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The Role of Development Finance Institutions:
The Case of the Land Bank and the Industrial Development Bank

September 2019

South Africa has a number of development finance institutions whose mandate is to contribute to economic development. These include the Industrial Development Corporation (IDC), Development Bank of Southern Africa, the Land Bank, National Empowerment Fund, and the Small Enterprise Finance Agency, amongst others. They all have mixed results with respect to promoting economic inclusion. They have, in the main, failed to produce a sizeable number of black entrepreneurs in the economy. The reason for this failure has to do with identity crisis of some of the larger development finance institutions, leadership, and lack of imagination on overcoming their mandate strictures.

There is a long history to the evolution of these institutions. Some of them predate the advent of democratic government in 1994. In this note we take a look at two of these institutions: The Land Bank and the Industrial Development Bank. These two are chosen for their long history as well as the importance of their sectors. The former focuses on primary agriculture, and the latter on lending to support industrialisation.

Land Bank

The Land Bank was established by the *Land Bank Act of 1912*, a year before the *Land Act of 1913* was promulgated. Its objective was to extend credit support to Afrikaner farmers and to ensure that they commercialise their farming cooperatives.

The Land Bank was created as a developmental tool to address previous government policy failure as well as market failure since this category of farmers could not obtain credit from the market. The Union Government created this mechanism in order to ameliorate the harsh conditions visited upon many Afrikaners as an effect of the Anglo-Boer War and ensuing drought conditions. Many of them were condemned to destitution: they were landless in the rural outskirts and wandering in towns in search of employment opportunities. Those who wanted to get into farming were discouraged by heavy requirements for capital to engage in commercial farming. Their challenges were not that different from those faced by black farmers today: limited access to land with commercial potential, poor infrastructure, and constrained access to capital. In today’s definition, these would be poor farmers who are engaged in subsistence farming or unprofitable smallholder farmers.

With the deregulation of agriculture in the early 1990s and consolidation of small farming units into large enterprises – from above 100 000 farming units to under 40 000 – the role of the Land Bank also shifted somewhat. It departed from its developmental lending policy and configured itself more like a commercial bank. Government subsidies were also dismantled as a result of South Africa’s accession to the General Agreement on Trade and Tariffs (GATT) in the early 1990s. Other reforms such as monetary policy reforms that oriented financial services to the market led to the reduction of interest rate subsidies from the Land Bank. The use of interest rates by the South African Reserve Bank to defend price stability also witnessed a rise in interest rates over time.

The Land Bank It became tied to the interests of legacy farmers who had now consolidated into large commercial farming groups. This meant that over time the loan book of the Land Bank would comprise of predominantly large-scale commercial farmers, instead of smallholder farmers. This reality persists today. The lending practices of the Land Bank have contributed to the structural inequalities between smaller black farmers and larger commercial farmers.

Despite the *Land and Agricultural Development Act No15 of 2002*, which sought to align the Bank to government's socio-economic goals, the Land Bank still behaves more like a commercial bank than a development finance institution in its risk management and credit criteria. On paper, the Land Bank has structured its mandate along 3 pillars: transformation, growth and integration. It is the latter two pillars that are alive. Today, over 80 percent of the Land Bank's loan book is made up of established commercial farmers, a reality that also extends to its financial intermediation or on-lending facility. As of 2018, the transformation component in Land Bank finance is 12%. This is up from 4% in 2012. Constrained funding has inhibited the entry of new players in the sector. In short, the lending practices of the Land Bank are still anti-developmental.

Industrial Development Corporation (IDC)

The Industrial Development of Corporation (IDC) is a national public company that was established under the Industrial Development Act No. 22 of 1940. Its main purpose was to industrialise South Africa. It helped to pioneer the synthetic fuels and chemicals industries in South Africa. The importance of the IDC became more marked as South Africa experienced economic isolation and sanctions in the 1970s. Its developmental approach gravitated inwardly.

IDC became more instrumental in developing a domestic industry outside of the mining sector in South Africa. Essentially, it sought to create a new crop of Afrikaner industrialists, and set the economy on a manufacturing path with the state playing a catalytic role. It was a key pillar of apartheid's version of a developmental state for bolstering Afrikaner entrepreneurs and to serve as a bulwark against the English-centred Anglo-American Company.

Commercial activities such as the South African Coal, Oil and Gas Corporation (SASOL), Phosphate Development Corporation (FOSKOR), and Iron and Steel Corporation (ISCOR) were some of the entities that benefitted from IDC's largesse. The IDC operated like an industrial bank, offered cheap capital to new firms. It was also instrumental in venture creation through building partnership with domestic or foreign companies. It behaved like a state bank and state-backed venture capital to accelerate the development of Afrikaner capital.

Post-apartheid, the IDC was retained as a state-owned development finance institution, pursuing many of the same objectives that it was originally established to pursue, except that it had to advance transformation objectives, in particular, the empowerment of a new crop of black business players. An important change however was the expansion of its mandate. An amendment to the *Industrial Development Act* in 1997 widened the IDC's ambit. The new mandate was to for the IDC to expand its activities to the rest of Southern Africa, allowing the corporation to finance cross-border industrial development initiatives in the SADC region and support South African companies looking to expand geographically. The IDC's mandate was further expanded by another amendment in 2001 which extended the geographical area that it could invest in to include the rest of the African continent.

The IDC was also tasked in the amended *Act* with supporting the country's Black Economic Empowerment (BEE) agenda. It is difficult to measure the transformation credentials of the IDC domestically since there is poor monitoring and evaluation of development finance institutions.

The main activities of the IDC are:

- Providing development finance
- Project development
- Non-financial forms of business support
- Capacity building, and
- Research and policy inputs

As an independent financial institution, the IDC has increasingly become more commercially driven than assuming a strong developmental approach. Anecdotal evidence from many black entrepreneurs is that the IDC behaves like commercial banks in its lending practices, and that its interests are not more benign than those of commercial banks. The more the IDC operates like a traditional financial institution the more difficult it becomes to fulfil its mandate to create new markets and empower black entrants into the mainstream economy. Thus, a tension exists between its original role as a development financier, on the one hand and a commercially-oriented institution on the other.

Since 2011, it was guided by the strategic objectives of the Economic Development Department and also had to respond to the imperatives of the National Industrial Policy Framework, especially to direct its industrial finance towards boosting manufacturing. The IDC's activities are significantly directed to large companies than smaller players. The collateral requirements are high for small and medium enterprises, and interest rates are prohibitive. Its role in stimulating demand in the economy, especially under the current conditions of low growth, has been conspicuous by its absence. It is not clear how the IDC is injecting dynamism in the economy. It is quite a luxury for the IDC to be active in transactions across the continent when there are deep problems domestically. It can also play a role in the restructuring of the state-owned energy utility and inject equity in exchange for some of the assets that are slated for disposal. More importantly, the IDC needs to realise a serious transformative role, especially in financing a new crop of black entrepreneurs in the South African economy.

Conclusion: Reorienting Development Finance towards Economic Transformation

There has been much talk about reorienting the role of development finance institutions to pursue a transformative role. They seem to suffer an identity crisis as their desire is that of operating like other commercial banks. In the absence of close monitoring and evaluation, as well as reviewing the mandates of these entities to be a lot clearer, they will continue to direct their lending activities to established players. Curiously, the former CEO of the Land Bank is now the CEO of the IDC.

The small and medium enterprises will continue to struggle to secure finance for their activities or growth since the development finance institutions are not geared to support them. If it is a daunting task to transform these developmental finance institutions, government could think of setting up alternative mechanism, especially to enhance opportunities for small and medium enterprises. There are some lessons to be learned from countries such as South Korea.

The South Korean government has since 1979 supported their small and medium enterprises as a growth engine in the economy through provision of public funds and guaranteeing loans from private financial institutions. Lack of collateral, short credit history and lack of expertise needed to produce financial statements are some of the factors that have necessitated government support towards this sector in South Korea. Credit guarantees and funding by the Korean Finance Corporation through on-lending mechanisms are some of the means that are utilized to support SMEs in South Korea.
The Korean government has also created the Korean Venture Investment Corporation (KVIC) to provide equity funding to SMEs.

Through its Funds of Funds which was established in 2005 by the Special Measure for the Promotion of Venture Business Act, KVIC also participates with other private venture capital to invest in new venture creation. In addition, it set up the Foreign Venture Capital Investment Fund as an internationalization fund – to support the entry of Korean start-ups in international markets. Whereas the first fund which is aimed at supporting SMMEs through equity funding is aimed at overcoming a critical constraint in the ecosystem - that of market failure or discrimination of SMMEs by banks that are predisposed to funding large firms - the venture capital funds seek to sustain growth of SMMEs and bolster their internationalization. In an economy that is not growing and with high levels of unemployment, the existing development finance institutions need to be more than commercial entities and pursue measurable transformative outcomes. To achieve this, they require imagination and boldness.