

PD-ABK-464
93004

INVESTMENT PROPOSAL

FOR

REVOLVING FUND

BOTSWANA LOAN GUARANTEE FACILITY FOR

BARCLAYS BANK OF BOTSWANA LTD

(US\$ 750,000)

OFFICE OF INVESTMENT

BUREAU FOR PRIVATE ENTERPRISE

JUNE 1988

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

**INVESTMENT PROPOSAL
FOR
REVOLVING FUND FACILITY
TO
BARCLAYS BANK OF BOTSWANA LTD**

Table of Contents

- I. EXECUTIVE SUMMARY**
- II. TRANSACTION SUMMARY**
- III. THE SPONSOR**
 - A. Overview
 - B. The Commercial Banking Sector
 - C. Barclays Bank of Botswana Ltd
 - D. Summary
- IV. CURRENT PROBLEMS BEING ADDRESSED**
 - A. Economic Performance
 - B. Access to Credit
- V. CONTRIBUTION TO DEVELOPMENT**
 - A. USAID Policy Considerations
 - B. Relationship to PRE Objectives and Policies
 - C. Economic Impact on Botswana
 - D. Women in Development
- VI. MONITORING AND EVALUATION**

UMBRELLA LOAN GUARANTEE FACILITY

BARCLAYS BANK OF BOTSWANA LTD

I. EXECUTIVE SUMMARY

A. PROJECT DESCRIPTION

1.01

PRE proposes to make available to Barclays Bank of Botswana Ltd. ("Barclays Bank") a loan guarantee facility (LGF) of up to US\$ 750,000 for the purposes of mobilizing up to US\$1.5 million equivalent in short and medium-term credit for privately owned small and medium-scale enterprises (SMSE) in Botswana. While achieving a variety of developmental objectives, the focus of the proposed project is to provide financing to productive enterprises while strengthening the capabilities of Barclays Bank to undertake expanded lending initiatives for the small and medium-scale enterprise sector.

Under the project, a loan guarantee representing 50% of risk will be provided to Barclays Bank, reflecting in part market segmentation within Botswana. The US\$ 750,000 provided by the Revolving Fund will entail the mobilization of US\$ 1.5 million equivalent in local currency (Pula), and PRE/I's leverage in the facility is 2:1 at the guarantee level. Lending will be at market rates with semi-annual amortization over years three to seven. The term of the PRE facility will be seven years. The terms of the subloans will vary, but will not be greater than the term of the PRE facility.

In a consortium arrangement with the other two commercial banks operating in Botswana, a total of \$50,000 in grant funding will be made available to retain the services of Management Advisory Services (MAS). To be co-financed by PRE/I and USAID/Gaborone, the training will be provided to bank lending officers and, to a lesser extent, to borrowers from small and medium-scale enterprises. Two training programs are envisioned, one during initial implementation of the facility and the other in year two of the guarantee program.

The project is fully consistent with USAID/Gaborone activities, has full Mission support (see Gaborone 00778 and 02418), and has been designed with the full collaboration of the Mission. Independent studies, under the sponsorship of AFR/PRE and the Mission, have identified employment generation through an expanded productive sector as a major priority for USAID activities in Botswana. This

support has been mirrored by the Government of Botswana in its recent annual budget presentation and through the assistance provided by the Central Bank of Botswana throughout the development of the facility.

B. PARTICIPATING BANK

1.02

Botswana's financial sector while very small, reflects a higher degree of development than is typical for Africa. The Government of Botswana has promoted a highly favorable free enterprise climate and has deregulated financial markets. There are three private commercial banks in Botswana. During development of the Investment Proposal, Barclays Bank was examined and discussions were held with the bank's executive management, private business borrowers and the governing Central Bank authorities. As evidenced in the Transaction Summary, the guarantee facility has been developed to respond to a credit needs identified as essential to the economic growth of the non-mining sector in Botswana.

In terms of assets and market share, Barclays Bank is the largest commercial bank in Botswana. The bank is highly liquid and reflects very conservative lending practices. Its level of operations and profits mirror those of the stronger banks regionally and compares favorably with banks in developed countries. Despite the bank's financial performance, the bank recognizes the need to be responsive to demands related to the growth of the SMSE sector. Evidence of this is found in the formal announcements by the bank for developing lending to this important sector of the economy.

C. DEVELOPMENTAL BENEFITS

1.03

The target groups for this facility are the small and medium-scale productive enterprises. For our purposes, these are defined as those companies having one to fifty employees. A proposed split of 50% each for rural and urban based lending is envisaged, reflecting the geographic size and population distribution of the country. In recent years, economic growth in Botswana has been sustained principally through minerals development. Agriculture, manufacturing, construction and other productive sectors need support to develop a broader economic base. Assistance to the SMSE sector through the loan guarantee facility will support this objective.

The guarantee facility with Barclays Bank will provide a positive impact in key USAID policy areas: credit availability at market rates of interest, enhancement of bank lending activities, employment generation and increased expansion of the non-mining productive base through additional credit resources.

D. RECOMMENDATION AND PROJECT TIMETABLE

1.04

The Revolving Fund is taking a transaction risk in the case of a LGF. As such, we have determined that Barclays Bank is a responsible institution with a satisfactory financial condition and performance history to warrant participation in the proposed facility.

Botswana has demonstrated consistent economic growth with a corresponding low inflation rate. Its strong performance in the mining sector has resulted in the country having international reserves equivalent to 23 months of import cover.

It is recommended that PRE proceed with approval of the Investment Proposal.

Projections for project implementation are as follows:

--Investment Opportunity Proposal	4/21/88
--Investment Proposal	6/12/88
--Authorization	6/28/88
--Project Agreement	6/30/88
--First Disbursement	8/15/88

II. TRANSACTION SUMMARY

<u>AMOUNT</u>	US\$ 750,000
<u>FACILITY</u>	A loan guarantee facility covering a risk-sharing agreement with Barclays Bank for the latter's loans extended to 100% privately owned small to medium-scale enterprises. A loan will be effected with a U.S. bank through which a set-off agreement will issue Standby Letter(s) of Credit, guaranteeing 50% of the principal value of the subloans funded from Barclays Bank's own resources to qualifying sub-borrowers.
<u>TERM</u>	Barclays Bank will consolidate its portfolio coverage at twenty-four months with semi-annual installments reducing the guarantee coverage beginning at thirty months through seven years.
<u>DOCUMENTATION</u>	(1) Loan agreement with a U.S. bank, (2) project agreement with Barclays Bank and (3) transaction information reports.
<u>GUARANTEE FEE</u>	Barclays Bank will pay a guarantee fee to PRE equal to 1% p.a. on its outstandings under the facility, payable semi-annually in U.S. dollars.
<u>FACILITY FEE</u>	Upon signing all facility documentation, an acceptance fee of 1/2% flat will be paid to PRE in U.S. dollars from Barclays Bank.
<u>UTILIZATION PERIOD</u>	Up to twenty-four months (24) after loan guarantee facility agreement signing. (Utilization: 25% at six months, 50% at twelve months, 75% at eighteen months and 100% at twenty-four months).

QUALIFYING SUB-BORROWERS

Barclays Bank will provide Pula financing, from its own resources, to small and medium-scale enterprises within a set of predetermined parameters established jointly with PRE/I. Tentatively, these are identified as (a) firms with 1 to 50 employees, (b) maximum loan size of P75,000, (c) tenors split as 25% up to one year and 75% of one to seven years, (d) loans for productive purposes only and (e) best efforts to extend lending equally between urban and rural areas of the economy.

REPORTING REQUIREMENTS

(1) Transaction information reports will be provided to PRE/I as loans are made by the bank and (2) the bank will provide year end audited reports and interim financial information as deemed appropriate by PRE/I.

INTEREST ON LOAN

A negotiated yield based on Treasury Bills, less the fee for the issuance of the Standby L/Cs.

III. PROJECT SPONSOR: BARCLAYS BANK OF BOTSWANA LTD.

A. OVERVIEW

3.01

The Botswana financial system consists of banking institutions and nonbank institutions that provide financial services. The system is headed by the Central Bank (Bank of Botswana) which provides government oversight to all financial institutions.

3.02

In addition to the three commercial banks operating in Botswana, a limited number of other institutions are involved in the provision of financial services. Briefly, these are: (a) the Financial Services Company of Botswana Ltd. which undertakes installment financing activities; (b) The National Development Bank which provides term credit to agriculture, industry and commercial projects; (c) the Botswana Co-operative Bank which provides financing for cooperatives; (d) The Botswana Development Corporation an investment promotion and government finance agency, (e) The Botswana Savings Bank; (f) The Botswana Building Society which is the dominant mortgage lender, and (g) two insurance companies, IGI and Botswana Insurance Co.

B. THE COMMERCIAL BANKING SECTOR

3.03

The three commercial banks operating in Botswana, are Barclays Bank of Botswana Ltd, Standard Chartered Bank Botswana Ltd. and Bank of Credit and Commerce Ltd. (BCCI). With total assets of Pula 601 million (approximately US\$ 375 million) at year end 1987 (up from Pula 465 million in 1986), the commercial banks dominate the provision of credit to the private sector. The largest component of commercial bank assets is loans which, in 1987, amounted to P325 million, or 54.1% of total assets for that year (down slightly from 62.3% in 1986). In all, the three commercial banks have among them 35 branches/sub-branches, 40 agencies and seven encashment points. All towns and major villages are now served by one bank or another.

While loan loss reconciliation information has been deemed confidential by the Central Bank of Botswana and Barclays Bank, the Director of Bank Supervision has stated that the bank is highly profitable by regional and global standards, illustrate very strong capital ratios and maintains lending policies that are prudent and conservative.

As indicated in the following table and as detailed below, 1987 was a profitable year, following a slight decline in 1986 after record profits in 1985. The pattern of commercial bank profit in 1987 is largely due to foreign exchange income and various commissions and charges and not necessarily from interest income. Local retention of bank profits differs considerably between the commercial banks, and has affected their capital and lending capacities. By law, no more than a 75% dividend payout of after tax profits is allowed. Profit retention (the reverse of dividend payout) remains a key indicator of capital growth for the commercial banks operating in Botswana. Finally, capital increases has had a significant impact on Barclays Bank.

(000 Pula)

	<u>Barclays</u>	<u>Standard</u>	<u>BCCI</u>
Pretax income	10,479	8,933	1,003
Net Income	6,867	5,468	591
Increase (decrease)	7.36%	14.87%	69.82%
Return on Assets	2.31%	2.95%	1.18%
Dividend Ratio	49.79%	74.36%	NIL
Capital Growth Rate	32.27%	16.61%	77.38%
Capital/Total Assets	8.32%	7.02%	9.47%

C. BARCLAYS BANK OF BOTSWANA LTD.

3.04

Overview

Barclays Bank of Botswana Ltd. is the largest commercial Bank in Botswana in terms of operations, assets and capital resources. Barclays commenced operations in 1950 when it was controlled from South Africa. The Botswana Government decision to break away from the Rand Monetary Authority (RMA) was preceded by its local incorporation and the establishment of its head offices in Gaborone. The bank has five branches in Gaborone, three in Francistown and ten others throughout the country. In addition, it has twenty-five agencies throughout the country.

Ownership

Barclays is predominately owned by The Barclays Bank Group (London, U.K.). Through two share subscriptions in 1986 and 1987, the bank is now 20% locally owned. Total number of shareholders is 1,648 consisting of P8.2 million in shares. The second share subscription in November, 1987 was oversubscribed in excess of 200%.

Operations

Barclays conducts its business in the traditional mode of a commercial bank. Its lending is characterized by conservative, secured lending, heavily weighted toward short-term loans and overdraft facilities, with only a marginal amount of term lending. These loan assets are supported by funding from the general public, and are principally in the form of current accounts (2/3 of its deposit base) and time deposits.

In part in response to the recognized need to promote non-mineral enterprise development, Barclays is in the process of establishing a Small Business Unit. Its primary objectives will be to give guidance to smaller scale business in making applications for bank finance and to devise suitable products for this market. Two senior bank officers are to be seconded to this unit, and it is anticipated that the unit will be operational in the near future.

Financial Condition and Performance

Barclay's summarized financial statements and selected financial ratios for years 1985 through 1987 are presented in the following table.

The banks total assets increased from P 254 million in 1986 to P 340 million in 1987, an increase of 34%. A marked increase in deposits also occurred in 1987 with total deposits of P 291 million up from P 212 million in 1986. This was accompanied by a low dividend payout and its capital is now 1.9 times that of Standard Chartered and 6.2 times that of BCCI. Its pretax profit rose in 1987, due principally to non-interest income. The bank represents a strong financial condition, low leverage, high quality assets and a highly profitable operation.

BARCLAYS BANK OF BOTSWANA LTD.

(Thousands of Pula as of Dec. 31st)

<u>BALANCE SHEET</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>
Primary Assets	69,379	67,294	129,303
Loans	162,566	154,624	170,293
Other Assets	<u>29,709</u>	<u>31,937</u>	<u>40,884</u>
Total Assets	261,654	253,855	340,480
	=====	=====	=====
Deposits	188,867	212,269	291,135
Other Liabilities	<u>54,633</u>	<u>17,433</u>	<u>17,397</u>
Total Liabilities	243,504	229,702	308,532
Capital Funds	<u>18,150</u>	<u>24,153</u>	<u>31,948</u>
Total Liab & Capital Funds	261,654	253,855	340,480
	=====	=====	=====
Contingent Accounts	74,901	53,785	51,499
 <u>INCOME STATEMENT</u>	 <u>1985</u>	 <u>1986</u>	 <u>1987</u>
Interest Income	19,567	23,275	22,338
Non-Interest Income	<u>12,259</u>	<u>12,798</u>	<u>16,234</u>
Total Income	31,826	36,073	38,572
	=====	=====	=====
Interest Expense	8,739	9,269	8,504
Operating Expense	<u>14,553</u>	<u>17,103</u>	<u>19,589</u>
Total Expense	23,292	26,372	28,093
	=====	=====	=====
Operating Income	8,534	9,701	10,479
Taxation	<u>(3,050)</u>	<u>(3,305)</u>	<u>(3,612)</u>
Net Income	5,484	6,396	6,867
	=====	=====	=====
 <u>RATIOS</u>	 <u>1985</u>	 <u>1986</u>	 <u>1987</u>
Primary Assets/Deposits	36.7%	31.7%	44.7%
Loans/Deposit	86.1%	72.8%	58.5%
Capital Funds/Total Assets	6.9%	9.5%	9.4%
Capital Funds/Loans	11.2%	15.6%	18.8%
Capital Funds/Total Liab	7.5%	10.5%	10.4%
Net Income/Av. Total Assets	-	2.5%	2.3%
Net Income/Av. Capital Funds	-	30.2%	24.5%
Total Assets (Rate of Growth)	26%	-3%	34.0%
Yield on Funds Employed Av.	-	14.7%	13.7%
Average Costs of Funds	-	3.4%	3.1%
 Note: US\$/Pula as of 12/31	 1/1.6	 1/1.5	 1/1.6

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D. SUMMARY

3.05

PRE/I's direct contact with the senior management of Barclays Bank, independent opinion from the their local auditors (Price Waterhouse) and dialogue with the supervisory authorities of the Central Bank have assured PRE/I that the proposed facility is with a responsible institution which will exercise due diligence in carrying out the LGF. The financial markets are stable in Botswana, and the volume of LGF activity will ensure both a successful facility and a desired impact upon the SMSE sector.

IV. CURRENT PROBLEMS BEING ADDRESSED

A. ECONOMIC PERFORMANCE

4.01

Economic growth in Botswana has been spectacular since independence. Since 1981, GDP has grown at more than 5% annually. From 6% in the 1984-85 period, the GDP grew to 14.7% in the 1986-87 period, reflecting a significant firming and dominance of the mineral sector. The high real growth rate was sustained by the increase in value added in this sector which recorded a growth rate of 22.1 percent, while the non-mineral sectors together grew by only 7.8 percent.

Mining is a capital intensive sector, providing only six percent of paid jobs, and substantial employment imbalances continue to persist with a number of key employment sectors actually shrinking in relative size. This has been caused in large part to the six years of prolonged drought. Manufacturing and construction have not grown as expected, and agriculture has declined at an average rate of 9.6 % over the last four years. Combined, manufacturing and agriculture during the 1986-87 period declined 10.6 percent in real terms.

Thus, with a population growth rate of 3.7 percent, overall unemployment is in excess of 25% with a further 16 percent underemployed. Basic education, training of skilled personnel and creation of jobs are critical development needs. More than 12,000 jobs must be created annually just to keep pace with those entering the job market. There is also a serious economic vulnerability to South Africa from which comes most of Botswana's imports, and, to and through which pass most of Botswana's exports.

B. ACCESS TO CREDIT

4.02

Neither foreign exchange nor liquidity in the banking sector is a constraint to economic growth. Botswana has sufficient import coverage totalling just under two years and excess liquidity in the commercial banks continues to reflect unutilized financial resources. Access to credit, however, is a highly noted constraint. With excessive collateral requirements and a perceived dearth of viable projects, most productive sector lending has been limited to

the few medium to large scale non-mining enterprises existing in Botswana.

In September, 1987 USAID/Botswana undertook an extensive analysis of the private sector in Botswana. Resulting from that study is a recommendation for USAID support for establishing a loan guarantee scheme so as to broaden the base of lending within the economy. Subsequent discussions with private commercial banks, private business and the Government of Botswana have identified this as a priority area.

Equally important is the provision of technical assistance to promote bank lending, borrower education and the development of entrepreneurial and business management skills in the SMSE sector. Emphasis should be for private sources for the provision and usage of such assistance, particularly given the lack of local government sponsored initiatives.

In the annual budget speech given in February, 1988, the need for private sector led growth was clearly identified by the Government of Botswana. "The principal engine to sustained development must be the private sector...the primary focus of our efforts is to create an environment where the private sector is able to thrive". In July, there will be a donor led conference, co-sponsored with the government, entitled "National Conference on Strategies for Private Sector Development" which will address both the needs identified above as well as what mechanisms can be utilized to expand the productive base of the society to more fully include the non-mineral sectors of the economy.

V. CONTRIBUTION TO DEVELOPMENT

A. USAID POLICY CONSIDERATIONS

5.01

PRE participation in the project will provide a positive impact in the following USAID policy areas: credit availability; lending practices; employment generation and expansion of productive enterprise development.

Credit availability will be enhanced through the expansion of available term credit to small and medium-scale productive enterprises. Under the project, increased access to credit will be realized through the provision of the partial guarantee coverage provided for by the facility.

Lending practices of the participating commercial bank will be broadened to focus on a heretofore neglected market. Recognized as a priority area by both the government and the private sector, the abilities of the banking community to effectively lend to the small and medium-scale enterprise sector will be strengthened through both the guarantee facility, the MAS training to be provided and the USAID/Botswana's proposed technical assistance to be funded separately from this project.

Employment generation will be encouraged through the expansion of productive enterprises. Enterprises employing between 1 to 50 employees will be eligible for participation under the facility. Both urban and rural employment generation will occur.

Increased expansion of the non-mining productive base of Botswana will be achieved through the facility. The need for increased domestic market production and the need for employment outside of the capital intensive mining sector is a priority focus both for USAID and the Government of Botswana.

This project conforms to the priorities of the AFR Bureau and USAID/Botswana strategies for promoting private enterprise development, continued progress in policy dialogue and the fostering of market-oriented credit.

In the area of private enterprise development, the recently completed analysis of the private sector in Botswana highlighted the need to encourage access to credit while encouraging the commercial banking sector to examine

alternatives to its very conservative lending posture.

Particularly important in Botswana has been the development of an effective policy dialogue with the Government of Botswana in the area of strengthening the role of the private sector. This has led to joint development and possible funding for undertaking small business advisory services development as well as related technical assistance. In addition, with encouragement of USAID/Botswana, the Central Bank of Botswana has modified banking laws to create more market oriented interest rates, fees and lending parameters in the commercial banking sector.

B. RELATIONSHIP TO PRE OBJECTIVES AND POLICIES

5.02

PRE utilizes a variety of operating policies and programs for its Revolving Fund investments to ensure developmental impact with viable instruments with suitable financial returns. The LGF, as proposed in this project, is widely utilized by PRE's Revolving Fund and is responsive to the Bureau objectives by targeting the small to medium-scale enterprise sector.

The proposed guarantee facility will mobilize US \$1.5 million equivalent in credit on a self-sustaining basis. This credit will represent a net expansion of the credit resources directed to the small and medium-scale enterprise sector.

The project also meets PRE guidelines for management of the Revolving Fund investments. These are as follows:

- Has a demonstration effect by promoting private financial institution lending activities with a developmental impact.
- Exhibits financial viability based on a backdrop of effective demand, proven management on the part of the participating banks and market pricing of capital.
- Targets developmental impacts appropriate to the developmental needs of Botswana by responding to identified constraints to expansion of the non-mining productive sector.
- Makes resources available to the small and medium sized enterprise sector by leveraging PRE resources to create a pool of credit.

In addition, the proposed project meets project specific criteria of the Revolving Fund in that the proposed project cannot exceed US\$3.0 million and does not represent more than 50% of the project's proposed capitalization.

C. ECONOMIC IMPACT ON BOTSWANA

5.03

The proposed Revolving Fund facility targets the small and medium productive enterprise sector of the economy. It recognizes that the money supply within Botswana has not been a notable developmental constraint. It does respond to the very real need to mobilize existing credit resources within the economy for other than capital intensive mining activities.

Financing under the facility will be made available for productive purposes, including, agriculture, agro-industries, manufacturing, commerce, service industries, etc. Both working capital and term financing will be included under the facility. In addition to increased employment and private enterprise development, the facility will enhance production for domestic markets and, to a more limited extent, trade linkages with other than traditional South African markets.

D. WOMEN IN DEVELOPMENT

5.04

A substantial number of sub-borrowers will involve women. As in other developing countries in the Southern African region, women own and/or operate many small scale enterprises. The percent of women actively involved in productive enterprises in Botswana is high and with the expansion of credit to this sector, the role of women should be enhanced. Recently, the Governor of the Central Bank of Botswana formally communicated its desire to support the involvement of women owned enterprises in the LGF and planned USAID/Botswana technical assistance activities.

VI. MONITORING AND EVALUATION

A. MONITORING

6.01

Project monitoring will consist of review of (a) lending activities, (b) adherence to developmental covenants and (c) financial condition and performance of the participating bank. This will be done based on semi-annual reporting, debt service schedules and USAID/Botswana involvement in the project.

The primary responsibility for project monitoring will reside with the PRE Bureau, but could also include the usage of outside consultants. It is envisaged that USAID/Gaborone will continue to collaborate fully with the PRE Bureau during project implementation, and can be called upon to assist in the ongoing monitoring responsibilities associated with the facility.

6.02

Reporting on the project will consist of (a) transaction information reports, (b) participating bank interim and annual reports. As appropriate, additional reporting materials may be required on an ad hoc basis. The reporting requirements imposed on the participating bank will provide baseline data for the planned evaluations.

B. EVALUATION

6.03

Two evaluations are planned for under the project. An interim, internal USAID evaluation will be held following year two of the LGF to determine achievement of facility objectives and to make whatever requisite changes may be required. This evaluation will also determine the overall impact of the grant-financed training to be provided during the initial two years of the facility. An external evaluation is planned for following year seven of the LGF. This latter evaluation will include (a) extent to which SMSE lending has been effective, (b) costs and performance of the LGF, (c) impact on employment generation and (d) profitability of the LGF for both the participating bank and SMSE sector.