, board of directors and shareholders.
- Well performing and sustainable NDBs have achieved their success by having well-defined mandates; identifying and mitigating market failures; using innovative instruments to adapt to evolving surroundings and carrying out good corporate

governance. Therefore Government ownership of banks can be efficient when the relevant conditions are attached to them.

- Government owned banks show increased lending patterns in election years and that these banks fund the government at a higher degree compared to private banks in developing countries
- Africa has market failures in the financial system that NDBs are able to correct by filling the finance gaps, however this financing must reduce as these gaps close and equity and capital markets develop.

1.3 Purpose and Significance of the Research

Literature provides evidence that a large number of state-owned financial institutions fail to deliver on their policy mandates. Rudolph (2009) states that, state-owned banks have underperformed and consequently have had an adverse impact on economic growth; La Porta et al. (2002) also adds that government owned banks are considered to provide lower economic growth with lower productivity to the economy, coupled with slower financial development to the countries financial sector. Rudolph (2009) reports that the underperformance of these banks is associated with a lack of a precise and clear mandates and weak corporate boards and management as a result of government intervention.

Overall the majority of the studies undertaken are mostly based on state-owned financial institutions Dinc (2005); La Porta et al (2002); Khwaja and Main (2005); Cole (2009) and not specifically on national development banks. The term state-owned financial institution includes an extensive array of financial institutions, namely commercial banks, insurance companies, postal banks, credit guarantee funds, leasing firms and development banks. The development banks which are also referred to as Development Finance Institutions (DFIs) or policy banks are the largest in the sector and are peculiar type of lender (Luna-Martinez and Vicente, 2012).

They differ from the banks highlighted above which usually offer generalized lending comparable to private banks. As mentioned above National Development Banks specialize in long-term lending with a clear mandate to foster economic development. Lazzarini et al (2014) states that Development Banks are a specialized type of lender whose lending requires specialized skills, with a clear mandate to foster industrial development.

And yet regardless of the critical nature of their role they are few in-depth quantitative research papers on their operations and behaviour. Most of the work done is either theoretical Bruck (1998); Armendariz de Aghion (1999); Amsden (1989); Aronovich and Fernandes (2006) or is based on qualitative case studies Fordwor (1981); Amsden (1989); Amsden (2001); Rodrik (2004); Ndongko (1975) (Lazzarini et al, 2014).

Regardless of their importance there is scarce literature on African National Development Banks. Calice (2013) points out that current studies are either based on case studies or take a cross-country viewpoint as indicated by De Luna-Martinez and Vincente (2012).

Very little is known about why most African (NDBs) perform poorly and particularly how corporate governance arrangements and risk management systems impact these banks. Calice (2013) points out that further study of these two elements is important, as existing literature suggests that Corporate Governance and Risk Management frameworks are the main detriments to the historical underperformance of Development Finance Institutions and more specifically National Development Banks.

Banda (2014) adds by stating that there are no specific studies on African NDB landscape particularly very little is known about their mandates, corporate governance arrangements, financial performance, risk management systems, legal and regulatory environment and policy. The researcher states that it is critical that research is done in these areas as studies by Thorn (2011), World Bank (1976) and Boskey (1961) have pointed out that weaknesses in these areas are the main hindrances of the poor performance of DFIs historically.

It is therefore of at most importance to carry out studies on the reasons for the underperformance of African NDBs, as 65% of African NDBs recorded non-performing loans (NPL) above the acceptable average of 15% threshold as specified by the Association of African Development Finance Institutions (AADFIs). This is an indication of a poor loan book which according to Calice (2013) stems from weaknesses in areas such as corporate governance and risk management. The current challenge is how NDBs can be used as an effective counter-cyclical policy instrument (Calice, 2013).

Caprio and Levine (2002) state that Corporate Governance of banks in developing countries has received limited attention by researchers. It is only recently that the topic has received

enormous attention in literature, Lin (2001); Oman (2001); Malherbe and Segal (2001); Goswami (2001).

Luna-Martinez and Vicente (2012) examination of a survey undertaken by the World Bank in 2009, found that the World Bank has over the years received an increasing number of requests from various NDBs on data and recent studies about NDBs. Such requests are encouraged by ongoing efforts by various Governments in a number of countries to strengthen their NDBs by making them become more profitable and financially sustainable institutions, protecting them from political interference and bringing on board innovative governance systems and arrangements.

This type of request for information which is focused on insulation from political interference, sound governance systems and profitable sustainability are at the core of the success for NDBs, hence the high demand for information in this area.

Therefore the study will be used to understand what causes weak corporate governance in African National Development Banks and the effects this weakness has on the successful performance of African NDBs. Data from the Development Bank of Zambia (DBZ), an African National Development Bank will be used to carry out the study. Governance of National Development Banks varies on a case by case basis, nonetheless with ample caution it is conceivable to draw broad lessons from the findings based on DBZ.

The study will provide suggestions on how to strengthen corporate governance in African NDBs, insulating them from undue political interference and letting them become profitable institutions that are financially sustainable. The study is mainly quantitative in nature, as the data to be used for the analysis is financial. The measuring statistical tools are regression analysis and time series analysis. The methodology approach is based on case study research method.

As Government interference has been identified in the contextual background as one of the main causes of problems in NDBs and is prevented using good corporate governance; the study will use election years as a means to measure government intervention and political interferences in these banks. A number of researchers have studied politically motivated lending focused on election years, as they agree with Dinc (2005) that this isolates the

effects of other political influences by focusing on one political event. This brings out clearly the political motivation and therefore eliminates any doubt regarding the intention of political influence.

1.4 Research Questions and Scope

In accordance with the preceding contextual background and the academic work in the literature review that follow, the study will narrow the scope by focusing on the following research questions:

Question 1 - How does weak corporate governance affect the successful performance of African National Development Banks?

Question 2 - What are the causes and effects of weak corporate governance in African National Development Banks?

The scope of the study is limited in two ways. It is focused on examining African National Development Banks corporate governance practices and therefore the findings will not be generalised to those NDBs located in other parts of the world. Also regardless of the study pointing out other causes of failure besides Corporate Governance, such as Risk Management affecting the underperformance of African NDBs, the study will not measure their impact on the performance of the Banks.

1.5 Research Objectives

In broad terms the objective of the study is to identify the causes and effects of weak corporate governance on the performance of African NDBs and specifically the study tries to achieve the objectives listed below:

Objective 1 - To establish how Weak Corporate Governance affects the successful performance of African National Development Banks.

Objective 2 - To investigate the causes and effects of Weak Corporate Governance in African National Development Banks.

1.6 Research Hypothesis

In accordance to the preceding contextual background and the academic studies contained in the literature review that follows the study will investigate the following hypothesis:

Hypothesis

Null Hypothesis (H0): Weak Corporate Governance impairs the successful execution of National Development Banks Policy Mandate.

Alternative Hypothesis (H1): Weak Corporate Governance does not impair the successful execution of National Development Banks Policy Mandate.

1.7 Research Assumptions

Research “assumptions are so basic that without them the research problem itself could not exist” (Leedy and Ormrod, 2010). You must validate that each assumption made is undoubtedly true or else the study cannot advance (Simon, 2011).

Two assumptions have been made for this research. The first one is that focusing on a political event such as an election isolates the effects of other political influences. This clearly brings out the political motivation and as a result eliminates any doubt regarding the intention of political influence (Dinc, 2005).

Secondly, as economies and government capacity differ across countries and over a period of time, the involvement of the government in the financial sector also varies on a case by case basis. Nonetheless it is assumed that with ample caution it is conceivable to draw broad lessons for policy makers from a varied number of analysis and experiences (Martin Cihak and Asli Demirguc-Kunt, 2013). The lessons drawn from the sampling of data will be in the Methodology section and will be used as a guide for other African NDBs.

2 LITERATURE REVIEW

There are varied questions as to whether National Development Banks should continue to be in existence or not? Literature asks the question should the government play a role in the banking industry and if so should the government own banks directly or intervene through regulations and subsidies? These are highly controversial matters in development economics. Some policy makers and economists answer with a strong “yes” claiming that government ownership of banks is required to foster economic and financial development; while others with an opposing view argue that government ownership of banks depresses and stunts financial development and economic growth (Yeyati et al, 2004).

These questions are justified because of the overwhelming evidence found on the underperformance of these banks as mentioned earlier and yet there are also numerous NDBs that are successful and in some cases outperform the private commercial banks. Hence the argument on their presence and role in the financial industry.

Bank-level research suggests that in Russia and Germany government owned banks are more efficient than private commercial banks. There is further evidence found in China, which demonstrates that “government owned banks dominate the banking system”. This indicates that these banks contributed to the promotion of economic growth by enhancing productivity and growth for the enterprises they financed (Andrianova, 2010).

Therefore it is evident that NDBs can make valuable contributions to mitigating market failure and add to the growth of the financial industry and the economy as a whole.

The important question to ask is how can those NDBs that underperform be made to improve on their performance? More especially those found in emerging economies such as Africa. How can these banks emulate best practise from successful NDBs in the area of Corporate Governance? Which according to literature found in the contextual background points to this practise as the main cause of their underperformance.

2.1 Definition and Evolution of National Development Finance Institutions

2.1.1 Definition of National Development Banks

Luna-Martinez and Vicente (2012) defined National Development Banks as banks or financial institutions that have at least 30 percent equity that is state-owned with a precise legal mandate to target socioeconomic goals in a given region, sector or a particular market segment.

Literature on the definition of development banks is diverse however a salient feature defining these banks overall is their focus on long-term finance to projects that promote development. This characteristic has stayed with NDBs since after 1945 and continues to be of prime importance till today. National Development Banks support and finance enterprises in the private sector, largely for medium and long-term industrial projects (Diamond, 1957 and Boskey, 1959). Two other researchers describing the long term financing nature of development banks are Kane and Panizza. According to Kane (1996) they are described as “a financial intermediary supplying long-term funds to bankable economic development projects and providing related services”. Panizza (2004) incorporates externalities in the description, by stating that national development banks are “financial institutions primarily concerned with offering long-term capital finance to projects generating positive externalities and hence underfinanced by private creditors” (Luna-Martinez and Vicente, 2012).

Lazzarini et al (2014) in determining what development banks do agree with the researchers above and point out that the main feature of development banks is in essence long-term financing. The researchers continue and report that unlike state owned commercial banks whose focus is on generalized lending closely related to private bank lending, national development banks specialize in lending over long periods for industry growth and promotion of new industries.

Other definitions are Scott (2007) who defines NDBs as institutions that are regarded to be financed largely by non-deposit capital, such as loans from the government, including long term loans from multilateral institutions and bonds from international and local capital markets.

Gutierrez et al (2011) adds that development banks should practically be effective and efficient national government policy instruments being run as commercial- quasi entities, striving to fill

both long-term structural gaps and short-term cyclical gaps. The researchers further states that the role of development banks is to mitigate market failure that stems from a number of sources, including asymmetric information that may deny access to finance especially for first time borrowers and socially valuable projects that do not reflect financial profitability.

The United Nations Department for Economic and Social Affairs UN-DESA (2005) refer to the development banks as “financial instruments of national development policy whose performance is measured more in terms of social benefits generated than in terms of social (economic) and private (financial) returns. Development banks are organized to achieve the preparation, appraisal, financing, implementation, and evaluation of investment projects and programs. UN-DESA (2006) further adds to this description by stating that these banks are “financial institutions primarily concerned with offering long-term capital financing to projects generating positive externalities and hence underfinanced by private creditors.”

Therefore as demonstrated above the long term nature of Development Bank financing of credit is evident in all descriptions above stated by a large number of researchers, including those in recent times.

Broadly development banks can be described as institutional public policy tools created by National Governments to service the financial industry by providing long term credit to correct market failures in times when the financial market is unable to adequately service the financial system. Therefore the role of development banks is twofold firstly to tackle market failure in the financial industry by supporting projects that are unable to access financing from private financial institutions and secondly to play a counter-cyclical role in times of financial downturns.

Development banks come in three forms International, Regional and Sub-national (Doctor, 2015). The focus of this study is on National Development Banks (NDBs) which is the precise definition of the type of banks the research is based on.

2.1.2 Evolution of National Development Finance Institutions

A United Nations Department for Economic and Social Affairs UN-DESA (2005) study “Rethinking the role of national development banks” reports that subsequently after the II World War, the scarcity of long-term funding for investment projects stimulated a number of countries to use public funds and create Development Finance Institutions (DFIs) to help fill a financing gap. The specific stages of this evolution included “development finance companies” (public entities with non-banking activities), development funds (special funds from the central bank), ending with what is now known as National Development Banks.

The report continues that the role of Development Banks has evolved over the past decades, in the 1950s there was a clear world view that these Banks were needed in the economy, this concept changed over time when they were seen as creating more distortions and inefficiencies, and this eventually evolved into a more varied view of “market friendly interventions”. The 1980s and the late 1990s saw the banks go through a period of liquidations and privatisations in a number of emerging markets with restrictions to resources. This was essentially a reflection of their underperformance and whether or not they were needed to help develop the private financial industry.

The DBs also underwent restructuring, strengthening their governance to ensure the sustainability of the institutions.

2.2 Counter-Cyclical Role of Development Banks

The body of literature on development banks points to another source of market failure that justifies the role of government intervention in the financial credit market (*Gutierrez et al, 2011*).

This is the counter-cyclical role that development banks play in the financial market. According to Levy et al. (2004) private banks reduce their lending during periods of economic downturns and when the market experiences low interest rates. This type of market failure provides incentive for development banks to ensure continued lending by providing credit to the economy when it needs it most as the private sector cuts back its lending.

The retraction of investments by foreign investors in developing countries due to the global financial crisis had a devastating effect on these countries vulnerable economies. As a result of the turbulent risky environment, private banks curtailed their lending leaving enterprises with little or no access to credit finance worsening the economic downturn. This resulted in governments turning to development banks as a countercyclical source of credit finance for continued availability of finance to enterprises during the recession (Thorne, 2011).

Gutierrez et al (2011) adds that by Development Banks (DBs) acting in a counter-cyclical manner to mitigate financial instability, increase their lending to viable enterprises and projects. In doing so they are in a position to make profits as the economy recovers. The researchers find that this prevents them acting as lenders of last resort which involves supporting companies that are unviable in order to prevent closures of the companies and layoffs. The researchers adds that lending to unviable enterprises creates high financial risk on the national treasury and brings distortions to the countries business landscape.

It should be noted that risk management structures need to be adequately in place to support additional business as the DB performs its counter cyclical role. This will ensure that financial stability of the bank is not compromised. To perform this role well the shareholders need to be in a position to increase the capital required for lending (*Gutierrez et al, 2011*).

An interesting finding reported by Luna-Martinez and Vicente (2012) in a survey undertaken by the World Bank in 2009, on the counter-cyclical role of DBs is that the period between the end of 2007 and towards the end of 2009(during the financial crisis), the loan portfolio for DBs rose from USD 1.16 trillion to USD1.58 trillion dollars. This is a 36% growth in a space of three years, and is a major increase compared to the 10% increase by private bank lending. The DBs in the survey took on a countercyclical role and increased their lending to both existing and new clients to contribute to the mitigation of the financial crisis.

As mentioned above an efficient risk management framework needs to be in place, when the NDB plays its counter cyclical role, and the new credit extended during this period must be assessed to ensure that the NDBs financial sustainability is not at risk.

2.3 Efficient Performance of National Development Banks

A wide number of countries around the world have benefited from the role of National Development Banks. The industrialization in Europe, Latin America and East Asia involved credit from development banks. They played a central role as reported by wide literature Rodrik (2004); Amsden (2001); Cameron (1961); Aronovich and Fernandes (2006). They differ from multilateral banks that have shareholding from a number of different governments; as mentioned previously instead these are government-owned development banks, controlled by the countries government and have a mandate to support local business operations (Lazzarini et al, 2014).

These banks in recent times continue to play an important role of providing credit in developed and emerging markets. In the year 2012, the China Development Bank, Brazil's BNDES and Germany's KfW all being national development banks had impressive loans extended of 12.4%, 11.3% and 15.5% respectively of their countries GDP as stated by Ferraz, Alem and Madeira (2013) (Lazzarini et al, 2014).

However it must be noted that regardless of the size of the loans given out being substantial it is also important to measure the type of impact that the loans have on the economies of the respective countries. Are they achieving their objective of supporting social developmental projects with developmental externalities? Otherwise the allocation of funds maybe misplaced as according to Lazzarini et al (2014) credit misallocation may happen in national development banks when these Banks service companies and projects that can afford to obtain credit from Private Banks but instead borrow from them to benefit from the subsidies they offer.

2.4 Inefficient Performance of National Development Banks

Thorne (2011) states that National Development Banks have a long history of failure particularly in developing countries, in the 1970s and 1980s a number of governments in developing countries created development banks based on the success of Development Finance Institutions (DFIs) that were established after the second world war in developed nations. As attributed to by both Yaron (2004) and Thorne (2011) these Banks were poorly managed with wasteful spending contributing to fiscal crises in a vast number of developing economies, this poor performance gave rise to minimal delivery on economic development.

De Aghion (1993) identifies the failures of African NDBs to high Non-Performing Loan ratios with poor cost-benefit evaluations which is heightened by poor Government intervention of mismanagement and wide spread corruption.

Luna-Martinez and Vicente (2012) state that a number of the challenges commonly associated with State Financial Institutions, which also include Development Banks are in areas such as wide mandates as described above, financial problems, weak performance and unfair competition with Private Financial Institutions.

The authors conclude by highlighting the challenges identified from their findings of their 2009 World Bank Survey of NDBs, it was found that:

- 71% of NDBs highlighted that their most critical need was to improve their risk management operations. This demonstrates the struggles faced throughout the credit cycle.
- The second most important challenge was that 59% of NDBs identified the need to become self-sustainable on a financial basis. This is a reflection of their need to reduce their dependency on the National Government and instead improve on their profitability.
- The third challenge was that 50% of the Banks reflected the need to make improvements on their corporate governance practices and their transparency as an organization. Most research will point to the fact that corporate governance should be the first priority challenge identified, as according to Scott (2014) numerous problems associated with DBs can be credited directly to corporate governance weaknesses. Therefore once corporate governance is corrected all other challenges will follow suit.
- The fourth challenge was that 40% of the NDBs surveyed revealed the need to have the flexibility of recruiting and retaining staff that are highly qualified and the
- The fifth challenge was the need to decrease political interference, 31% NDBs indicated this need.

2. 5 Corporate Governance in National Development Banks

2.5.1 Corporate Governance Definition

Scott (2014) and Luna-Martinez and Vicente (2012) both define Corporate Governance as “the process and structure for overseeing the direction and management of a corporation so that it carries out its mandate and objectives effectively”. Luna-Martinez and Vicente (2012) go on to state that Good Corporate Governance is an important aspect to the success of a NDB.

The Cadbury Committee first introduced the principles of Corporate Governance in 1978, they have evolved and sharpened since then. The Committee's definition of corporate governance is defined as “the system by which companies are directed and controlled”. The simplistic definition of the Cadbury Committee has since been adopted and enhanced to fit into the ever developing world of business. The regulatory bodies of countries around the world have adopted the principles by publishing them in their own codes to fit their environments (DFCC Bank, World Bank Report, 2007).

The most dominant feature in the definitions of corporate governance is the description of the intertwined relationships of the various stakeholders involved in an institution or enterprise.

This is evident in the Organization for Economic Cooperation and Development (OECD) definition of corporate governance. The OECD principles of corporate governance, OECD 2015 report defines corporate governance as “a set of relationships between a company's management, its board, its shareholders, and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring.”

This definition of Corporate Governance by the OECD principles provided above is broad and is intended for financial and non-financial publically traded enterprises. The OECD principles however also provide particular guidelines of corporate governance on enterprises that are state-owned. As the Government is both the owner and regulator of these institutions, the principles are directed precisely on the conflict of interest that this creates (Thorne, 2011).

As per (OECD, 2004:6), the principals provide guidelines for the Government to be an “informed, accountable and active owner”. The guidelines request the following:

- “ensure that its ownership role does not distort its policy decisions”
- “create a clear and simple set of legal rules governing state-owned enterprises”
- “make the developmental roles of these institutions and any funding for such roles clear and transparent”
- “ensure that state-owned institutions do not enjoy special privileges.”

2.5.2 Structure of Corporate Governance in National Development Banks

DFCC Bank, World Bank Report (2007) suggests that the whole essence and substance of the idea of corporate governance is to strike a balance between accountability and power. The regulations that are incorporated in the interrelationships amongst the main stakeholders in the organization who are made up of the “shareholders, the board of directors and management create the core structure of corporate governance.” The structure has a hierarchy beginning with the shareholders, who go on to elect the board of directors, the directors perform the role of trustees and represent the shareholders. The board of directors carry out their fiduciary functions and hire the management of the company, including the Chief Executive Officer. The daily operations are performed by management. The report highlights the dilemma of managing the day to day operations which involve making decisions and taking actions that may put the organization at risk while being supervised by the board; in essence this is the core of the corporate governance dilemma

Both Luna-Martinez and Vicente (2012) and Scott (2007) support Gutierrez et al (2011) quoted earlier that the governance in NDBs is usually much more challenging as compared to private financial institutions. This is evident from the ownership structure of NDBs which is complex compared to commercial banks and other private financial institution. As these banks maybe owned by an enormous number of government institutions made up of ministries of finance, housing, agriculture, labour, housing, only to name a few and sometimes may include the legislature. As expected these units have their own expectations which are sometimes conflicting on how the NDB ought to carry out its goals and objectives.

Therefore as illustrated above by Gutierrez et al (2011) and Yeyati et al (2004) and echoed by Luna-Martinez and Vicente (2012) when the mandate of NDBs is broad and defined generally, this leaves room for some elected politicians and government officials to influence the activities of the NDB and the direction it should take.

And as pointed out by both Martinez and Vicente (2012) and Calice (2013) it is therefore imperative that the institutional framework of the NDB is strong in order to resist unwarranted political pressure. Otherwise the NDB is open to political interference and maybe seized by interest groups enforcing pressure for the Bank to take on excessive credit risks, resulting in financial losses in the future for the NDB.

2.5.3 Board of Directors

When the shareholders appoint a board of directors in essence they have acquired an instrument to control the managers of the enterprise ensuring that it is run in accordance to their interest (Jakob de Haan and Razvan Vlahu, 2015). The researchers find that the two most critical roles played by the board of directors are to monitor and advise the management of the company. When they play the role of monitoring the institution they supervise the managers of the enterprise ensuring their conduct is aligned with the interests of the shareholders. By the board playing the role of advisor they provide direction to the managing team to make informed strategic operational decisions.

(Mehran *et al* (2011) states that having a large board is found not to be in the interest of the shareholders. This is because large boards reduce the value of the enterprise as a result of the free-rider problem. Adams and Mehran (2012) add that external directors are usually more effective to monitor the management of the enterprise as they are less indebted to management and are better suited to bring on board a different perspective to resolve various issues the enterprise faces.

Luna-Martinez and Vicente (2012) global survey of development banks in low and middle-income countries found that on an average basis the boards of most NDBs are made up of 8 members and 22% of those surveyed have 10 or more board members represented on their boards. The results of the survey showed that a majority of these boards are composed of a majority of government representatives. These government officials usually represent different

ministries such as ministry of finance, housing, trade, labour, social affairs and they may also include central bank representatives. However as high as 75% of NDBs allow independent non-government officials to participate on their boards. Only 30% of the banks surveyed allow majority of independent board members on their boards. And only a few cases allow their boards to be composed of entirely independent board members.

2.6 Specific Governance Challenges faced by African National Development Banks

According to the Association of African Development Finance Institutions (AADFI), Prudential Guidelines the three areas of Operational Mandate, Financial Capitalization and Governance are the most problematic areas that have proven to be a challenge for African NDBs.

Calice (2013) observations of the results for the 2011 peer review process of the Prudential Standards, Guidelines and Rating System for African NDBs, which involved the study of 33 African NDBs in areas of Governance and Risk Management had the following findings in regards to Governance:

The researcher found that 45% of African NDBs are neither supervised nor regulated by their countries reserve bank or any other financial sector regulatory body.

It was also observed that 50% of African NDBs do not have a signed performance agreement with the government that captures the mandate, objectives including the NDBs strategy and targets. This may led to political interference by government intervening using distorted policies as observed above, as there are no signed agreements on the deliverables of the NDB. The study also found that 79% of African NDBs do not have a clearly defined development criteria as part of their investment plan, as a result their investments are poorly aligned to their countries National Development Plan.

According to Calice (2013) one of the contributing elements to the poor performance of most African national development banks is poor corporate governance structures, Scott (2014) strongly supports this finding as indicated above, as 42% of African NDBs surveyed do not have a well-defined board, with a transparent board candidature nomination process. This hinders the board of directors to efficiently perform their roles. As stated earlier 33% of NDBs found in Africa have a board of directors where government appointees make up the majority of the directors (Calice, 2013). The researcher goes on to state that up to 70% of the 33 surveyed

do not have a system in place to provide incentives for performance. It was further found that in 45% of the Banks, Government approval is necessary in a minimum of one area of operations.

Calice (2013) finds that African NDB's "compliance with best practices in corporate governance needs improvement in a number of areas". Specifically there is need to firstly improve the supervisory and regulatory structure in order to separate ownership from control; secondly there is a need to strengthen and reinforce the framework defining the mandate, objectives, strategy and targets of the NDBs; thirdly the selection process and the appointment of the board of directors needs improvement plus there is a need to reinforce the Boards role.

Scott (2007) finds that numerous problems related with State Financial Institutions (SFIs) can be associated with or entirely attributed to weaknesses in corporate governance. The researcher identifies some of these problems which are highlighted below:

- Government Influence - National government officials acting in the capacity of the shareholders (the minister to whom the NDB reports to or other individuals) directly interfere in day-to-day operations which include making decisions as sensitive as, who to lend to, the terms of lending and when to forego an unpaid debt.
- Weak Management Systems – Executive managers acting with undue autonomy, pursuing unplanned objectives and acting contrary to sound business management principles.
- Weak Board – NDB Board members do not have the experience and professionalism to properly carry out their duties and lack independence.
- Poor Reporting – Financial and non-financial reporting of internal and external reports is not accurate and is incomplete. Therefore the reporting does not provide accurate basis for decision-making by the executive managers and is misleading to the national government who are usually the shareholders, the legislature and the general public.

Scott (2007) goes on to state that the result of the problems mentioned above can be devastating to the performance of a NDB and the surrounding financial system in which it exists. As these problems do not only cause losses, they create an extremely inefficient NDB and also weaken the financial system in the country. The researcher finds that poor corporate governance leads to the NDB under-pricing risk associated with investment projects and may displace the delivery of commercial financial services by the private financial institutions. It may go on to

hinder the entrance of new private financial institutions into the market and undercut competition.

2.7 Clear and Precise Mandates of a National Development Bank

Clear mandates increase the accountability of management and the board of directors and assists with monitoring the performance of the NDB. The mandate should preferably be specified in the law that created the NDB, this will highlight the significance of continued focus on the NDBs policy objectives (Gutierrez et al, 2011).

Both Gutierrez et al (2011) and Yeyati et al (2004) point out that having a narrow and clear mandate prevents deviating from the goal and objective of the NDB and prevents “mission creeps” from the Government.

Gutierrez et al (2011) states that failure to outline their objectives is one of the key problems of NDBs. Numerous countries struggle to justify the need for NDBs. In many instances the NDBs are a “legacy from past administrations that retain political power to stop any attempts of reforming them”. In other instances the government maintain the NDB in order to influence subsidies to factions of interest through the NDB. Also the NDB can concurrently finance activities that are not related to the objectives of the NDB with “cross subsidies from profitable sectors of the NDB”. The researcher continues that to gain market share using these profitable businesses, the NDB will offer interest rates below the market. This results in crowding out the private banks and creating titanic and fragile NDBs that are extensively dependent on the government for support.

Yeyati et al (2004) adds to the concept of having a clear and precise mandate by reporting that while NDBs with a general mandate maybe in a position to achieve more in terms of “economies of scale and scope” as compared to NDBs with narrower mandates, NDBs with well-defined mandates are less affected by “mission creep and conflicting objectives”. A precise mandate can also inhibit managers of the NDBs from interchanging from trying to fulfil their mandates and pushing to maximize profits. However the researchers continue by stating that having a well-defined objective is not essentially in conflict with striving to maximize profits or becoming self-sustainable.

According to Banda (2014) of the NDBs surveyed in the Southern African Development Cooperation (SADC) region, 29% of them have a narrow mandate, these banks have specific policy mandates designed to support specific sectors such as housing, agriculture and the SME sector. Examples of the NDBs with this type of mandate are the Agri Bank of Namibia, Botswana Housing Corporation and the Land and Agriculture Development Bank of South Africa. The rest of the 71% NDBs in the SADC region have broad mandates which support a wider range of operations and sectors. These banks include Development Bank of Zambia (DBZ) which provides loans to enterprises, participates in joint venture partnerships in the form of equity or loans and facilitates the administration of special funds and covers a wide range of sectors. These include agriculture plus its sub-sectors of agro-industries, fish farming and forestry, tourism, manufacturing, mining and haulage.

Development Bank of Mauritius (DBM) also has a broad mandate dealing in sectors such as manufacturing, agriculture and SME financing and Information Technology in areas of diversification and modernization. The Industrial Development Corporation of Southern Africa (IDC) also has a broad mandate, which entails facilitating, promoting, assisting and guiding the funding of new industries and expansion of these industries, including modernization and improved organization of new industries

Luna-Martinez and Vicente (2012) exemplify this notion by stating that when the mandate is only mentioned in broad and general terms it is exposed to interferences, as elected politicians or high-ranking government officials have the ability to influence the activities and direction of the NDB. Unless if the institutional framework of the NDB is resilient enough to resist undue political pressure, the NDB may become exposed to political meddling or could be seized by interest groups putting pressure on the Bank to take on extreme credit risks resulting in financial losses in the future for the NDB.

Having a clear and precise mandate is crucial for the survival of the NDB, it can be seen as the blue print of the institution, directing the actions and decisions of the Board and management to meet the gaps in the economy that need to be addressed. As mentioned above broad mandates encourage influences that may result in the NDBs performing activities that are meant for the private financial institutions which may result in crowding out the private banks.

Gutierrez et al (2011) adds that it is also necessary for the mandates of NDBs to have flexibility in order for these banks to adapt its financial products to the needs of the market. Though, the arrangement of the financial system and the point of institutional development of the country must be considered when determining the kind of activities allowable for the NDB.

Rudolph (2009) points out the need for the government to identify the market failure it is trying to solve before creating a NDB. The market failures are normally related to the absence of financial support to identified groups of the population. An example is the SME sector, agriculture and infrastructure sectors.

The researcher continues that market failures may stem from private banks not having sufficient savings to support the sectors mentioned above and in some cases they do not want to take on the high risk that comes with financing infrastructure projects that are normally long term and therefore pose an increased risk.

Thorne (2011) adds to having clear mandates by stating that NDBs need appropriate mandates to guarantee that they are correctly placed in the market in which they exist. The lessons learnt from experiences of development banking have provided evidence of disastrous effects emanating from inappropriate mandates. However countries such as Brazil, Malaysia, Rwanda and Canada have shown that NDBs with suitable and flexible mandates make positive contributions to development.

2.7.1 Periodic Mandate Review to Mitigate Out Dated Mandates

One method governments are able to implement in order to mitigate the mandates becoming obsolete are periodic mandate reviews. Over a period of time NDBs begin to perform activities and pursue objectives that were never intended by the shareholder representative or the government. Sometimes the NDB may remain focused on specific and clear mandate, however the changing market environment, “public policy objectives” and evolving customer needs may declare the mandate no longer appropriate for the needs of the economy (Scott, 2007).

Rudolph (2009) adds that considering that market failures are prevalent over time, it is imperative that governments periodically review mandates of government owned enterprises to

verify if the market is truly incapable of fulfilling the functions obligated by the government owned enterprises.

The researcher goes on to add that some countries have adopted policies that require such reviews to be carried out. An example is the Canadian Auditor General's report of December 2000 that reported the need for regular reviews of Government owned enterprises corporate mandates. The report highlighted that the government must outline guidelines for conducting regular periodic mandate reviews. The report suggested that the review be led by a shareholder representative, with external expert support. The reviews goal would be to evaluate the continued validity of the mandate plus an assessment of the cost-effective performance of the enterprise over time. It was recommended that the results be shared with Parliament and all relevant stakeholders in the Government Owned Enterprise accountability framework.

The Development Bank of Southern Africa based in South Africa, is subject to a "periodic internal and external" review of their mandate. The review carried out in 2007 included the whole development finance system which encompasses all government DFIs (Scott, 2007).

2.8 Government Involvement in the Banking Industry

Several well-renowned development economists such as Gunnar Myrdal, Arthur Lewis and Alexander Gerschenkron writing in the 1950s and 1960s were in overwhelming agreement in the state playing a major role in the banking industry. During this period Governments took on this view which saw them own 40% of bank assets of the largest banks in industrial countries and 65% of bank assets in the largest banks in developing countries (Yeyati et al, 2004).

In the years that followed, the 1980s and 1990s saw most banks privatized reducing government ownership of banks. Consequently from 1987 till 2003 over 250 banks underwent privatization and raised USD143 billion. However regardless of this privatization the researcher states that the presence of the government in the banking industry was still high and pervasive. The mid 1990s saw one quarter of the largest banks assets in the hands of the state in industrial countries and about 50% of assets in the largest banks in developing countries belonged to the state. It is therefore only fair to ask whether it is justifiable for the government to have such an immense presence in the banking industry (Yeyati et al, 2004).

A number of researchers have pointed out the need to have the government involved in the financial sector. It is therefore interesting to ask whether there is a justification for such a massive public presence in the banking sector.

Gonzalez-Vega (1995) argues that instances of asymmetric information where the private banks refuse to lend to those customers it does not know well, this prevents worthwhile projects from being funded, reducing investments in the economy. This is prevalent in the agriculture sector and therefore creates a market failure. Therefore in this situation it is suggested that national development banks are brought in to correct the market failure.

Andrianova et al (2010) contradict the finding that Governments cannot run Banks effectively. Their empirical findings which involved cross country data from 1995 to 2007 implies that on average ownership of banks by the government is associated with increased economic growth rates. Yeyati et al (2004) narrates the sentiments of a number of researchers including those described above who argue that government presence in the banking industry is vindicated by market failures and developmental objectives and goals. These supporters of government presence demonstrate that the banking industry differs from other markets and that government involvement can better improve the activities of the financial sector and the general functioning of the economy.

Dinc (2005) states that the issue of political influence will be higher at financial institutions than other government owned organizations for a number of reasons. Firstly, asymmetric information between banks and external stakeholders on the quality of an identified loan, allows the political intentions to be masked behind the loan. Secondly showing the actual costs of a politically inspired loan can be delayed until loan maturity. Thirdly other government owned organizations exist in a confined industry and limit the politician's ability to transfer funds, banks on the other hand are wide spread and conduct their business across the entire economy. This gives politicians an opening to move funds relatively easily compared to other sectors that may have entry barriers (Rajan and Zingales, 2003).

As evidenced by Dinc (2005), Caprio et al (2004), and La Porta et al (2002) numerous NDBs globally are associated with limited managerial capacity and are subject to government intervention in relation to credit decisions.

Government interventions in the operations of most NDBs is eminent, as Government is one of the owners and in some cases the majority or sole shareholder and therefore is in a position to intervene in the operations of the NDB. Scott (2007) points out that the ownership of any enterprise comes with the ability to have influence on the enterprise, acquire information, and partake in the profits of the institution. Scott (2007) further states that the main tasks attributed to the ownership of an institution include, participating in shareholder meetings and have voting rights on issues that are decided by the shareholders, including having access to information on the enterprise required to monitor and access the performance of the board of directors, management and the company as a whole.

As a result of the Government having influence on the NDBs, they are susceptible to political interference. Rudolph (2009) points out that political intervention is recognized as one of the key threats for a successful State Financial Institution (SFI). The researcher further adds that this is a result of non-independence of the board and top management with a lack of having transparent communication between the SFI and the owners. Rudolph (2009) continues by stating that National Governments are inclined to exercise their influence by using SFIs to satisfy their political ambitions over the short term at the expense of the financial sustainability of the DB and are not prepared to take responsibility for their actions.

Luna-Martinez and Vicente (2012) point out that as government owned institutions, NDBs are seldom faced with the risk of takeovers by other institutions. Therefore this revelation coupled with the lack of a comprehensive evaluation and monitoring framework, results in the management and board of NDBs to become increasingly tolerant of the “inefficiencies and weak performance” in NDBs. Therefore interventions by Governments in NDBs may be misplaced and may result in misallocation of funds and as a result negatively impact the bank’s profitability hindering the successful performance of the bank.

2.9 The Political Policy View and the Developmental Policy View of NDBs

2.9.1 The Political View

The political view in the literature of government owned banks is widely recognized. Andrianova (2010) states that the resentment towards national development banks reflects the hypothesis known as the ‘political view’. The researcher adds that according to this view NDBs are seen as banks created by politicians to be used for the benefit of their power by commanding them to lend to politically connected supporters and government-owned companies. This benefits the politicians by gaining votes and other favours.

The researcher finds that this hypothesis also suggests that government banks make poor lending decisions, resulting in nonperforming loans, slower economic growth and financial instability. La Porta et al (2002) provides evidence of the political view by utilizing cross-country regressions that show an adverse relationship between government owned banks and the average growth rates. The research predicts a 0.23% increase in “annual long run growth rate” per reduction in government ownership of banks by 10 percentage points; this is a significant effect.

The Bretton Woods institutions used the La Porta et al (2002) econometric findings to support privatizing government owned banks in developing countries (Andrianova, 2010).

Lazzarini et al (2014) adds to the political view and states that wide literature on the lending practices of state owned commercial banks, show results that are usually aligned with the “political view” these include research by Dinc (2005) and Sapienza (2004). The general finding of this literature is that state owned commercial banks generally misallocate credit by lending to companies based on political motives rather than on merit of the projects. The researcher continues that “the political view” causes lending by national development banks to result in credit misallocation caused by two main reasons. The first one is the “soft-budget constraint hypothesis”, which suggests that development banks may help enterprises that might otherwise fail. The second is the “rent-seeking hypothesis” which argues that politicians establish government owned banks to use development funds to finance their personal objectives instead of socially developmental projects.

Yeyati (2004) further adds to this finding by stating that some researchers on government owned banks suggest that market failures should be tackled by subsidies and regulation instead of direct government ownership of banks. The reason for their suggestion is because they find that the political view is at work in these banks. They point out that politicians establish and maintain government owned banks not to fund socially viable projects but instead allocate funds to benefit their political ambitions.

2.9.2 The Developmental Policy View

On the other hand, the ‘developmental view’ of NDBs which goes back to Gerschenkron (1962) as mentioned earlier, stresses the need for governments to boost financial economic development. Andrianova (2010) states that government ownership of banks helps resolve co-ordination problems that would normally prevent socially beneficial projects from being financed. More broadly, government finance can be more appealing than market finance when effective controls are in place or when “self-enforcing risk-sharing arrangements” in the economy are lacking.

Lazzarini et al (2014) states that the industrial policy view which is also referred to as the “developmental view” points out that development banks are specialized in long term finance and provide credit to those firms that would be unable to access credit, if subsidize and long term funds were unavailable. Countries with large capital constraints can rely on national development banks to provide the capital needed and encourage entrepreneurial activity, as a result uplifting new and existing industries as confirmed by a number of researchers Armenda´riz de Aghion (1999); Cameron (1961) and Gerschenkron (1962). This type of environment from an industrial policy view is meant to result in enterprises growing their capital investments and become profitable organizations.

The key problem in establishing whether government owned banks play a positive role in economic development is mainly that both the political view and the development view are “consistent with a negative relationship between government ownership of banks and both financial development and institutional quality.” The key difference amongst the two interpretations is that, according to the development view, government ownership supports financial development at the initial stages and alleviates the negative impact of poor institutional quality. While the political view entails that government ownership of banks depresses financial development and may promote corruption. As both institutional quality and

financial development are closely linked to economic growth, it is tremendously difficult to make a declaration on the role of national development banks without knowing the causal relationship between the two variables and government ownership of banks. To this end a definitive answer on the role of government owned banks on economic development will require investigating this causality problem which remains one of the problematic issues in economics (Yeyati, 2004).

2.10 General Election Effects on National Development Banks

Dinc (2005) finds that lending of government owned banks increases in election years in comparison to private banks. The increased lending is an estimated 11% per “government owned bank’s total loan portfolio”, or almost 0.5% of the GDP of the specific country in emerging countries.

As documented earlier government ownership of banks is linked to reduced economic growth and that government politicians use NDBs to enhance their political motives (La Pota et al, 2002). Other researchers further support this notion such as Barth et al (1999) who provide evidence that government ownership is related to low financial development and Beck and Levine (2002) contribute to these findings by reporting that they fail to establish any positive result on growth when governments own banks.

However as stated by Dinc (2005) the negative impact on development is not the only cost related to government ownership of banks. As Caprio and Peria (2000) conclude that government ownership of banks is linked to a higher likelihood of facing banking crises. Dinc (2005) adds that these negative factors are expected to continue, as the findings by Megginson and Netter (2001) suggest that banking is identified as one of the few industries where privatization has not been dominant around the world. This is aligned to the findings highlighted above by Yeyati et al (2004) reporting that the government’s presence in the banking sector is widespread.

In spite of the vast empirical evidence on the prevalent ownership of Banks by the government and its damaging effects, there has been “no direct cross-country empirical evidence of politically motivated actions by these banks” (Dinc, 2005).

Dinc (2005) provides the first paper using “cross-country, bank-level evidence of politically motivated lending” of government owned banks in developing economies in the form of increased lending in election years relative to private banks”. Dinc (2005) asked the question, do government owned banks behave differently around election periods? And “do they increase their lending in election years?” The researcher studied these questions by comparing the activities of government owned banks to private banks during general elections in emerging markets. The researcher finds that the increase in lending by government owned banks is strong relative to private banks during these periods. He adds that despite differences in effectiveness and objectives between the two types of banks the methodology used is capable of isolating political effects from other confusing factors by “focusing on a political event”.

Numerous authors have studied politically motivated lending focused on election years, as they agree with Dinc (2005) that this isolates the effects of other political influences by focusing on one political event. This brings out clearly the political motivation and therefore eliminates any doubt regarding the intention of political influence.

However the researchers that have studied politically connected lending focused on elections are usually based on “single-country studies”.

Examples are Cole (2009) who conducted research in India and concludes that the lending cycles of agricultural loans in this country follow election cycles. Sapienza (2004) find that the performance of the Italian ruling party in election years affects the lending actions of government owned banks. This follows with Baily et al (2011) who studied the same using Chinese data, including Khwaja and Mian’s (2005) investigation of the lending actions in Pakistan identified a collection of enterprises with negative performances receiving or requesting loans from government owned banks during election periods. Clarke and Cull (2002) argue that bank governors who were part of a fiscally conservative party were inclined to privatize Argentinian Banks (Dinc, 2005).

General studies related to bank lending with political affiliations are Kane (1996) and Kroszner and Strahan (1999) who research the designing of bank regulation and what role politics play. Brown and Dinc (2004) show that the application of existing regulation is also politically determined. Pagano and Volpin (2004) study the role of the electoral system at the level of minority protection (Dinc, 2005).

Other recent studies on the role of politics in finance are Johnson and Mitton (2003) establish that capital controls in Malaysia gave rents to politically connected enterprises. Faccio (2004) in a cross-country study finds that enterprises with political affiliations have better access to credit financing and pay lower taxes. Ramalho (2003) concludes that politically connected enterprises in Brazil lost value at the time of the then president Collor who was impeached in 1992 and Faccio et al (2004) show the role that political connections play in the government's decision to save a financially troubled enterprise (Dinc, 2005). Other research of bank lending related to political influence use firm-level data such as Lazzarini et al (2014) focusing on elections years using "single-country studies".

Therefore after analysis of the literature identified above the argument that Dinc (2005) is the only study that uses cross-country research of politically motivated lending is strengthened. However it must be noted that the only African country included in the Dinc (2005) research paper is South Africa. Therefore as literature on African National Development Banks is limited it would be beneficial to perform a cross-country study on politically motivated lending focusing on election years on the African continent as this is lacking. The study by Banda (2014) on Southern African Development Countries, SADC is broad and not specific to governance or political influence.

2.11 National Development Bank's in Relation to Private Bank's

In emerging markets the three types of banks that are dominant are government owned banks, the private domestic banks and private foreign banks (Mian, 2003).

The researcher goes on to state that it is of at most importance to know and analyse the differences in the three types of banks as they differ in significant ways. They differ in the structure of their organization, incentives and regulation. For instance while NDBs tend to have modest cash flow incentives and are faced with moral hazard problems of being both regulator and owner, private domestic banks on the other hand have increased cash-flow incentives with separate regulators and owners. This applies to private foreign banks as well, however they differ in their organizational structure as they have a hierarchical type of structure with their top management based in another country, usually overseas.

Mian (2003) analysis of 1,600 Banks in at least 100 emerging economies gave important insights into the governance of both government banks and private banks.

The research finds that the management of government owned banks and private foreign banks have external safeguards when they face challenges; such as support from the government in regards to NDBs and support from the foreign parent company in regards to private foreign banks. The author state that this may lead to a moral hazard problem as the management of these two types of Banks may not bother with taking adequate measures to reduce risks as they are confident of being bailed out when faced with financial challenges.

Nevertheless if the supporting institutions establish sufficient control mechanisms, the inherent risks can be reduced. The foreign private banks ordinarily have good quality assets (loans) and high internal ratings and therefore more often than not have strong internal control systems. The author gives an example of such a control mechanisms such as limiting the bank's lending to publically listed enterprises.

Government banks however do not usually poses such controlling mechanisms internally, this results in Bank management becoming relaxed in regards to their risk exposure, leading to high default rates. The researcher finds that since private domestic banks do not have external support they do not suffer from this type of moral hazard and as a result have lower default rates which translate into low NPLs (Mian, 2003).

Dinc (2005) uses the balance sheets of private and development banks and uncovers some fascinating differences between the two banks. The differences are not automatically uniform between developing markets and developed economies. The table 1 below displays the differences:

Table 1. Differences between National Development Banks and Private Banks

Balance sheet Item	National Development Banks versus Private Banks
Book value of assets	In NDBs these are around twice as large as private banks in developing markets on average but are smaller in developed markets. The “differences are statistically significant at the 1% level”
Loans to total assets ratio	This ratio is lower for NDBs in emerging markets compared to private banks, however it is higher in NDBs found in developed countries compared to private banks in these economies, “with the latter difference being statistically significant at the 5% level”.
Yearly increase in loans, relative to bank size	This is abundantly higher in private banks in both developing and developed economies. In emerging economies loans grow by around three times as fast in private banks in comparison to government owned banks. In private banks found in developed economies loan growth is four times as fast compared to NDBs. “Both differences are statistically significant at the 1% level.”
Government Securities	NDBs in developing economies hold a greater share of their assets in government securities, whilst private banks in these markets only hold 9% of their assets in government securities. The ratio highlighted is 13% for NDBs in these countries, on an average basis, “the difference is statistically significant at the 1% level” In regards to developed markets.
Deposits to total assets ratio	This ratio is lower in NDBs in both emerging and developed economies, with the difference being at a 1% significant level
Annual net operating revenue	The annual net operating income ratio is also lower in NDBs of both economies.
Income to assets ratio	The income to assets ratio is an estimated 0.4% in NDBs in both emerging and developed markets in comparison to private banks it is at 1.6% and 0.8% in emerging economies and developed economies, respectively.
Capital ratio, defined as total equity divided by total assets	Dinc (2005) finds no significant difference in the capital ratio in developing and developed economies of both types of banks.

Source: Composed from data from Dinc (2005)

According to Dinc (2005) the differences acknowledged above between private and government owned banks are generally consistent with Mian (2003).

The government owning banks as highlighted above is occasionally justified on the basis that these banks are able to finance projects that exude positive externalities for the entire economy but maybe too large and unprofitable for private banks to fund. The evidence however shows that government owned banks are more active in financing the government itself in relation to private banks who do not take an active role in financing the government (Dinc, 2005).

2.12 Mitigating Government Interference in NDBs

Scott (2007) suggests that to allow for a reliable and inclusive approach to government ownership, the national governments must compile and publicly announce an ownership policy that provides confidence to the financial markets. The policy must outline the terms and conditions which will be applied to government investments and the way in which government will execute its ownership.

Scott (2007) continues by adding that the ownership policy must be based on guiding principles and aligned with comprehensive commercial practices and good corporate governance, including competitive neutrality. These commercial practices combined with good corporate governance must be applied to making decisions that concern the NDBs investments in regards to the investment amount, the terms and conditions, structure of the investment and how the investment is managed within the NDB. In other words the government's aim should be to copy the practices of private financial institution owners.

According to Rudolph (2009) the peril of political interference can be reduced by making sure that shareholder representatives on the board are clearly defined. As with most government owned banks, their shareholders represent a large number of separate government entities creating an environment of tremendous pressure on management and the board; this leads to credit misallocation or other inadequacies.

2.13 Profitability in National Development Banks

Poor Corporate Governance and weak risk management systems are key causes of meagre financial performance. Regardless of the fact that NDBs are not eager to maximise profits, their capacity to generate profits is undoubtedly a major factor in their success or failure (Calice, 2013).

The act of balancing financial and social returns can be a complex affair for National Development Banks; which poses a contradiction of pursuing both profits and development. On one hand they must invest astutely and generate earnings and on the other they must aid economic development in the countries in which they invest. Pursuing this double bottom line

tends to be time consuming and complex especially in an effort of “measuring projects’ social impact” (Calice, 2013).

2.13.1 Private Banks are more profitable than National Development Banks

Yeyati et al (2004) states that a common argument often raised against government ownership of banks is that privately owned banks are usually more profitable than publicly owned banks, more especially in developing countries.

Yeyati et al (2004) analysis on public owned banks in Latin America show that the difference in return on assets between privately owned banks and public banks is “0.4 percentage points”. Further evidence is that Demirgüç-Kunt and Huizinga (2000) and Micco and Panizza (2004) using a wider number of countries also find that government owned banks are less profitable than private banks. However this is not the case in developed countries, Micco and Panizza (2004) find that when the analysis is carried out on industrialized countries the result of government banks having lower profitability does not hold.

The general finding is that NDBs tend to have lower profitability than their private counter parts this is in essence true for countries such as Colombia, Mexico, Guatemala and Chile (Yeyati et al, 2004). However the finding of Micco and Panizza (2004) is demonstrated in countries such as Bolivia and El Salvador which have NDBs that are found to yield more profits than private banks (Yeyati et al, 2004).

Yeyati et al (2004) goes on to state that the reason for some of the NDBs having higher or equal profitability could be because their cost of funds is lower than private banks. The researchers continue by stating that another cause for this higher profitability could be a case of the “Sisyphus syndrome” were NDBs stop adhering to their mandates and instead imitate the activities of private commercial banks.

The researchers continue by pointing out that it is not justifiable to gage NDBs against a benchmark of profitability, as this type of examination could encourage NDBs to begin seeking to maximize profits instead of social benefits.

This argument that government owned banks are less profitable than privately owned commercial banks is often raised (De La Torre et al, 2002). Evidence of this understanding is heightened in the points above more especially in developing countries that are less industrialized.

However as pointed out by Yeyati et al (2004) above and De La Torre et al (2002) government owned banks cannot and should not be “judged by their profitability benchmark” as government banks in their quest to maximize profits could result in inconsistency and a vicious cycle.

The Government banks would begin with a social policy mandate as expected and target high risk companies and projects with low returns. This would then lead to repeated losses which would require the banks to be recapitalized, this would be followed with the banks being aligned towards taking on board profitable projects and enterprises which they would compete for with private commercial banks. Consequently this would result in reduced attention to the social policy mandate and political influence which would restart the cycle (De La Torre et al, 2002).

Therefore it is vital to stress that government-owned banks should not maximize profits but instead focus on social welfare. Consequently, it is possible for an efficient government bank to lose funds in projects with a negative present value but produces social benefits or positive externalities (Yeyati et al, 2004).

In this regard, it is essential that the Governing Boards of NDBs are sensitized on this matter to ensure that funds for lending are adequately allocated to those projects that will yield social and economic benefits for the country.

2.14 Non-Performing Loans and their impact on National Development Banks

The financial sustainability of a bank does not depend purely on foreign and domestic sources of funds but also on the rate at which it recovers its loan repayments (Asfaw et al, 2016).

Therefore it is essential that loan repayments from the Bank’s clients are made timely in order for the Bank to be sustainable and build quality assets. An effective way of measuring the bank’s asset quality is by using the non-performing loan (NPL) ratio (Asfaw et al, 2016). Consequently the Association of African Development Finance Institutions (AADFIs) have set the standard of NPLs at 15% of total outstanding loans. Therefore if African National Development Banks are to successfully borrow especially from International Lenders they need to conform to the acceptable standard as defined by AADFIs (Asfaw et al, 2016).

A non-performing loan refers to “a loan that is in default or close to being in default”. The term default is used when the loan fails to repay the principal and/ or interest as outlined in the loan agreement with no plan to repay the funds of the loan in the future (Pilbeam, 1998). A loan

usually becomes non-performing after being in default for 3 months (90 days) or more depending on the agreed terms. When the borrower fails to payback the Bank in full, the Bank has the option of restructuring the repayment plan or foreclose on the security provided by the borrower. Whichever option decided upon costs the Bank money, hence why Banks and other financial institutions try to avoid NPLs at all costs (Asfaw et al, 2016).

According to Sinkey and Greenawalt (1991) the decisive risk from Non-Performing Loans results largely from the deterioration of the external economic environment, which mostly occurs during economic down turns. Chang (1999) states NPLs can be viewed as damaging to the bank and have a harmful influence on the bank's overall performance (Asfaw et al, 2016).

The observation by Calice (2013) of the 2011 peer review process of the Prudential Standards, Guidelines and Rating System for African NDBs found that African NDBs poses on average a poor asset quality. As 52% of the NDBs observed reported an NPL ratio of over 15% which is unfavourable compared to the levels found in the banking industry of many of the countries in which they operate. It is factual that most NDBs usually take on projects with higher risks as compared to private financial institutions, however the levels of loan impairments are drastically high and this is a signal of a weak risk culture in these Banks and lack of efficient monitoring and measuring tools (Calice, 2013).

The Board are responsible for overseeing the operations of the NDBs, therefore it is essential that the Board of Directors and management have the capacity to put structures in place that reduce the occurrence of NPLs to ensure the sustainability of the Bank.

As alluded to by Scott (2007) earlier numerous problems related with State Financial Institutions (SFIs) can be associated with or entirely attributed to weaknesses in corporate governance.

2.15 Good Corporate Governance for National Development Banks

According to Aebi et al (2012) in the literature of corporate governance several features can be identified as “good governance.” An example is a strong representation of the board of directors that are independent with no connections to management of any form. This is as identified earlier by Luna-Martinez and Vicente (2012) who find that very few African NDBs

allow for a majority of independent board members on their boards and even fewer allow their board to be composed of entirely independent board members.

Another feature of good corporate governance practices in financial institutions as identified by Jakob de Haan and Razvan Vlahu (2015) is the formation of various committees' these may include audit, nomination and compensation committees. Yeh et al (2011) adds that independent directors sitting on audit and risk committees work well in civil law countries which normally have poor shareholder protection practices.

According to Ndikumana (2006) national development banks to be successful must be efficiently governed, which is crucial for their sustainability. Therefore NDBs need to be given a high degree of managerial autonomy, more especially political autonomy. Ndikumana (2006) further states that Development banks are usually managed similar to other state owned enterprises and face political interference both on a managerial level and in the allocation of credit. The author goes on to state that the appointment of staff is also often dictated by political motives which hinder efficiency. The author suggests a different approach for NDBs which constitutes the banks operating under the same principles of efficiency as private commercial banks, however the social and development goals must be balanced around profits and objectives. In so doing efficiency must not be seen entirely on the basis of profitability but must be accompanied with development objectives.

2.16 Critique of Literature

The preceding review of academic works indicate that National Development Banks are policy instruments that can benefit the economy if critical areas such as good corporate governance, are adhered to.

None the less the body of literature poses some limitations. Most of the scholarly works carried out are focused on development banks found in developed nations, there is limited literature on NDBs in developing countries and less so on the African continent. Those studies covering emerging markets are mostly carried out on Asian or South American Banks. Economic and the financial markets differ and more so those found on different continents; therefore it is unprecedented to conclude that the research findings undertaken in other parts of the world conform to African NDBs. Most of the studies that include development banking in Africa

mostly use the Development Bank of Southern Africa (DBSA) and not the numerous found on the continent.

The literature on Governance in National Development Banks is scarce, most of the work done on governance in banks has been carried out on private banks. National Development Banks as observed in the literature are very different in structure compared to private banks, as they tend to be more complex comprising of a number of stakeholders representing different organisations. Further they tend to have either public ownership or both public and private ownership making their governance structure highly complex (Scott, 2007).

The academic works on these banks is mostly focused on the political interference which has been identified as their chief cause of failure, poor governance practises allow for political influence which results in the banks underperformance. Therefore there is a need to change the direction of future studies on these banks by making them more focused on Governance to understand how it can best be applied to mitigate government interferences.

Institutional quality and financial development have been found to be closely associated with economic growth. However the causal relationship between the two variables and government ownership of banks is not known and needs to be studied as it is difficult to make a decision on the role of these banks in the economy without knowing this relationship. According to Yeyati (2004) this remains a problematic topic in economics.

Research on how governance can be supported with internal systems in the NDBs is also lacking more especially with African National Development Banks. Good Corporate Governance structures can be put in place but without the necessary support of an efficient risk management framework, credit decisions will be based on credit applications processed through a weak risk management criteria questioning the viability of the approved credit applications by the board. According to Scott (2014) highlighted earlier an estimated 71% of NDBs indicated that their most pressing need is to improve their risk management operations.

Finally it is evident that Good Corporate Governance is a means to attaining a sustainable NDB, free from political interference with the ability to make credible contributions to economic growth and financial development with the necessary support factors in place.

2.17 Conclusion

The literature review above shades light on a number of observations that can be used for this particular study of investigating the causes and effects of weak corporate governance and how they hinder the successful performance of African National Development Banks.

The studies investigating National Development Banks are found in three categories:

Most of them are either theoretical in nature, Bruck (1998); Armendariz de Aghion (1999); Amsden (1989); Aronovich and Fernandes (2006) or is based on qualitative case studies Fordwor (1981); Amsden (1989); Amsden (2001); Rodrik (2004); Ndongko (1975), (Lazzarini et al, 2014).

The second type are general studies on NDBs affiliated to political influences, some of these are Kane (1996); Kroszner and Strahan (1999); Brown and Dinc (2004), (Dinc, 2005).

The third type of study is based on quantitative analysis, most of these studies investigate the performance of National Development Banks and its impact on financial and economic growth, La Pota et al (2002); Barth et al (1999); Beck and Levine (2002); Caprio and Peria (2000); Yeyati et al (2004).

As stated earlier government intervention in these banks has been identified as one of the key issues in regards to the underperformance of NDBs and this is brought about through weak corporate governance practices which lead to wide and broad mandates that allow “mission creeps” by the Government to influence credit decision making (Gutierrez et al, 2011) and (Yeyati et al, 2004).

As a consequence of this occurrence a number of studies have used political interference from the government to study the performance of NDBs, Dinc (2005); Caprio et al (2004); and La Porta et al (2002).

This type of methodology carries out the studies on political interventions in NDBs by “focusing on a political event” such as election years. Dinc (2005) as previously indicated above produced the first paper of politically motivated lending of NDBs in developing countries using increased lending in election years in comparison to private banks using “cross-country,

bank-level evidence of politically motivated lending”. The methodology is effective as in spite the differences in the efficiency and objectives amongst the two types of banks, the methodology manages to “isolate political effects” from other distracting factors by focusing on an identified political event.

This methodology has been adopted over the years as numerous researchers have followed suit agreeing with Dinc (2005) that it clearly brings out the political motivation eliminating any doubt regarding the intention of political influence, Cole (2009); Sapienza (2004); Baily et al (2011); Khwaja and Mian’s (2005); Lazzarini et al (2014) (Dinc, 2005).

As noted from the analysis of the literature above the negative effects found in the studies of government ownership of banks is expected to continue as the banking industry has had limited privatisation of banks worldwide (Dinc, 2005).

The aim of this study was to add to the body of literature on understanding the underperformance of African National Development Banks, consequently two main causes and three effects of weak corporate governance were drawn from the literature to measure the performance of African NDBs using Development Bank of Zambia data. The causes and effects have been placed in table 2 below and aligned to statements throughout the literature pointing to each individual cause and effect.

Table 2. Causes and Effects of Weak Corporate Governance

CAUSES		
	Non-Independent Board, Influenced by Government Intervention	Author
1	Political intervention is one of the key threats to a successful NDB, this is a result of non-independence of the board and top management with a lack of having transparent communication between the NDB and the owners.	Rudolph (2009)

2	33% African NDBs constitute board of directors composed of majority government representatives	Calice (2013)
3	Few African NDBs allow for a majority of independent board members on their boards.	Luna-Martinez and Vicente (2012)
4	42% African NDBs do not have a transparent board nomination process to ensure the directors ability to perform their roles	Calice (2013)
5	External board directors are more effective to oversee management and the enterprise as they are less indebted to management.	Mehran <i>et al</i> (2011)
6	NDB Board members do not have the experience and professionalism to properly carry out their duties and lack independence.	Scott (2007)
Broad Mandates		
7	A broad and generally stated mandate allows government to influence activities and direction of the NDB.	Luna-Martinez and Vicente (2012)
8	71% of African NDBs have broad mandates, which are easily influenced by the national government	Banda (2014)
9	Underperformance of these banks is associated with a lack of a precise and clear mandate and weak corporate boards and management as a result of government intervention.	Rudolph (2009)
10	A narrow and clear mandate prevents deviation from objectives of the NDB preventing mission creeps from the Government.	Gutierrez et al (2011) and Yeyati et al (2004)
11	It was also observed that 50% of African NDBs do not have a signed performance	Calice (2013)

	agreement with the government that captures the mandate	
12	There is a need to reinforce the framework defining the mandate, objectives, strategy and targets of the African NDBs	Calice (2013)
13	Clear mandates increase the accountability of management and the board of directors and assists with monitoring the performance of the NDBs.	Gutierrez et al (2011)
14	“NDBs with well-defined mandates are less affected by “mission creep and conflicting objectives”	Yeyati et al (2004)
15	Lessons learnt from the past of having an inappropriate mandate indicate disastrous effects.	Thorne (2011)
EFFECTS		
Crowding Out the Private Sector		
16	The Government may use the NDBs to finance activities not related to the objectives of the NDBs with “cross subsidies to profitable sectors”	Gutierrez et al (2011)
17	To gain market share the government will influence the NDBs to offer interest rates below the market.	Gutierrez et al (2011)
18	Having a clear mandate and target sector, NDBs remain focused avoiding carrying roles meant for private banks.	Gutierrez et al (2011)
19	The Governments behaviour may cause unjust competition with the private sector	Luna-Martinez and Vicente (2012)
20	The Government may displace services by the private financial institutions and hinder entrance of new private financial institutions into the market and undercut competition.	Scott (2007)

21	NDBs must play a complementary role to private banks in order to avoid entering areas meant for private banks	Rudolph (2009)
	Governments may use NDBs to provide subsidies to factions of interest.	Gutierrez et al (2011)
	Private banks reduce lending during times of financial volatility and when the market experiences low interest rates. This market failure is an incentive for NDBs to continue lending by providing credit to the economy when it needs it most as the private sector cuts back its lending. (Counter-cyclical role)	Levy et al. (2004)
Misallocation of funds		
22	Mismanagement of resources is associated with weak board of directors and management; political interference; and the absence of a clearly defined mission.	Rudolph (2009)
23	Credit misallocation may occur in NDBs when enterprises can afford to borrow from private banks but access credit from NDBs instead to benefit from subsidies.	Lazzarini et al (2014)
24	State owned commercial banks generally misallocate credit by lending to companies based on political motives rather than on merit of the projects.	Dinc (2005); Sapienza (2004).
25	“the political view” causes lending by national development banks to result in credit misallocation caused by two main reasons, “soft-budget constraint hypothesis” and the “rent-seeking hypothesis”	Dinc (2005); Sapienza (2004).

26	Most NDBs have shareholders representing a wide array of separate government entities creating pressure on the management and board which leads to credit misallocation.	Rudolph (2009)
Low Profitability		
27	High NPLs can be viewed as damaging to the bank and have harmful influence on the bank's overall performance.	Chang (1999)
28	52% of African NDBs recorded non-performing loans (NPL) above the acceptable average of 15%, as specified by the Association of African Development Finance Institutions (AADFIs); this is an indication of a poor loan book which stems from weaknesses in areas such as corporate governance and risk management.	Calice (2013)
29	59% of NDBs showed the need to become self-sustainable on a financial basis, this is a reflection on their need to reduce their dependency on the National Government and instead improve on their profitability.	Luna-Martinez and Vicente (2012)
30	Ultimately if the NDB is not profitable the directors and managers of the NDB become dependent on the Government and are subject to frequent recapitalizations.	Rudolph (2009)
31	Failures of African NDBs are associated to extremely high Non-performing loans (NPLs) which is aligned to poor cost-benefit evaluation and worsened by misplaced Government Intervention.	De Aghion (1993)

2.18 CONCEPTUAL FRAMEWORK

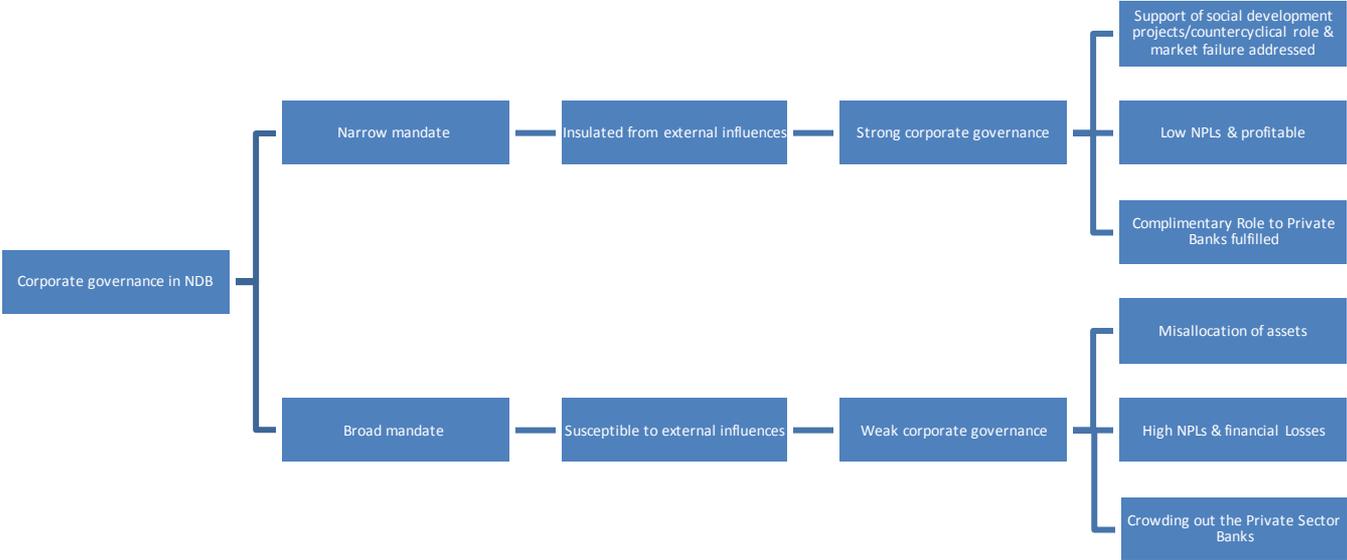
As shown by literature, all NDBs have mandates used to create them which should be specified in the law and need to highlight the significance of continued focus on the NDBs policy objectives (Gutierrez et al, 2011). Mandates can either be narrow or broad. A NDB must have a clear narrow mandate as the blue print of the institution that limits undue political influence and directs the actions and decisions of the Board and management to meet the gaps in the economy that need to be addressed. Both Mullineux and Murinde (2014) and Gutierrez et al (2011) add that the mandates also need to be flexible in order to adapt to the changing environment and the current needs of the financial market at that particular moment in time.

A broad mandate on the other hand encourages influences that may result in the NDBs performing activities that are detrimental to the survival of the NDB and may have far reaching effects in the financial system. It follows that NDBs that have narrow mandates should also have strong corporate governance as the board and management are insulated from sometimes destructive political influences. They are free to focus on ensuring that they deliver on the mandate for which the NDB was created as enshrined by law. This means that such NDBs can address market failures, invest in social development projects while growing the profitability of the bank.

Conversely, NDBs with broad mandates tend to have weak corporate governance as the board and management are susceptible to outside political influences. This may lead to the NDB abandoning its role of addressing market failures and instead start competing with private commercial banks for viable projects and as NDBs usually have cheaper money than the private banks this results in crowding out the private sector. It may also mean that the NDB misallocates funds by increasing lending in unviable projects and this coupled with weak risk management leads to high non-performing loans and as such poor profitability.

Figure 1 below illustrates how the two types of mandates affects corporate governance and ultimately the success of the NDB.

Figure 1. Conceptual Framework



2.19 Summary/Conclusion

The academic work found in the literature review above and the conceptual framework that follows provide a clear demonstration of the causes and effects of weak corporate governance and the impact this has on the performance of NDBs. Literature provides evidence that these Banks can be successful if operating in an environment that is conducive for them to thrive. This environment as illustrated in the framework above needs to accommodate a narrow mandate, must be insulated from external influences leading to a governance system that is strong protecting the Bank from mission creeps and wondering away from their goals of fostering economic development. There is hope that NDBs in developing countries can make a genuine contribution to economic development and growth as NDBs in emerging economies such as Brazil, Malaysia and Rwanda have shown that NDBs with appropriate and flexible mandates make credible contribution to their countries development.

The academic work provided in the literature review above shows the challenges faced by African NDBs, the World Bank Survey on NDBs (2009) points to the main challenges being poor risk management operation affecting their credit processes being the most critical challenge, the second challenge was the need by the NDBs to be self-sustainable on a financial basis and not depend on their National Governments, the third challenge was improving corporate governance practices and transparency, the fourth challenge was recruiting and retaining skilled employees and the fifth was insulation from political influence.

These challenges are an accurate description of the difficulties faced by these Banks, however the body of literature highlights that these challenges can be corrected by putting in place strong corporate governance practices as several problems associated with NDBs are credited directly to corporate governance weaknesses. Obtaining credible corporate governance starts from having a focused narrow mandate preventing external influences. This is clearly shown in the conceptual framework highlighted above.

An efficiently functioning NDB is then able to perform the functions it was designed to perform such as providing finance to sections in the economy that cannot easily access financing and perform its counter cyclical role of providing finance during periods of financial down turns.

3 RESEARCH METHODOLOGY

3.1 Research Approach

Researchers of government owned banks researching the performance of these banks tend to use a methodology focused on a political event, such as elections to separate influences from other confounding issues. Dinc (2005) This is done because one of the main cause of underperformance of these banks stems from inappropriate government intervention.

The approach focusing on elections is usually carried out based on a “single-country study”. Researchers that have conducted this type of study are Cole (2009); Sapienza (2004); Baily et al (2011) and Khwaja and Mian’s (2005) as mentioned earlier. Dinc (2005) carried out the first paper on “cross-country, bank-level evidence of politically motivated lending” of NDBs in developing economies based on increased lending in election years in comparison to private banks.

Another approach used is a general type study on bank lending by government owned banks that are associated with political influence. A number of researchers have used this approach, namely Kane (1996) and Kroszner and Strahan (1999); Brown and Dinc (2004); Pagano and Volpin (2004) (Dinc, 2005).

The third type of study as stated earlier investigates the performance of these banks on economic and financial growth, La Pota et al (2002); Barth et al (1999); Beck and Levine (2002); Caprio and Peria (2000); Yeyati et al (2004).

The approach that is used in this paper is a single-country study of bank-level evidence using election years as an isolated measure of outside interferences, specifically political influence on NDBs corporate governance.

3.2 Research Design and Strategy

The main purpose of the study is to identify the causes and effects of weak corporate governance that hinder the successful performance of African National Development Banks in order to make suggestions on how these banks can become profitable and sustainable over the long term whilst carrying out their social and developmental objectives. Therefore a case study design has been identified as suitable for this research, according to Zainal (2007) case study research as evidenced from previous studies encourages exploration and clear understanding of complex issues. The author continues that it can be recognized as a robust design more especially when an in-depth investigation is mandatory.

In order to answer the research questions put forward in this study, financial data was collected from the Development Bank of Zambia (DBZ) an African NDB upon which the case is based using the bank's annual reports. Secondary financial data was also collected on Zambian private banks from the Zambian Reserve Bank website. This study uses single-country bank-level evidence using a cross-sectional design, time series and regression analysis, therefore the study can be categorised in the context of quantitative research. In accordance to Bryman and Bell (2007) a cross-sectional design involves the "collection of data on more than one case and at a single point in time in order to collect a body of quantitative and quantifiable data in connection with two or more variables which are then examined to detect patterns of association".

3.3 Data Analysis Methods

As mentioned above the study sought to identify the causes and effects of weak corporate governance and their hindrance to the successful performance of African NDBs. Therefore the assumption was made that by studying one African NDB broad lessons could be drawn from the findings in relation to the other NDBs found on the African continent.

The preceding body of literature brought out two causes and three effects as highlighted in the concluding notes of the literature review. Therefore four tests were carried out to test the causes and effects using election years.

The **first test** measures the causes of weak corporate governance using a time series analysis demonstrating increases in lending by DBZ in election years. The causes identified in the preceding pages is are **non-independent boards, influenced by government intervention and broad mandates of African NDBs.**

The test is meant to find if the NDB increases lending of credit facilities during elections, a consistent increase in lending during the election years under the period of study indicates that the NDB board, is not independent and is susceptible to political influence and that its mandate is broad enough to allow for outside influences such as “mission creeps” from the Government

The **second test** measures one of the effects of weak corporate governance on African NDBs, **crowding out the private sector.** The test was conducted using a cross-sectional comparison analysis, carried out between DBZ lending and Zambian private bank lending. Regression analysis is used to conduct the cross sectional comparison of the two variables.

The test is meant to establish if DBZ follows the same pattern of lending as private commercial banks. In essence NDBs are meant to play a complimentary role to private banks and should not compete with them. They should play a counter-cyclical role and lend in times of financial down turns when private commercial banks hold back on their lending. As highlighted above Gutierrez et al (2011) states that to gain market share the government will influence NDBs to offer low interest rates compared to private commercial banks and play a competing instead of a complimentary role.

The **third test** measures the second effect found of weak corporate governance in these banks, **misallocation of funds.** The test was conducted using time analysis that compared loans disbursed in an election year against the banks Non- performing loans two years after elections. The test aspires to demonstrate if government interference and broad mandates cause the board of directors to support projects from political influence instead of project viability. The aim of the test is to measure if those projects approved during elections years had outside intervention in credit decision making; as an increase in non-performing loans two years after an election is a clear indication that decisions were made not on the financial viability of the project but instead to benefit a political ambition.

The **fourth test** measures the third effect found on weak corporate governance in African NDBs, **low profitability**. The test was carried out using regression analysis in a cross-sectional comparison analysis of DBZ loan increases in relation to the bank's profitability.

The test aims to find if there is a correlation between the loans given out by the bank and its profitability. According to Luna-Martinez and Vicente (2012) 59% of NDBs showed the need to become self-sustainable on a financial basis, this is a reflection on their need to reduce their dependency on the National Government and instead improve on their profitability.

Therefore it is important for the loans given out by African NDBs to be profitable for the bank and not turn into NPLs. Therefore the test measured if an increase in approved loans resulted in an increase in profitability.

3.4 Research Reliability and Validity

The data sources used for the research are reliable and valid, the DBZ annual reports represent the Banks audited financials. These are audited by one of the top audit firms in the country and are signed off, by the Banks Chairman, the Managing Director and the Auditors. The reports are available for public viewing and are used by other public and private institution as a reliable source of the Banks performance. Statistics from the Central Bank on Private Commercial Banks Consolidated Annual loans and advances are valid and reliable as Central Banks are considered to be reliable sources of information.

The data covers a period of 32 years, covering 7 general elections over the period. This is sufficient amount of data to give us accurate information. As other researchers with similar data and methodology such as Dinc (2005) had samples of data covering 6 years and Lazzarini et al (2014) used data covering 7 years only.

3.5 Limitations

The data does not include company level specific analysis of individual loans given by the Bank, therefore it was not possible to investigate and separate those loans that under performed as a result of other factors not related to outside influences during election years, such as the death of the key man in the project/company and negative economic factors.

Most development banks around the world do not disclose company-level loan data due to confidentiality clauses in the loan agreements with the companies (Nelson, 2001).

4 RESEARCH FINDINGS, ANALYSIS AND DISCUSSION

Overview - This chapter includes the research findings, the analysis of the findings and discussions of the findings on each method of testing as it relates to the questions of this study.

4.1 Research Findings

4.1.1 Investigating the Causes of Weak Corporate Governance in African NDBs using Election Years

The causes identified of weak corporate governance in African NDBs from the preceding literature was non-independence of the board and wide and broad mandates. The test measured increases in lending during elections; increases of lending during elections prove that the board is not independent and is prone to political influence with broad mandates that are open to “mission creeps” by the Government. Dinc (2005) finds that using a country’s elections to study political influence is an accurate measure of political interference as it brings out very strongly the political motivation and as a result eliminates any doubt regarding the intention of political influence.

Table. 3 – DBZ Lending in Election Years

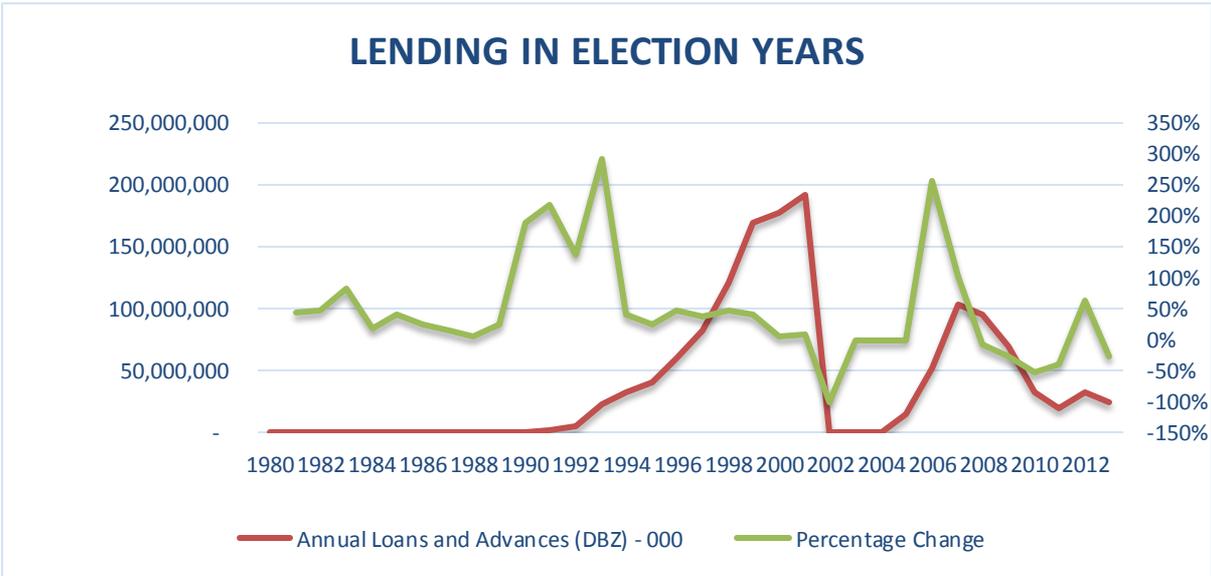


Table 4. DBZ Percentage Increases of Lending in Election Years

General Election Year	Percentage Increased lending
1983	82%
1988	6%
1991	217%
1996	46%
2001	8%
2006	257%
Average increase in lending over the 32 years in 47%	

4.1.2 Research Analysis

The evidence from the tables 3 and 4 above shows that in about half of the 6 elections undertaken, lending increased significantly above the average of 47% achieved in the 32 year period under review. In 1983 lending increased by 82%, in 1991 lending increased by 217% and in 2006 election year lending increased by 275%.

4.1.3 Discussions

The analysis demonstrates that over the 32 years there has been a spike in lending in most election years. We can therefore establish that DBZ lending in election years was likely used to support the re-election of the government of the day. We can therefore conclude that the DBZ board has been susceptible to political influence. DBZ corporate governance can therefore be said to have been weak over the 32 years under study.

According to the conceptual framework highlighted above a mandate that is not clear, precise and narrow, leads to external interferences, resulting in weak corporate governance and an inability to carrying out the NDBs objectives. This is manifested into the misallocation of assets i.e. loans are awarded to unviable projects resulting in high non-performing loans and reduced profitability.

This should also see a failure in performing the countercyclical function that NDBs are also expected to perform, instead the NDB competes with the private banks and as a result crowds out the private sector.

4.2 The Effects of Weak Corporate Governance

4.2.1 Crowding out the private sector– when there is political influence the NDB may be unable to play its counter-cyclical role as it does not respond to market down turns when private banks stop lending in the event of a financial shock such as a jump in interest rates. If the NDB does not play its counter-cyclical role market failures remain unaddressed and they instead compete with the private banks. According to Gutierrez et al (2011) political influence may stop the NDB from performing its key roles and take on activities unrelated to its objectives. The researcher continues that to gain market share the NDBs begin to finance profitable businesses, by offering interest rates below the market as they have access to cheaper funds. This results in crowding out the private banks and creating titanic and fragile NDBs that are extensively dependent on the government for support.

Research Findings

Table 5 below shows a regression analysis demonstrating the correlation between private commercial bank lending and DBZs loans and advances.

Table 5. Regression Framework comparing Private Banks and DBZ patterns of lending

SUMMARY OUTPUT								
<i>Regression Statistics</i>								
Multiple R	0.9837944							
R Square	0.96785143							
Adjusted R Square	0.966244							
Standard Error	11876119.3							
Observations	22							
<i>ANOVA</i>								
	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>ignificance F</i>			
Regression	1	8.49231E+16	8.49E+16	602.1116	2.109E-16			
Residual	20	2.82084E+15	1.41E+14					
Total	21	8.7744E+16						
	<i>Coefficients</i>	<i>Standard Error</i>	<i>t Stat</i>	<i>P-value</i>	<i>Lower 95%</i>	<i>Upper 95%</i>	<i>Lower 95.0%</i>	<i>Upper 95.0%</i>
Intercept	2358243.11	2989094.001	0.788949	0.439395	-3876897.7	8593383.9	-3876897.717	8593383.935
Commercial Banks Annual Lending	0.18183461	0.007410338	24.53796	2.11E-16	0.1663769	0.1972923	0.16637691	0.197292301

Model Specification

The tested linear regression model was set out as follows:

- $y = mx + b$ where: $x =$ Private Banks Annual loans and advances

$$y = \text{DBZ Annual loans and advances}$$

- The Linear regression analysis satisfied the following four assumptions: Linearity of residuals, Independence of residuals, Normal distribution of residuals and Equal variance of residuals

$$Y = 0.1818X + 2,358,343.11$$

Analysis

As can be seen from the ANOVA table above commercial banks annual lending is positively correlated with DBZ annual loans and advances with a positive slope coefficient of 0.18183. This slope coefficient means that every K1 million increase in commercial bank lending results in an 18% increase of DBZ loans and advances. The correlation is significant with an r square of 0.96785. The positive correlation entails that DBZ lending increases with an increase in lending of commercial banks and vice versa. This shows that DBZ does not increase lending when commercial bank lending reduces as you would expect if the NDB was performing the countercyclical function.

Discussions

DBZ in the 32 years under study does not appear to have been performing the countercyclical role and appeared to have been in competition with commercial banks. This not only shows a failure of fulfilling the one of the core mandates of a NDB but it also entails that market failures will often not be addressed. It also means that DBZ cannot reap the profits that come with taking advantage of the lack of lending by commercial banks. If NDBs invest in viable projects in times when liquidity is lacking in the financial markets they can achieve significant profits. As according to *Gutierrez et al (2011)* when NDBs perform their counter-cyclical role function they not only correct financial instability they also increase their lending to viable projects as private banks hold back their lending, the researchers find that as a result of the increased lending the NDBs are in a position to capitalize on profits as the economy recovers.

The bank was competing with private banks which eventually results in crowding out the private sector as they cannot compete with the subsidies and low interest rates offered by NDBs.

4.2.2 Misallocation of funds: this results in the NDBs investing in unviable projects. This occurs when NDBs become susceptible to external political influence as a result of non-independence of the board. This is because proper loan appraisal procedures are flouted or ignored by the board and management when awarding loans to politically connected projects and enterprises or with the objective of wooing political support (*Lazzarini et al, 2014*).

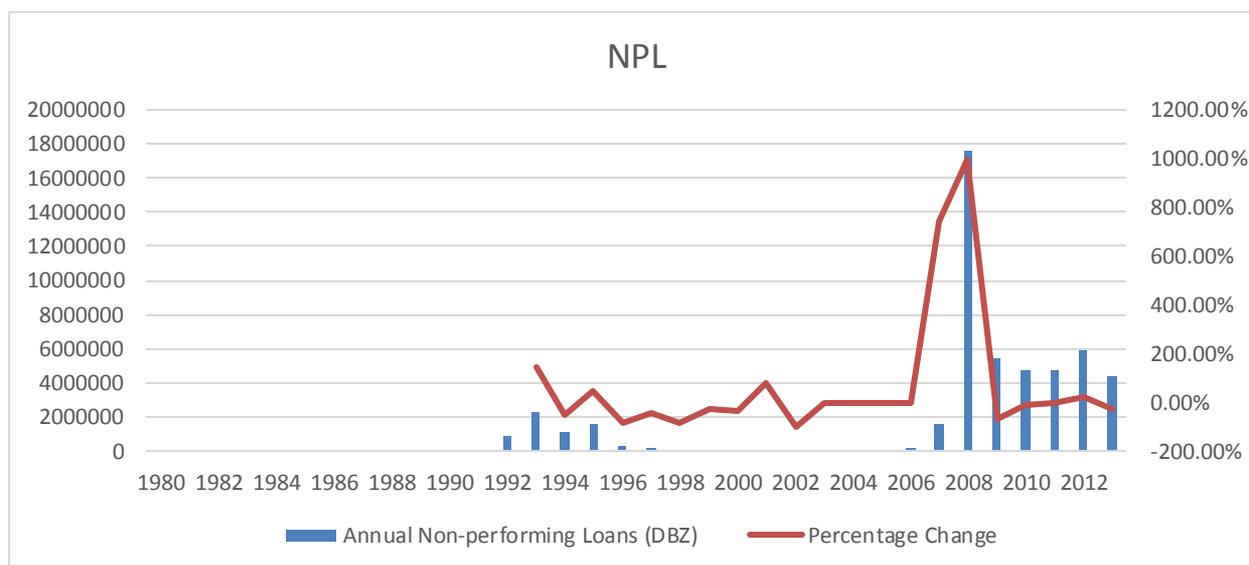
Table 6, shows significant increases of lending in election years followed by high non-performing loans.

Research Findings

Table 6 - Percentage Increases in Lending and Increases in Bad Debt Provisions

General Election Year	Percentage Increased lending	Increase in Bad Debt Provisions 2 years after elections
1983	82%	
1988	6%	
1991	217%	143%
1996	46%	-83%
2001	8%	
2006	257%	1000%
Average over the 32 years	47%	72%

Table. 7 Non-Performing Loans Showing Percentage Increases



Analysis

Table 6 above shows that the election years that had significant increases in lending by DBZ, were followed by huge above average jumps in provisions for bad debts, the proxy for non-performing loans. This suggests a high likelihood of misallocation of assets by board and management. In 1991 election year for instance, the 217% increase in loans and advances was

Table 8 Regression Analysis Showing the Relationship between DBZ Loans and Advances and Bank Profitability.

SUMMARY OUTPUT OF REGRESSION

<i>Regression Statistics</i>	
Multiple R	0.78
R Square	0.62
Adjusted R Square	0.60
Standard Error	7382603.77
Observations	31.00

ANOVA

	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>Significance F</i>
Regression	1	2537128622586040	2537128622586040	46.55	0.00000017
Residual	29	1580582313347830	54502838391305		
Total	30	4117710935933870			

	<i>Coefficients</i>	<i>Standard Error</i>	<i>t Stat</i>	<i>P-value</i>	<i>Lower 95%</i>
Intercept	3364913.06	1682312.19	2.00	0.05492410	-75802
Loans and Advances	-0.16	0.02	-6.82	0.00000017	-0.21

A linear regression analysis was conducted to examine the relationship between loans and advances and Bank profitability. The table above summarizes the analysis of variance (ANOVA).

$$Y = 3364913.06 - 0.16 X$$

Research Analysis

As can be seen from the ANOVA table above loans and advances are negatively and significantly correlated to Bank profitability, indicating that Bank profitability appears to reduce as more loans are advanced and vice versa. In fact the Bank appears to be loss making during years that had the highest number of loans and advances while profits were made during years were fewer loans were given out.

The results are reliable (statistically significant) because the significance test F gave us a value of 0.00000017 which was less than 0.05. This means that the study gives us a 95% level of confidence in the findings.

The coefficient of -0.16 in the table above means that when loans and advances increase by K1 million, then Bank profitability reduces by 16% and vice versa.

Table 9 DBZ Percentage Changes in Lending and Profitability

General Election Year	Percentage Change lending	Change in profitability election year	Change in profitability a year after election
1983	82%	37%	-10%
1988	6%	112%	-23%
1991	217%	14%	-2559%
1996	46%	-62%	65%
2001	8%	73%	
2006	257%	-175%	-67%
Average over the 32 years	47%		

The table above supports the regression analysis on bank lending and profitability. The table shows percentage changes in the bank's lending during general elections, it also gives changes in profitability in the election year itself and a year immediately after the election. The data supports the findings of the regression above as it demonstrates that the more the bank lends in the election year the less profitable it becomes a year after the election. As can be seen all increases in lending above the average lending rate results in negative profits a year after the elections. The most significant years are 1983, 1991 and 2006. In 1983 lending increases by 83% this results in negative profits of -10%. In 1991 lending increases by 217% and this reduces the bank's profitability to a colossal -2559% the following year and general elections held in 2006 caused an increase in lending to 257% this saw profits decrease by -67%. Interestingly the years in which the elections are held are showing positive profits. Only two years out of the 7 elections held over the 32 year period show negative profits in the actual

election year. Therefore it can be concluded that the more loans approved in election years the worse off the banks performance becomes.

Discussions - As stated in the analysis of the findings it is evident that there is an inverse relationship between the loans and advances given out and the profitability of the Bank; proving that the higher number of loans given out the less profitable the Bank becomes. This all stems back to the cause of the underperformance of NDBs which is a poor policy mandate that is easily penetrated by government influence. As stated by Yeyati et al (2004) narrow mandates that are clear and precise are less affected by “mission creep and conflicting objectives”. The broad DBZ mandate allowed the government of the day to influence lending and this was encouraged by weak corporate governance resulting in under performance. This negatively affects the banks sustainability and unusually leads to the NDB becoming reliant on the government to sustain it through continuous recapitalization of the bank. As stated by De La Torre et al (2002) once NDBs are recapitalized this results in a vicious cycle, the NDB would continue misallocating funds, which results in repeated loses, this would lead the bank taking on profitable projects and compete with private banks to survive. Consequently this would lead to a position of moving away from social development projects and political influence, this position would restart the cycle.

Therefore it is essential for the NDB to take on a narrow clearly stated mandate and ensure it's executed accordingly. This would insulate these banks from external pressures such as political interference resulting in strong corporate governance.

4.3 Summary/Conclusion

The methodology used for this study is one focused on a particular political event, in this case the event adopted is the general elections held by sovereign nations as this helps to separate influences stemming from other confounding elements. The reason for using this type of methodology is because the poor performance of most of these banks is caused by misplaced government intervention. Two causes of the weak performance of African NDBs and three effects were found in the literature review. The causes are non-independent boards and broad mandates and the effects were found to be crowding out of the private sector, misallocation of funds and low profitability.

The tests carried out using data from DBZ proved the findings obtained from the academic work, which flow into the conceptual framework. The causes of non-independent boards and broad mandates were proved by carrying out a time series analysis that showed increased lending during election years an indication that the board was influenced by the government and that the mandates were broad enough to allow for mission creeps. The effects were also clearly proven, crowding out the private sector was tested using regression analysis showing a positive correlation between DBZ lending and the private bank lending, meaning that DBZ lending increases with an increase in lending by the private banks and vice versa. This entails that the countercyclical role that the Bank was designed to play of increasing its lending when private banks curtail their lending is not being performed and instead is competing with the private banks and crowding them out of the market. The second effect of misallocation of funds is proven by demonstrating that an increase in lending during election years result in non-performing loans two years after the elections showing that unviable projects were funded due to outside influence which is a clear demonstration of the misallocation of funds. The third and last effect being low profitability, this was proven by using regression analysis to prove that the more loans given out by the Bank the less profitable the bank became.

These effects are a result of non-independence boards and wide and unclear mandates which have been proven by the tests carried out above.

5 RESEARCH CONCLUSIONS AND RECOMMENDATIONS FOR FUTURE RESEARCH

5.1 Research Conclusions

The investigations conducted were aimed at establishing the causes and effects of weak corporate governance hindering the successful performance of African National Development Banks. The investigations were carried out using DBZ data upon which we draw broad conclusions in relation to other African National Development Banks.

The literature studied highlighted the benefits of using election years as a measure of political interference in corporate governance, hence the methods of testing focused on election years to bring out the findings shown above.

As it was found from the literature that the two main causes of weak corporate governance in NDBs are non-independent boards and weak mandates which are usually broad and unclear. DBZs mandate was found to be broad and therefore became susceptible to government influence. As a result of political influence on the board the effects found were crowding out of the private sector, misallocation of funds and low profitability. These effects have had a major impact on the banks performance over the study period of 32 years. The study has brought out these effects using proof of quantitative investigations showing the detrimental effects they have on the Bank. This helps give DBZ and indeed other African NDBs facing governance shortcomings, clear evidence that these problems exist and opens the way to find credible solutions to resolve them in order to arrive at African NDBs that are profitable, financially sustainable and insulated from undue political interference.

Political interference penetrates the governance structures and influences the operations, activities and objectives of these banks. Therefore it is imperative that these causes and effects are mitigated to allow these banks perform the roles they were created to perform, of fostering economic development through providing financing for long term social developmental projects. Consequently it is recommended that the Bank implements the following to correct this position:

Acquiring a narrow mandate - DBZ needs to move towards reducing the sectors it covers in its mandate and if possible specialize in a particular sector such as agriculture or infrastructure. These are high risk sectors that the private commercial banks are not inclined to support and therefore prevents the NDB from competing with the private sector and also provides funding to an industry that is underfunded hence responding to a market failure. Most importantly a clear and precise mandate will provide a focused approach for the Board of directors to follow and will provide a barrier for political interference. Once the board is free from government interventions they are in a position to execute the policy mandate with no distractions, strengthening the corporate governance of the NDB.

Undertaking Mandate Periodic Reviews – mandates may become obsolete after a period of time therefore it is essential to conduct a review of the mandate to ascertain if the objectives of the mandate are still relevant to the needs of the economy. As over a pro-longed period of time the NDBs may continue pursuing goals that do not reflect the economic and market conditions of the time. Therefore the NDB may have a clear and precise mandate however it may not conform to the current needs of the market as the ever changing economic environment may demand for a different approach as per the needs of the NDBs customers. It is recommended that a review of the banks mandate be carried out every decade to keep abreast of the changes in the market this will mitigate against the mandate becoming obsolete.

Playing a counter cyclical role – one of the core objectives of NDBs is to play a counter cyclical role during times of financial down turns. Once political influence has been mitigated it is essential for the NDB to play its counter cyclical role in the economy. As private banks stop lending it is imperative that the NDBs increase their lending to combat the market failure and provide credit to enterprises and projects that need it. They must desist from practicing pro-cyclical lending as private banks do, otherwise this creates competition with the private banks who are then crowded out of the market. By competing with the private banks NDBs create unfair competition as they can afford to lend at cheaper lending rates compared to their private counterparts. This is because NDBs have access to cheaper funds through Government capitalization and other International Development Finance Institutions through cheap lines of credit.

They should instead complement the private sector and only increase lending to commercially viable projects when the private banks curtail their lending. This allows the NDBs to make

profits over the recession period making up for the losses that may have been incurred from developmental projects with more social benefits than financial gains. Increasing lending during times of financial instability to viable projects prevents NDBs from acting as lenders of last resort. As if the enterprises go unsupported during the crisis they become unviable and to prevent foreclosures NDBs need to bail them out and therefore play a role of lender of last resort. Lending to unviable enterprises creates high financial risk on the national treasury and brings distortions to the countries business landscape. Therefore playing a counter-cyclical role prevents increased lending to unviable enterprises by acting as a catalyst during financial downturns.

Balancing Profits and Social developmental goals – the counter-cyclical role allows the NDBs to balance their profits around social developmental projects. As highlighted they are able to service commercially viable projects during recessions upon which they are able to make excessive profits. Thus this helps to bring on board projects on their portfolio that provide the banks increased revenue adding to the sustainability of the Bank.

Reducing Non Performing Loans – non performing loans reduce the bank's profitability and are a threat to the Banks sustainability. As evidenced from the test carried on the misallocation of funds it is clear that significant increases in lending during election years resulted in increased non-performing loans two years after an election. Sharp increases of NPLs can be avoided in the future by shunning excessive lending, monitoring the rate of portfolio growth and improving the credit skills of staff appraising credit applications and board of directors approving the loans. Therefore a reduction in non-performing loans will increase the bank's profitability and make it sustainable (Asfaw et al, 2016).

Strong Risk Management Framework - The NDBs need to incorporate a strong risk management framework in the credit process of the bank and it needs to be executed without compromise. The framework can only be effective if there are no external influences and the board is approving loans independently.

Credit Monitoring - Credit monitoring after the loan is disbursed must be executed rigorously to ensure the funds are being utilized as per the credit application. This way loans that may have received a biased approval will be forced to implement the loan as intended, otherwise the Bank has the authority to call back the loan as per the risk policy framework.

Research on African National Development Banks is limited as most studies include NDBs from other parts of the world and are not entirely focused on those NDBs found on the African continent. Studies on NDBs found in emerging markets such as Dinc (2005), Levine (1997), Rudolph (2009) and Scott (2014) only include one or two African NDBs in their research. Specific studies on African NDBs corporate governance are lacking.

5.2 Research Recommendations for Future Research

It is recommended that an inclusive study of the causes and effects of weak corporate governance that hinder the successful performance of African NDBs be carried out across the continent using election years as a measure of political influence on these banks corporate governance. This will allow for specific recommendations be provided for each individual bank on how to mitigate against government interferences in their respective organisations.

Another area of study that needs to be researched is the causal relationship between institutional quality and financial development as both variables are closely associated with economic growth. It is immensely difficult to comment on the role of NDBs without understanding this relationship and government ownership of banks (Yeyati, 2004).

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APPENDICES

Percentage increases of lending in election years

Years	Annual Loans and Advances (DBZ) - 000	Percentage Change
1980	226	45%
1981	327	46%
1982	477	82%
1983	867	17%
1984	1,017	39%
1985	1,417	24%
1986	1,761	16%
1987	2,045	6%
1988	2,167	26%
1989	2,720	189%
1990	7,865	217%
1991	24,944	138%
1992	59,301	293%
1993	232,980	42%
1994	331,040	24%
1995	409,226	46%
1996	599,202	37%
1997	819,482	48%
1998	1,209,601	39%
1999	1,686,690	6%
2000	1,779,970	8%
2001	1,921,350	-100%
2002	-	
2003	-	
2004	-	
2005	144,080	257%
2006	513,940	100%
2007	1,029,140	-7%
2008	954,930	-28%
2009	689,740	-52%
2010	332,330	-40%
2011	200,160	63%
2012	325,650	0%

Comparing Private Banks and DBZ patterns of lending

Years	Annual Loans and Advances (DBZ)	Commercial Banks Annual Loans and Advances (Central Bank Statistics)
1980	22,558,000	431,613
1981	32,678,000	699,775
1982	47,695,000	747,716
1983	86,704,000	862,899
1984	101,726,000	1,029,280
1985	141,718,000	1,146,585
1986	176,139,000	1,712,152
1987	204,548,000	2,322,671
1988	216,653,000	4,303,983
1989	271,995,000	8,906,043
1990	786,534,000	13,218,333
1991	2,494,448,000	21,728,466
1992	5,930,089,000	40,584,766
1993	23,298,001,000	91,323,572
1994	33,104,039,000	135,644,202
1995	40,922,551,000	245,520,746
1996	59,920,168,000	352,578,104
1997	81,948,178,000	328,421,850
1998	120,960,068,000	501,838,000
1999	168,669,000,000	759,870,000
2000	177,997,000,000	1,077,349,000
2001	192,135,000,000	1,126,058,000
2002	-	1,026,207,000
2003	-	1,401,047,000
2004	-	2,106,368,000
2005	14,408,000,000	2,501,730,000
2006	51,394,000,000	3,923,695,274
2007	102,914,000,000	5,757,191,275
2008	95,493,000,000	7,868,299,409
2009	68,974,000,000	7,167,692,000
2010	33,233,000,000	8,073,418,000
2011	20,016,000,000	11,025,243,000
2012	32,565,000,000	15,624,197,000

Percentage Increases in Lending and Increases in Bad Debt Provisions

Years	Annual Loans and Advances (DBZ)	Annual Non-performing Loans (DBZ)
1980	22,558,000	
1981	32,678,000	
1982	47,695,000	
1983	86,704,000	
1984	101,726,000	
1985	141,718,000	
1986	176,139,000	
1987	204,548,000	
1988	216,653,000	
1989	271,995,000	
1990	786,534,000	
1991	2,494,448,000	
1992	5,930,089,000	936,912,000
1993	23,298,001,000	2,279,745,000
1994	33,104,039,000	1,083,024,000
1995	40,922,551,000	1,624,867,000
1996	59,920,168,000	305,138,000
1997	81,948,178,000	184,320,000
1998	120,960,068,000	31,198,000
1999	168,669,000,000	22,027,000
2000	177,997,000,000	14,678,000
2001	192,135,000,000	26,829,000
2002	-	-
2003	-	-
2004	-	-
2005	14,408,000,000	-
2006	51,394,000,000	191,000,000
2007	102,914,000,000	1,604,000,000
2008	95,493,000,000	17,636,000,000
2009	68,974,000,000	5,502,000,000
2010	33,233,000,000	4,765,000,000
2011	20,016,000,000	4,787,000,000
2012	32,565,000,000	5,914,000,000

Percentage changes in lending and profitability

Years	Annual Loans and Advances (DBZ)	Annual Financial Performance of DBZ (Profit or Loss)
1980	22,558,000	1,376,000
1981	32,678,000	2,130,605
1982	47,695,000	2,205,236
1983	86,704,000	3,018,000
1984	101,726,000	2,712,000
1985	141,718,000	3,544,000
1986	176,139,000	3,490,000
1987	204,548,000	3,637,000
1988	216,653,000	7,700,000
1989	271,995,000	5,912,000
1990	786,534,000	38,191,000
1991	2,494,448,000	43,397,000
1992	5,930,089,000	(1,067,065,000)
1993	23,298,001,000	(1,388,882,000)
1994	33,104,039,000	2,648,643,000
1995	40,922,551,000	2,530,721,000
1996	59,920,168,000	955,803,000
1997	81,948,178,000	1,578,100,000
1998	120,960,068,000	(8,789,418,000)
1999	168,669,000,000	(38,279,000,000)
2000	177,997,000,000	(23,750,000,000)
2001	192,135,000,000	(40,982,000,000)
2002	-	-
2003	-	-
2004	-	-
2005	14,408,000,000	348,000,000
2006	51,394,000,000	(260,000,000)
2007	102,914,000,000	(87,000,000)
2008	95,493,000,000	(15,459,000,000)
2009	68,974,000,000	(749,000,000)
2010	33,233,000,000	(15,139,000,000)
2011	20,016,000,000	(12,000,000)
2012	32,565,000,000	11,708,000,000