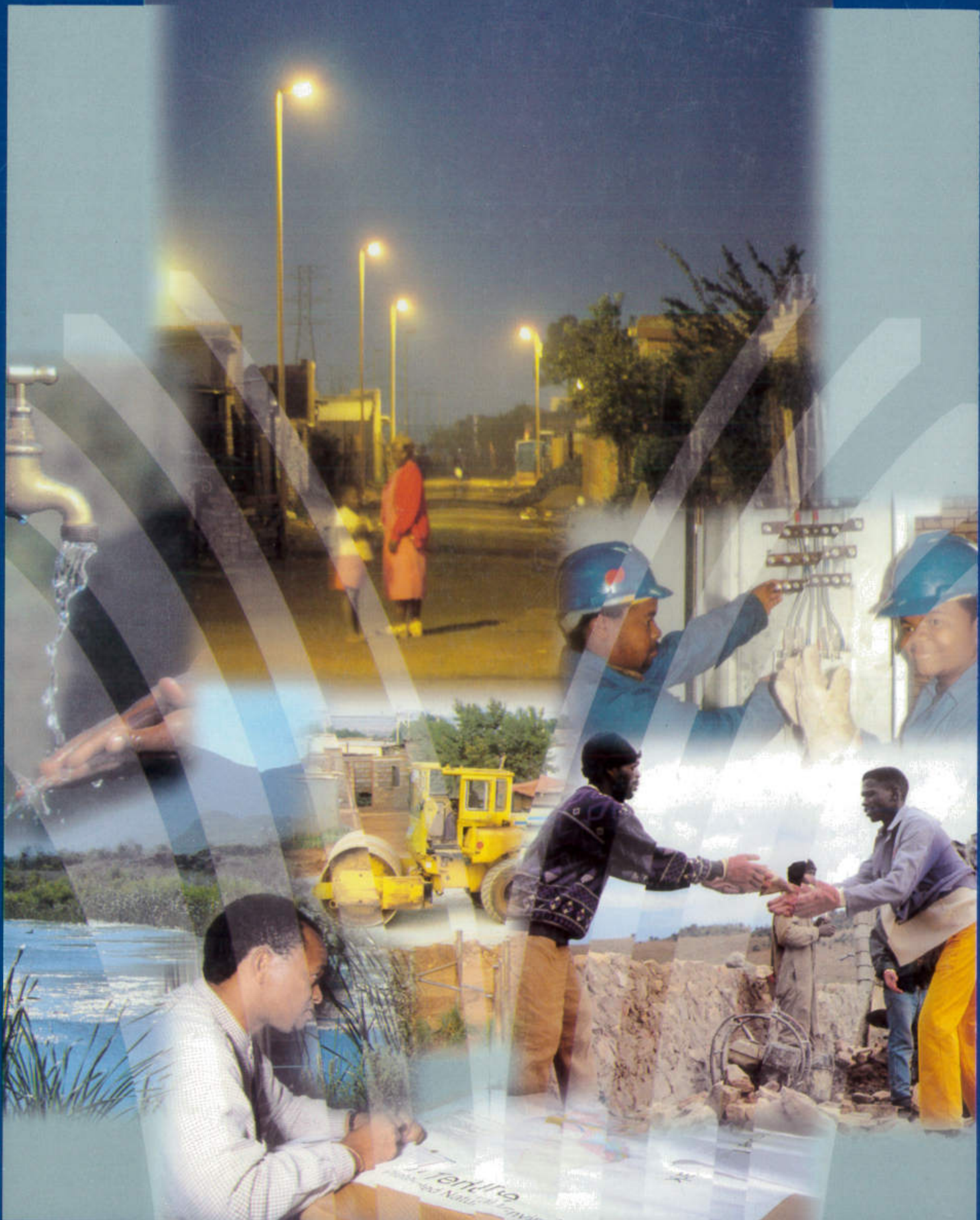
DBSA

Development Bank of Southern Africa

Building Foundations for Development



DEVELOPMENT BANK OF SOUTHERN AFRICA
ANNUAL REPORT 1998

DBSA

MISSION

The Development Bank of Southern Africa aims to maximise its contribution to development by mobilising and providing finance and expertise that focuses on infrastructure, in order to improve the quality of life of the people of Southern Africa.

Countries of operations

The DBSA's countries of operations (the Southern African Development Community) and the Bank's operational structure are listed on the inside back cover.

Exchange rate

The average Rand/US$ exchange rate during the year under review was R4,7/$1.

Financial year

The financial year of the Development Bank of Southern Africa is from April 1 to March 31. Unless otherwise stated, when reference is made to a combined year, for example, 1997/8, this refers to the financial year ending on 31 March 1998.

DEVELOPMENT BANK
OF SOUTHERN AFRICA

CONTENTS

Glossary of abbreviations used in the annual report

DBSA	Development Bank of Southern Africa
DFI	Development finance institution
DIBU	Development Information Business Unit
GDP	Gross domestic product
GEAR	Growth, Employment and Redistribution
LALF	Local Authorities Loans Fund
MIIU	Municipal Infrastructure Investment Unit
MIP	Municipal Infrastructure Programme
OEU	Operations Evaluation Unit
PPI	Public-private investment
PPP	Public-private partnership
PSIU	Private Sector Investment Unit
RDP	Reconstruction and Development Programme
SADC	Southern African Development Community
SDI	Spatial development initiative
SMME	Small, medium and micro enterprise
TLC	Transitional Local Council
WIC	Women in Construction

CORPORATE PROFILE

The Development Bank of Southern Africa (DBSA) is a South African development finance institution which supports infrastructural development in the Southern African Development Community (SADC) region.

The DBSA was established in 1983 and, following the country's first democratic election in April 1994, was transformed by the new government to bring it in line with the Constitution of the new South Africa and the transformation of the region.

In April 1997, the Development Bank of Southern Africa Act was passed, confirming the DBSA's new mandate as a development bank in the SADC region. Regulations promulgated later in 1997 confirmed the Bank's focus on infrastructure. The South African government is the sole shareholder of the DBSA and the Minister of Finance serves as the shareholder representative.

In terms of this new mandate, the Bank:

- Facilitates development partnerships to promote economic growth and development in the southern African region through an integrated development finance system.
- Covers four levels of investment – municipal and household infrastructure to serve basic needs; economic infrastructure to facilitate regional, national and sub-national linkages; institutional infrastructure and social infrastructure to enhance the sustainability of development.
- Sees itself as a catalyst and has rapidly increased its leverage of other sources of funding to maximise the impact of the projects it supports. In the 1997/8 financial year, 68 per cent of the total investment value of projects funded was mobilised from the public and private sectors and other third parties. This represents a ratio of R2,13 private sector/third party funding for every R1,00 direct DBSA funding compared to R0,4:R1 in the previous year.

The cumulative amount of loans approved up to the end of the financial year amounted to R17,661 billion. The breakdown of these loan commitments is:

- Per country: South Africa (83 per cent), Lesotho (7 per cent), Swaziland (3 per cent), Mozambique (2 per cent) and Botswana, Malawi, Namibia and Zambia (5 per cent).
- Per sector: Water and sanitation (31 per cent), roads and drainage (19 per cent), energy (18 per cent), municipal services (13 per cent), entrepreneurial support (12 per cent), education (6 per cent) and post and telecommunications (1 per cent).
- Per type of client: Local government (32 per cent), former regional governments (23 per cent), public utilities (20 per cent), development finance institutions (16 per cent) and private sector and non-governmental organisations (9 per cent).

During the past year the Bank was firmly placed on a sustainable financial footing. The introduction of a cost- and risk-based loan pricing system ensured that it will be able to serve its mandate without any subsidies (all government transfers to the Bank and guarantees on loans ceased in 1995). The Bank's total assets amounted to R12 069 million at year-end (31 March 1998).

At the end of the 1997/8 year the Bank has a staff of 465, down from 494 at the end of the 1996/7 year. All are based at the headquarters at Midrand, South Africa.

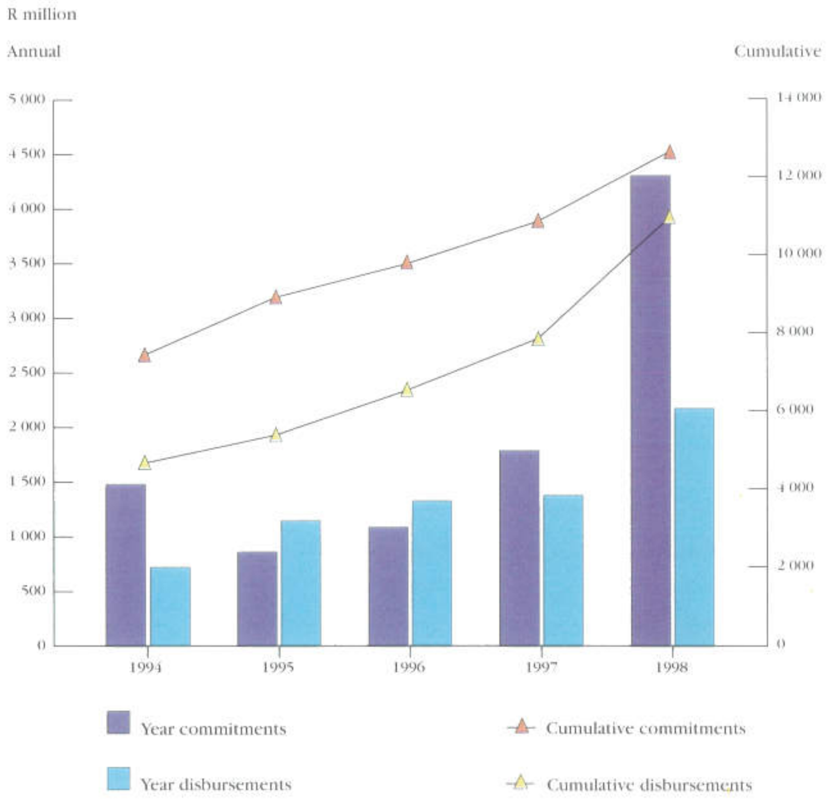
During the year under review, the DBSA operated the following agency programmes on behalf of the government:

- The Local Authorities Loans Fund (LALF), which was closed on 1 January 1998 as part of the restructuring of development finance institutions. The Fund's assets and liabilities were transferred to the DBSA.
- A special job creation programme, set up under the auspices of the National Economic Forum, which by the end of the 1997/8 financial year had benefited 60 000 people in 570 job creation projects.
- An agreement with the National Electricity Regulator to invest and manage funds from Eskom for electricity connections in previously disadvantaged areas.

In all its activities, the Bank aims to:

- further development, by maximising its development impact
- be additional to other financial institutions, by acting as a catalyst for public and private sector co-funding
- apply sound banking practices to ensure financial independence and sustainability.

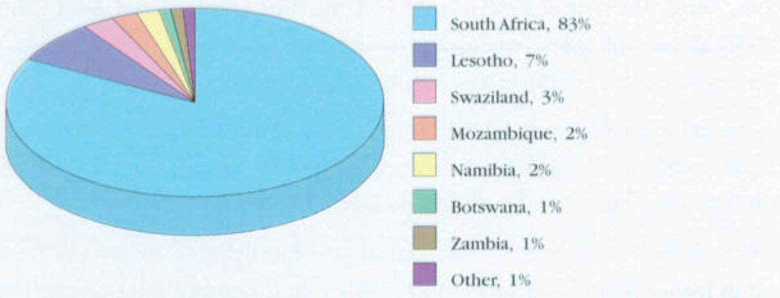
Five-year commitment and disbursement profile



CUMULATIVE LOAN APPROVALS
AS AT 31 MARCH 1998

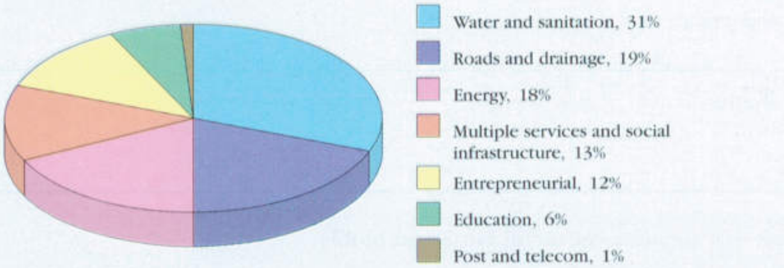
	R million
Per country	
South Africa	14 743
Lesotho	1 259
Swaziland	507
Mozambique	344
Namibia	263
Botswana	242
Zambia	210
Other (Malawi and multi-state)	93
Total	**17 661**

DBSA loans per country



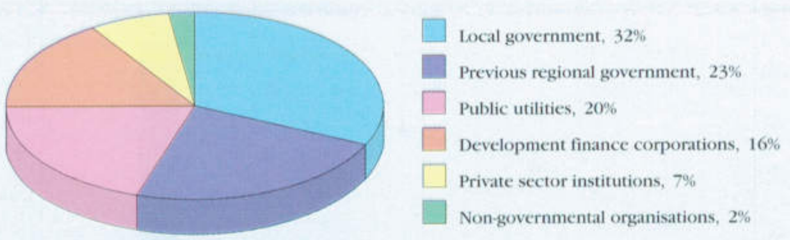
Per sector	
Water and sanitation	5 273
Roads and drainage	3 385
Energy	3 241
Multiple services and social infrastructure	2 374
Entrepreneurial	2 164
Education	979
Post and telecom	245
Total	**17 661**

DBSA loans per sector



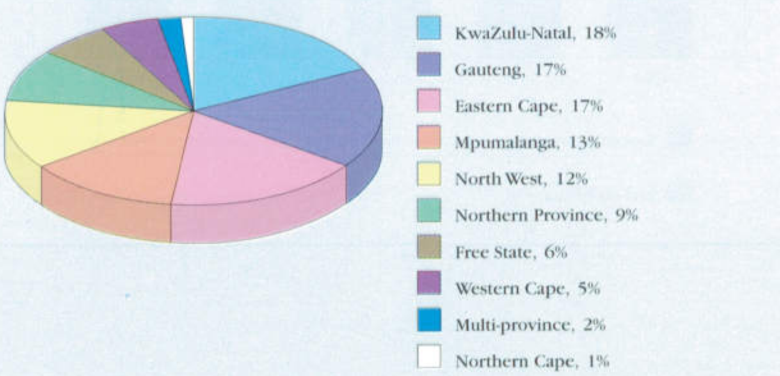
Per type of client	
Local government	5 801
Previous regional government	3 995
Public utilities	3 581
Development finance corporations	2 743
Private sector institutions	1 229
Non-governmental organisations	312
Total	**17 661**

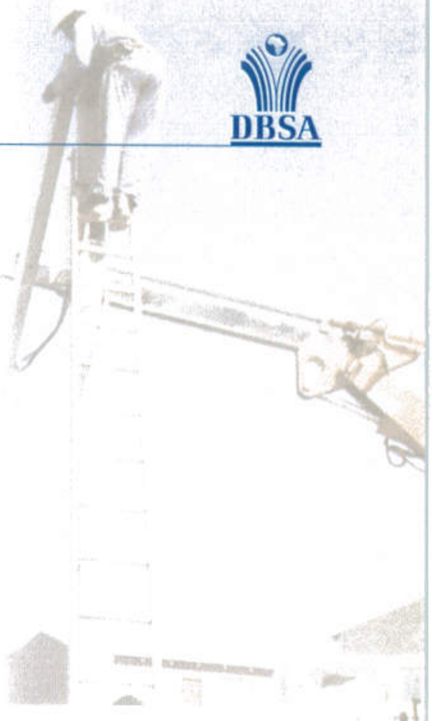
DBSA loans per type of client



Per province	
KwaZulu-Natal	2 732
Gauteng	2 509
Eastern Cape	2 505
Mpumalanga	1 916
North West	1 726
Northern Province	1 323
Free State	925
Western Cape	697
Multi-province	221
Northern Cape	189
Total	**14 743**

DBSA loans per province (South Africa)





Investment performance: 1997/8 (percentage increase against previous year)

- Investment loans approved – R4,3 billion (87 per cent increase, from R2,3 billion)
- Projects to be financed by new approvals – 148 (13 per cent increase, from 135)
- Total leveraged by new project approvals – R13,5 billion (322 per cent, from R3,2 billion)
- Cash disbursements to projects – R2,2 billion (58 per cent, from R1,4 billion).

Client base

- Grew by 320 to 545 during 1997/8 (142 per cent increase, including LALF borrowers)
- 426 local authorities are on the loan book
- Of the new loans, 87 were for local authorities, 11 for public utilities, 7 for development finance institutions, 6 for private sector and non-governmental organisations and 5 for education institutions.

Economic impact (per year of project life)

- Estimated GDP impact of disbursements – R1,6 billion
- Estimated GDP impact of newly approved loans – R2,6 billion
- Estimated jobs created or maintained by disbursements – 20 000 per year
- Expected jobs created by new approvals – 34 000 per year.

Financial/technical impact

- Promoted sound financial systems for borrowers – for example, improved credit controls and restructured capital programming loan conditions applied to the Greater Johannesburg Metropolitan Council
- Supported research by government on a new financial framework for municipal infrastructure investment
- Provided technical assistance on an industrial development zone in the Eastern Cape, water and sanitation projects in Mpumalanga and KwaZulu-Natal and for 15 projects in the Municipal Pilot Projects Programme (public-private partnerships).

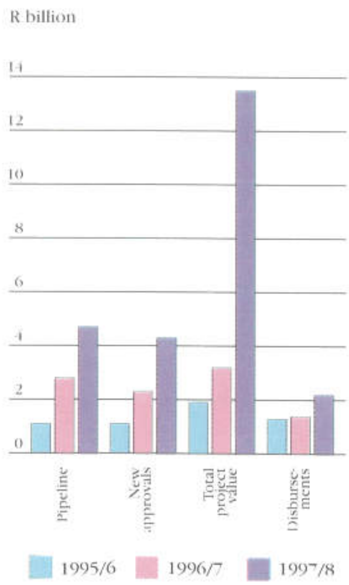
Social impact

- Facilitated conflict resolution and community participation in several projects, e g Franschhoek and Welkom/Thabong
- Set conditions for and analysed the socio-economic impact of the projects and programmes it funded
- Promoted small, medium and micro enterprise projects in conjunction with larger investments in the Fish River Spatial Development Initiative
- Promoted small contractor involvement in the Driekoppies and Maguga Dam projects, the Nkomazi Irrigation Expansion Programme, the Makhado College of Education and KaNgwane Nurses Training College
- Disbursed R240 million on 570 job creation projects that benefited 60 000 people as part of the National Economic Forum's job creation programme.
- Funded 233 projects benefiting 205 704 households in 1997 in terms of the agency agreement with the National Electricity Regulator
- Approved loans to Namibia Development and Malawi Development Corporations.

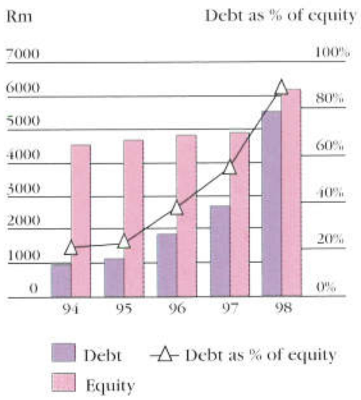
Institutional impact

- Participated in drafting the new local government green and white papers

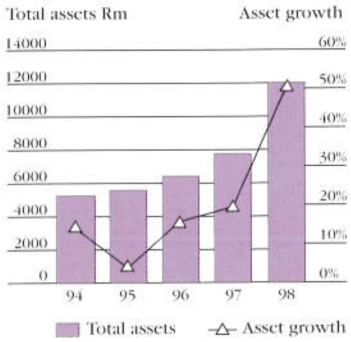
Growth in lending operations



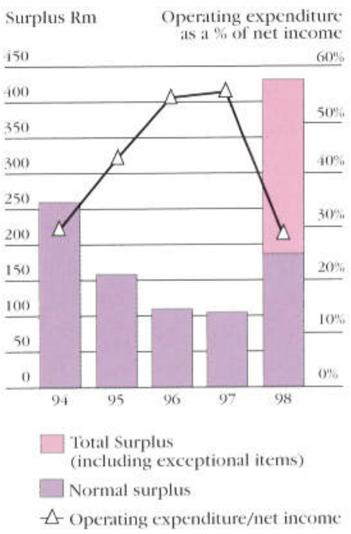
Debt to equity



Asset growth



Surplus for the year



- Established a Municipal Infrastructure Investment Unit (MIIU) to facilitate public-private partnerships in municipal infrastructure
- Supported the Portfolio Committee for the Public Service and Administration
- Housed the unit guiding the Maputo Development Corridor and other spatial development initiatives (SDIs)
- Project related client support.

Environmental impact

- Promoted regular environmental audits
- Assisted in securing one of Gauteng's wetlands
- Helped to rehabilitate sludge ponds in the Western Cape and construction sites in environmentally sensitive areas.

Strong capital base

- Record funding of R2,8 billion (1996/7: R0,9 billion)
- Surplus of R427 million, of which R177 million is normal and R250 million is accounted for by exceptional items (the total surplus increased 317 per cent from 1996/7's total surplus of R103 million)
- Transfer of Local Authorities Loans Fund reserves/net asset value of R812 million to DBSA
- Increase of R3 billion in callable capital to R4,8 billion.

Asset growth and quality

- Record disbursements of R2,2 billion (increase of 58 per cent)
- High liquidity levels (increase of R1,1 billion)
- Take-on of Local Authorities Loans Fund loans of R910 million
- Risk-free assets equal 40 per cent of total assets (1996/7: 6 per cent).

Profitability and tight control of expenses

- Normal surplus of R177 million is indicative of the success of new lending policies and also reflects one-off transactions
- One-off early release of deferred interest of R334 million on former homeland governments' debt
- One-off charge for post retirement medical benefit liability of R21 million
- Increase in loan loss provision of R164 million
- The loan loss provision is 7 per cent of development loans (1996/7: 3,8 per cent)
- Write-offs curtailed to 0,04 per cent of portfolio (1996/7: 0,4 per cent).

Improved risk management

- Credit rating system and risk pricing methodology developed
- Integration of risk management.

Innovation in funding and lending instruments

- Introduced variable interest rate loans
- Established a guarantee instrument to leverage private sector involvement
- Led the market in long-dated coupon Eurobonds.

Premier credit ratings

- Long term AAA
- Short term A1+
- Legal 2
- Best rating among South African commercial and development finance institutions
- Rating by an independent international rating agency – Fitch IBCA
- International lending institutions have started lending to the Bank on the basis of its balance sheet strength, without requiring a government guarantee.

Organisational review

Transformation: The Bank was fundamentally restructured and a new management system introduced in October 1996. The changes introduced between 30 September 1996 and 31 March 1998 included:

- The organisation was delayered and the number of organisational units reduced from 57 to 24 and the number of managers from 57 to 27
- Management positions filled by affirmative action appointments increased from 36 per cent to 76 per cent
- The total number of staff decreased from an average of 520 to 490 for the period (while the percentage of total staff deployed in the operations units increased from 40 per cent to nearly 50 per cent)
- Business and financial policies were aligned with the transformed mandate, operational systems streamlined, risk management introduced
- All policies and systems were aligned to ensure financial independence and sustainability.

Human resources development: Staff were trained in financial and risk management skills and other competencies needed as a result of the changed business and financial policies. Other highlights were:

- Introduction of a new broad-band grading system for staff
- Improvement in the evaluation and performance management systems
- Ending of all discrimination based on race or gender: this involved contributing R2 million out of savings to address the anomalies found in staff salaries
- Signing of a recognition agreement between management and the South African Commercial, Catering and Allied Workers Union (SACCAWU).

Productivity: The increase in the levels of lending and other development support was achieved with zero growth (in real terms) in operating costs and a 6 per cent drop, on average, in staff levels. The following key indicators reflect improvements in productivity, comparing the 18-month periods before and after the major transformation on 1 October 1996:

- ***Increase in outputs***

– Approvals per staff member – from R2,8 million to R12,5 million (351 per cent increase)
– Approvals per calendar day – from R3,8 million to R16,7 million (325 per cent increase)
– Increased gearing of other sources of funding (for the 18-month period) – R1,60 private or other sources, for every R1,00 DBSA funding (a 77 per cent increase over the previous period)
– Improved appraisals, analysis and support which enhanced the development impact of projects.

- ***Improvement in efficiency of business processes***

– Total value of projects approved in a programme context – increased from 7 per cent to 29 per cent (318 per cent increase)
– Share of value of all projects approved within six months of application – up from 24 per cent to 56 per cent (improvement of 133 per cent)
– Average process rate, from application to approval – 115 calendar days (36 per cent improvement).

- ***Improvement in efficient utilisation of resources***

– Total operational costs as share of value of approvals decreased from 14 per cent to 4 per cent (improvement of 74 per cent)
– Total operating costs as a percentage of total income decreased from 24 per cent to 13 per cent (improvement of 46 per cent).

DBSA

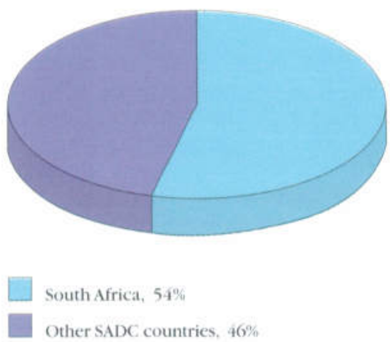
For periods ended	31-03-98 Rm	31-03-97 Rm	31-03-96 Rm	31-03-95 Rm	31-03-94 Rm
Balance sheet					
Total assets	12 002	7 949	6 679	5 758	5 560
Capital employed					
Permanent capital	6 131	4 892	4 789	4 675	4 505
Medium- and long-term financing	5 432	2 668	1 818	1 055	974
Employment of capital					
Development loans					
– opening balance	8 332	7 040	5 856	4 835	4 455
– disbursed	2 173	1 378	1 241	1 141	710
– Local Authorities Loans Fund taken on	910	0	0	0	0
– interest capitalised	658	657	546	432	389
– loans written off	(4)	(36)	0	0	0
– repayment of former homeland governments' debt	(3 159)	0	0	0	0
– gross repayments	(896)	(707)	(603)	(553)	(718)
Provision against development loans	(558)	(287)	(279)	(235)	(215)
Deferred interest	(442)	(708)	(604)	(518)	(467)
Closing balance	7 014	7 337	6 157	5 102	4 154
Cash, deposits and tradable securities	1 573	429	390	605	1 384
Commitments					
Total commitments outstanding	5 449	3 368	2 630	3 163	3 464
(1994 constant prices)	3 981	2 647	2 235	2 898	3 464
Guarantees outstanding	0	4	4	4	4
Income statement					
Interest on development activities	925	567	464	380	385
Interest on investments	480	42	48	83	162
Interest expense	(621)	(329)	(214)	(174)	(169)
Operating expenses	(158)	(130)	(135)	(122)	(109)
Specific and general provisions	(208)	(44)	(44)	(20)	(21)
Surplus for the year	427	103	114	163	258
Number of staff	465	496	529	574	586
Ratios					
Cash, deposits and tradable securities/total assets	13,1	5,4	5,8	10,5	24,8
Cash, deposits and tradable securities/undisbursed loans[1]	45,6	18,8	17,2	23,9	49,3
Debt to equity	88,6	54,5	38,0	22,6	21,6
Reserves/development loans outstanding	30,5	12,3	12,9	13,4	12,5
Provision for losses/development loans[2]	7,4	3,8	4,3	4,4	4,9
Weighted average interest rate on development loans	12,0	9,6	8,9	8,5	8,3
Operating expenditure/total income	11,2	21,4	26,4	26,3	19,9
Normal interest income/interest expense[3] (times)	1,7	1,9	2,4	2,7	3,2
Inflation deflator (1994=100)	73,1	78,6	85,0	91,6	100,0

1. Cash, deposits and tradable securities/loans approved but not disbursed
2. Provision for loan losses/development loans outstanding net of deferred interest
3. Normal interest income excludes exceptional items

OVERVIEW OF LOAN APPROVALS
FOR 1997/8

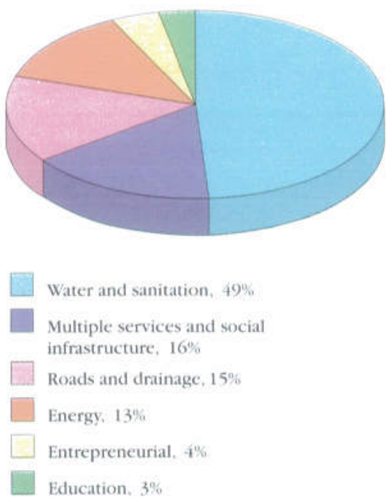
	R million	
	Total value	DBSA loans
Per country		
South Africa	4 095	2 341
Other SADC countries	9 405	1 964
Total	**13 500**	**4 305**

DBSA loans per country



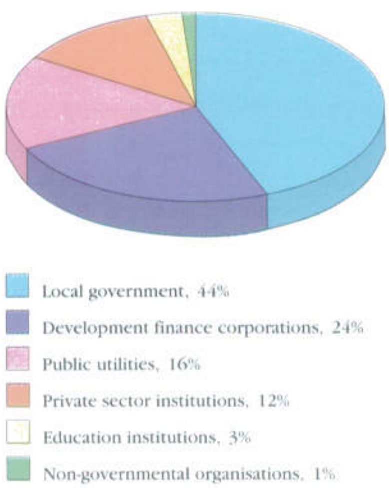
Per sector		
Water and sanitation	2 533	2 060
Multiple services and social infrastructure	736	695
Roads and drainage	7 928	667
Energy	1 598	562
Entrepreneurial	506	185
Education	199	136
Total	**13 500**	**4 305**

DBSA loans per sector



Per type of client		
Local government	2 228	1 907
Development finance corporations	1 345	1 028
Public utilities	1 956	689
Private sector institutions	7 751	530
Education institutions	200	136
Non-governmental organisations	20	15
Total	**13 500**	**4 305**

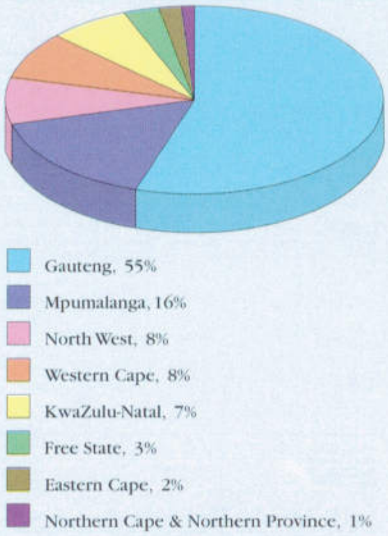
DBSA loans per type of client



BREAKDOWN OF LOANS APPROVED
IN SOUTH AFRICA 1997/8

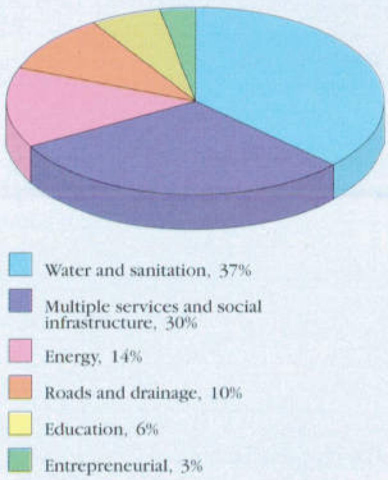
	R million Total value	R million DBSA loans
Per province – South Africa		
Gauteng	1 337	1 258
Mpumalanga	1 740	382
North West	303	194
Western Cape	228	194
KwaZulu-Natal	269	153
Eastern Cape	96	70
Free State	79	51
Northern Cape and Northern Province	43	39
Total	**4 095**	**2 341**

DBSA loans per province – SA



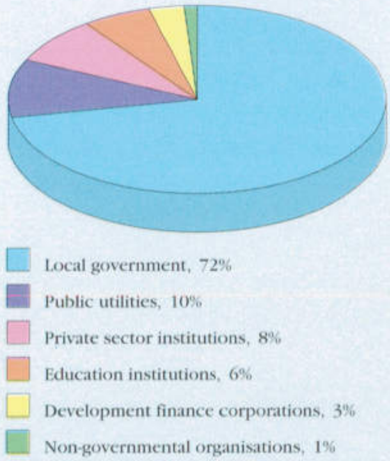
	Total value	DBSA loans
Per sector – South Africa		
Water and sanitation	1 110	870
Multiple services and social infrastructure	736	695
Energy	339	319
Roads and drainage	1 615	245
Education	200	136
Entrepreneurial	95	76
Total	**4 095**	**2 341**

DBSA loans per sector – SA



	Total value	DBSA loans
Per type of client – South Africa		
Local government	2 011	1 708
Public utilities	254	233
Private sector institutions	1 535	189
Education institutions	200	136
Development finance corporations	75	60
Non-governmental organisations	20	15
Total	**4 095**	**2 341**

DBSA loans per type of client – SA

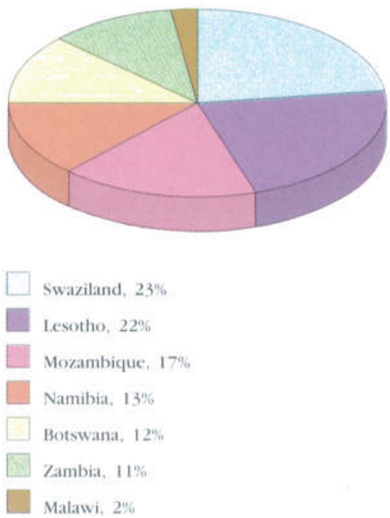


BREAKDOWN OF LOANS APPROVED

OUTSIDE SOUTH AFRICA 1997/8

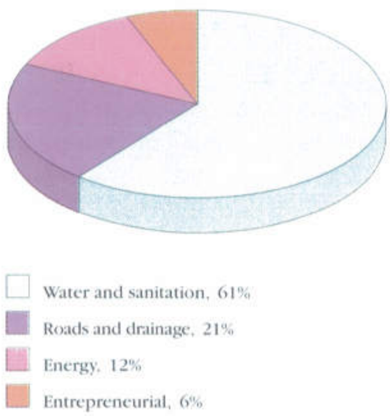
	R million	
	Total value	DBSA loans
Per country – other than South Africa		
Swaziland	440	439
Lesotho	420	420
Mozambique	6 216	342
Namibia	326	263
Botswana	471	242
Zambia	1 227	210
Malawi	303	48
Total	**9 405**	**1 964**

DBSA loans per country – other than SA



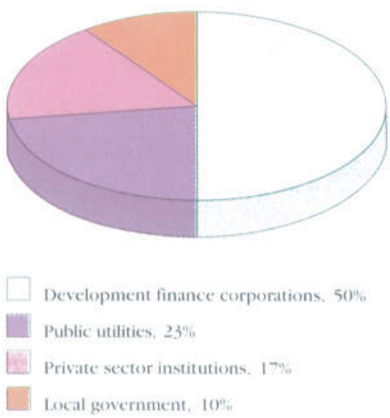
Per sector – outside South Africa		
Water and sanitation	1 423	1 190
Roads and drainage	6 313	4 21
Energy	1 259	243
Entrepreneurial	410	110
Total	**9 405**	**1 964**

DBSA loans per sector – outside SA



Per type of client – outside South Africa		
Development finance corporations	1 272	968
Public utilities	1 701	456
Private sector institutions	6 216	342
Local government	216	198
Total	**9 405**	**1 964**

DBSA loans per type of client – outside SA



CHAIRMAN'S REPORT

The DBSA is a development institution that needs to balance financial sustainability with involvement in projects that will improve people's lives throughout southern Africa.

In the past year, it struck this balance as it tackled the development challenges of South and southern Africa. Supported by comprehensive internal restructuring to align itself to a redefined mandate, the Bank judiciously invested resources in basic infrastructure and achieved record disbursements of R2,2 billion in the year under review and new commitments (approvals) of R4,3 billion. The real contribution, however, is through the development impact of these loans and the technical assistance programme.

Later in this report there is a special section on the impact of the Bank's development initiatives, achieved in partnership with the public and private sectors through mobilising resources and managing project and programme finance in South Africa and other countries in the Southern African Development Community (SADC).

Professor Wiseman Nkuhlu
Chairman

Three aspects of these developmental activities put the Bank's performance in 1997/8 in perspective: the Bank's role in growth, reconstruction and development; its part in the overall development finance system; and, its role in the SADC.

The DBSA as an instrument of growth, reconstruction and development

The DBSA purposefully maintains an arm's length relationship with government. But, as a public institution, the Bank supports the policy thrust to put South and southern Africa on a sustainable economic growth path, to eradicate poverty and inequity and to empower people and institutions to take charge of development. Its policy work and technical assistance support its own and the broader development community's ability to establish sustainable and affordable policies, strategies and operational options for delivery in terms of the Reconstruction and Development Programme (RDP).

The Bank's impact is broad. It covers macroeconomic policy, urban, rural and human resource development strategies, service delivery in water and sanitation, electrification, education and health and the provision of economic infrastructure. The Growth, Employment and Redistribution (GEAR) strategy and a number of infrastructure-related policies acknowledge the need for public-private partnerships (PPPs) in order to achieve faster, extensive and affordable delivery. The DBSA facilitates these partnerships and adds finance and development expertise to the delivery process. This leveraging extends the Bank's impact well beyond the figures reflected on its books.

The institutional challenges and political complexities of partnerships are many but the Bank's strict adherence to best practice and its pragmatic approach have already promoted innovation around them. In addition, the Memorandum of Understanding between the DBSA and the Council of South African Banks (Cosab) is an important milestone in managing the Bank's relationship with private sector financiers.

Given its need to balance demands for assistance with maintaining a sustainable loan book, the DBSA's finance has to support investment in areas with some economic potential. Its policy and project analysis, therefore, is aimed at both affordable options for sustainable growth and optimal impact on poverty eradication. The

Bank's involvement in spatial development initiatives (SDIs) is an example of integrating infrastructure investment with broader socio-economic development through targeted policy work, planning, public-private co-operation and financing. The SDIs are aimed at spatially integrated economic growth, development and job creation. They target certain clusters and corridors for multi-sectoral and fast-track (public and private) investment into areas with inherent economic potential.

Many of the critical development opportunities and needs require action at municipal level. As a result, the Bank's portfolio has shown a marked increase in loans to local authorities. In the past year, loan finance of R2,2 billion was extended to 72 local governments. Operating in a system that includes inter-governmental transfers and commercial loan finance, the Bank must add value where the state is not required, and the private sector not able, to do so. The recent local government white paper confirms the need for such well-targeted concessional development finance to support delivery, promote best practice and build capacity in the local government sphere.

The DBSA's role in the wider Development Finance System (DFS)

The DBSA is one of five national development finance institutions (DFIs), each focusing on a specific aspect of the development challenge. These are Khula Enterprises (small, medium and micro enterprises – SMMEs), the Industrial Development Corporation (industrial development), the National Housing Finance Corporation (housing), the Land and Agricultural Bank (rural and agricultural development) and the DBSA (infrastructure). The following salient features of the development finance system put the DBSA in context:

• **Support to the financial markets:** It is government policy that the financing of development should be supported by financial markets: at the same time, the RDP and GEAR also hold that the public sector should be involved in fine-tuning market activity to serve the public good. The involvement of several national and international financial institutions in developmental investments will extend the scope of development efforts beyond the limited capacities of the public sector. However, private financial markets, motivated by concerns for the bottom line, cannot fully engage in the development sector. In addressing risk which these private institutions are either unwilling or unable to deal with, development finance institutions are complementary to the private and public sectors.

• **Internal complementarity and flexibility:** As the DFIs' mandates cover a spectrum of development concerns, networking between the institutions is encouraged. The chief executives and managing directors of the DFIs meet regularly and there is representation on one another's governing structures. A healthy pragmatism has been evident in the interim arrangements so far, demonstrating a flexibility in seeking solutions. For example, where other DFIs are still acquiring the necessary capacity, the DBSA performs a 'warehousing' function by maintaining a limited involvement in areas beyond its core mandate.

Instances of this are the Bank's ongoing involvement in the small enterprise sector, where Khula has been developing capacity, and in agricultural development, where the Land and Agricultural Bank has just been re-launched and is still undergoing transformation. The intention is only to sustain momentum while the necessary institutional capacity is being developed in the system as a whole.

In line with the policy to locate responsibilities in different specialised yet networked institutions, the Bank's Board decided in February 1998 to sell part of the DBSA's SMME portfolio to Khula.

- **The emphasis on self-sustainability:** Recognising the strategic importance of DFIs, government has taken up share-holding in them. This provides a basis upon which DFIs can mobilise further resources and engage in sustainable lending practices. In line with the overall fiscal goals of transparency, the DFIs have to become self-sustaining rather than being conduits for government subsidies. This creates a natural internal tension for an institution like the DBSA which has to maximise its development impact – a costly skills-intensive challenge – while generating a sufficient operational surplus. Accurate costing, risk management and a strong focus on its mandate are particularly important in this context.

The DBSA in southern Africa

The Bank has a significant developmental role beyond South Africa, illustrated by the growing portfolio of loans to other SADC countries. Loans to the cumulative value of R2,9 billion to SADC countries other than South Africa now constitute 16,2 per cent of the Bank's portfolio. While the Bank's focus in South Africa is primarily on the core mandate of infrastructure funding, it extends its reach to take in non-core activities, like financing agricultural projects and SMMEs, in other SADC countries.

During the past year, the Board devoted considerable effort to ensuring the Bank's impact in the region was optimally directed, given that its involvement in other SADC countries poses a unique set of development challenges. The DBSA has systematically established new relationships, developed country risk profiles and strategies and gradually built up an investment portfolio in the region. All this emphasises the benefits that can come through the Bank's involvement in other SADC countries, like the linking of regional economies, the opening of new trade channels, global contacts and opportunities for businesses of all sizes.

Some strategic priorities

Along with the public and private sectors and other DFIs, the DBSA faces the challenge of both investing in growth and managing such investments to optimise development and eradicate poverty. Several key issues clearly determine these parameters.

- The Bank and private financial institutions in the infrastructure market are refining their relationship, as the Memorandum of Understanding with Cosab illustrates. But the real test of a truly supportive relationship lies in the Bank's catalytic role and the effectiveness of projects undertaken.
- The potential and limits of public-private partnerships to deliver, need to be more clearly identified through experience.
- The DBSA's expertise in the communications area is to be strengthened. This sec-

tor is an RDP priority and although the private sector is likely to become involved in this potentially lucrative sector, the scope of RDP needs is vast and the Bank's role is poised to grow throughout the southern African region.

- SDIs will continue to feature prominently. The progress on the Maputo Development Corridor has given considerable impetus to the SDI approach in South Africa and other SADC countries. The DBSA prefers a limited financial role, seeking rather to add value or leverage other funds. This requires good planning, a sound understanding of the policy and operational issues and an ability to target investments very specifically.
- Institutional capacity constraints among clients continue to impede the Bank's operations. While most service areas need more finance, the institutions responsible for delivery are at times not able to disburse even their inadequate funds. Where they do, questions sometimes remain about the sustainability of their practices. A particularly notable example is the capacity constraints in local and provincial governments. Government efforts to address this problem are yet to come to fruition. The Bank's task is to supply technical assistance so as to ensure project design and management do improve the capacity of clients. But a larger role in a wider national effort is also necessary. In the long run, development impact will remain constrained and financing opportunities inhibited if capacity continues to be so limited.
- Involvement in other SADC countries remains a new exposure for the Bank, with many unknown risks. The policy, legal and practical implications of cross-border investment are multiple, regularly raising new issues of mandate and management. The Bank's role, relative to other DFIs and its involvement in non-core activities in SADC, will pose ongoing challenges. Moreover, the DBSA's role in these countries is also premised on the potential benefits of regional linkage. This demands well-directed strategic engagement and economically sound investments.

These strategic issues, which face a DBSA that is still fine-tuning its role in a new institutional and operational environment, demonstrate the exciting challenges awaiting the Bank as it embarks on this task with its development partners and clients.

A special thank you

It remains for me to thank the members of our new Board, appointed in August 1997, for their enthusiasm to participate in addressing these challenges and for the able way in which they have already supported the Bank in its endeavours. A special word of thanks also to the former Board, whose term expired at the end of July 1997. The members of this interim Board saw the DBSA through the period of transformation and helped put the institution on a sound footing for the future. Their strategic guidance and experience will have a lasting effect.

Finally, a special word of thanks to Dr Ian Goldin, the management team and staff of the DBSA. Committed to development and keen on innovation, they continue to serve their institution, the country and the region with distinction. Transformation is always strenuous; they have persisted in their task, building and moulding a DBSA that makes a real impact.

Wiseman Nkuhlu

DBSA

BOARD OF DIRECTORS
FROM 1 AUGUST 1997

Professor Wiseman Nkuhlu

Prof Wiseman Nkuhlu (Chairman)

Chief Executive and Chairman: Economic Equity Investment Promotions. He has been a Board member since 1983 and Chairman since January 1993. He also serves on the boards of various companies including Standard Bank Investment Corporation, Old Mutual, South African Breweries and Johnnic. He previously served as Chief Executive of the Independent Development Trust, Chairman of Worldwide African Investment Holdings and Principal of the University of the Transkei. Member of the DBSA Audit Committee, Investment Committee and Employment Equity Committee (Chartered Accountant (SA)).

Ms Lucienne Abrahams

Ms Lucienne Abrahams

Commissioner: Gauteng Provincial Service Commission. Also served on the Independent Mediation Services of South Africa's Panel of Labour Mediators and as a member of the drafting team of the White Paper on the Transformation of the Public Service. First appointed to the Board in June 1995, she was also a member of the DBSA Transformation Team. She also serves on the Board of Directors of Orbicom and Netday and is Chairperson of the Labour Development Trust. Member of the DBSA Employment Equity Committee (Post-graduate Diploma).

Ms Ann Bernstein

Ms Ann Bernstein

Executive Director: Centre for Development and Enterprise. Previously an Executive Director of the Urban Foundation from 1989 to its closure in 1995, she led its urbanisation unit and subsequently its development strategy and policy unit. She served on the DBSA's Transformation Team and Transitional Board of Directors and was a founding trustee of the Institute for Multi-Party Democracy and a member of the expert Commission on Regions in the constitutional negotiating process. She is the author of numerous publications on South African development and policy issues (MA).

Rev Frank Chikane

Rev Frank Chikane

Director General: Office of the Deputy President. He also served as Special Adviser to the Executive Deputy President from 1995 to 1996, Senior Research Fellow at the Research Institute on Christianity in South Africa (University of Cape Town), Commissioner of the Independent Electoral Commission, Secretary General of the South African Council of Churches and of the Institute for Contextual Theology. Member of the DBSA Employment Equity Committee (MA).

Dr Ian Goldin

Dr Ian Goldin (Chief Executive and Managing Director)

Has served as Senior Economist with the European Bank for Reconstruction and Development, Principal Economist for the World Bank, Director of Programmes for the Organisation for Economic Co-operation and Development and Director of Landell Mills Commodities. He was also an Economist for the South African Labour and Development Research Unit and lectured at the University of Oxford.

He was appointed Chief Executive of the DBSA in May 1996 and Managing Director in July 1997. He serves on the Board of Directors of the Commonwealth Africa Investment Fund, National Housing Finance Corporation, Lesotho/Trans Caledonian Water Authority and Khula Small and Medium Enterprise Finance Company. Member of the DBSA Audit Committee, Investment Committee and Employment Equity Committee (PhD).

Professor Brian de Lacy Figaji

Prof Brian de Lacy Figaji

Principal and Vice-Chancellor: Peninsula Technikon. Has served as the Technikon's Senior Vice-Rector and was also the Head of the Engineering Department. He has worked as a civil engineer in construction and design, and taught at the Alexander Sinton High School. Member of the DBSA Employment Equity Committee (MA).

Mr Chris Liebenberg

Mr Chris Liebenberg

Chairman: Nedcor and Hoechst SA. Formerly, national Finance Minister, he also serves on the Board of Directors of Old Mutual and Macsteel Holdings. He is a member of the International Advisory Council for the World Economic Forum. Member of the DBSA Audit and Investment Committees (CAIB).

Mr 'JB' Magwaza

Executive Director: Tongaat-Hulett Group. He is also a member of the Black Management Forum and non-executive Director of Dorbyl and Nedcor. He has also worked for Hulett Aluminium, Hulett Refineries and Tongaat-Hulett Sugar. First appointed to the Board in June 1995, he was also a member of the DBSA Transformation Team. Chairman of the DBSA Employment Equity Committee (MA).

Mr 'JB' Magwaza

Prof Renosi Mokate

Director: Centre for Reconstruction and Development and Extraordinary Professor: University of Pretoria's Department of Economics. She has served as a Senior Policy Analyst and Programme Manager for the Regional Economic Management Policy programme at the DBSA. She was also seconded by the DBSA to various organisations including the Independent Electoral Commission, the Consultative Business Movement, the RDP national office and the Commission for the Demarcation/Delineation of Regions. Member of the DBSA Employment Equity Committee (PhD).

Prof Renosi Mokate

Ms Hixonia Nyasulu

Director: Nyasulu and Associates. Also serves on the following Boards: Glodina Holdings Ltd, KwaZulu Finance and Investment Corporation, Marriot Holdings, McCarthy Retail Ltd, Nyoni Property Fund Managers, T and N Holdings. Through her consultancy, she has done work for some of South Africa's leading companies. Member of the DBSA Investment Committee (BA Hons).

Ms Hixonia Nyasulu

Dr Robin Plumbridge

Director: Newmont Mining Corporation and Standard Bank Investment Corporation. Appointed to the Board in 1983, he is the former Chief Executive and Chairman of Gold Fields of South Africa, served on the Board of the International Chamber of Commerce, was Chairman of the World Gold Council and President of the Chamber of Mines of South Africa. Chairman of the DBSA Audit Committee and Treasury Sub-committee and member of the DBSA Investment Committee (LLD HC).

Dr Robin Plumbridge

Ms Maria Da Conceicao Das Neves Calha Ramos

Director-General: Department of Finance. She has served in a number of public and private sector positions, including being Research Officer for the London School of Economics, Lecturer in Economics at the University of the Witwatersrand, Project Leader of the African National Congress' Department of Economic Planning as well as working for First National Bank. Member of the DBSA Audit Committee (MSc).

Ms Maria Ramos

Mr William Ramoshaba

Managing Director: Portfolio Business Holdings and Director of Johnson Wax South Africa. First appointed to the Board in June 1995, he also served on the DBSA Transformation Team. He is a Trustee of Redhill School and a member of the Corporate Forum. He has held senior positions with Coopers & Lybrand, Standard Bank of South Africa and Ebony Management and Secretarial Services. Member of the DBSA Employment Equity Committee (BCompt).

Mr William Ramoshaba

Mr Zamindlela Titus

Director-General: Department of Constitutional Development. He was a member of the constitutional negotiations as leader of the Transkei delegation. He also served as Chairperson for the planning committee of the Multi-Party Negotiations Process and Chairperson of the Transitional Executive Council. He was also responsible for setting up the Eastern Cape Provincial Legislature in his capacity as Provincial Secretary. Member of the DBSA Investment Committee (LLB).

Mr Zamindlela Titus

Board of Directors (up to July 1997)

Ms Lucienne Abrahams, Mr Chris Ball, Ms Ann Bernstein, Mr Henri de Villiers, Mr Viv Geeringh, Mr 'JB' Magwaza, Dr John Maree, Professor Wiseman Nkuhlu (Chairman), Dr Robin Plumbridge, Mr William Ramoshaba, Mr Tim Sewell.

Strategic overview

During the past year, the DBSA vigorously pursued its development mission while continuing with transformation to achieve this more effectively. In the previous year internal aspects of transformation inevitably dominated the agenda. During 1997/8 there was a greater focus on delivery and on the Bank's relationships with its clients, partners and target beneficiaries.

President Mandela and Dr Ian Goldin, Chief Executive, during the President's visit to the Bank in November 1997

A number of highlights testify to this outward-looking business approach:

- Record loan disbursements of R2,2 billion and new loan commitments (approvals) of R4,3 billion were made this year, compared to disbursements of R1,4 billion and approvals of R2,3 billion in the previous year (increases of 58 per cent and 87 per cent respectively).
- Productivity, measured across a range of ratios, more than doubled. This is indicated by the significant increase in activities which was achieved while staff numbers decreased from 494 to 465 and real operating expenditure was held at zero per cent real growth.
- Public-private sector partnerships to develop infrastructure were pioneered.
- Developmental financing criteria were improved and innovative measures put in place to put clients and projects on a sound financial footing. This resulted in write-offs falling to barely 0,04 per cent of loans, despite a doubling of the number of loans.
- Co-funding and other partnership arrangements were made with the private and public sectors and multi-lateral and bi-lateral funding agencies, leveraging three times the Bank's own contribution as additional resources into reconstruction and development.
- The Memorandum of Understanding, drawn up with private financial institutions, will facilitate co-operation and enhance the ability of public-private partnerships (PPPs) to finance and develop infrastructure; the Bank now devotes more staff and resources to PPPs than any comparable institution in a developing country.
- The Bank participated in several policy initiatives aimed at promoting effective and sustainable delivery across all infrastructural sectors.
- A more innovative and assertive approach was taken to mobilise funding. The Bank entered the Euro-rand market during the year and set the trend by being the first Euro-rand bond issuer of a 30-year coupon bond at a highly competitive cost.

- The Bank hosted President Mandela in November 1997 and increased collaboration with government and business leaders and officials, as well as with leaders of international institutions and other prominent role-players in the development field. At the provincial and municipal level, it is increasingly engaged in establishing a collaborative programme relationship and signed detailed Memorandums of Understanding with two provinces during the year under review.
- The Bank also increasingly assisted its borrowers to build institutional capacity.

Operational overview

Lending operations accelerated rapidly during 1997/8:

- Cumulative loan commitments increased at a rate of 32 per cent per annum during the year 1 April 1997 to 31 March 1998, compared to 15 per cent during 1996/7 and 10 per cent during 1995/6.
- New applications, with an expected DBSA contribution of nearly R4,7 billion, were accepted into the pipeline during the year, as against a comparative figure of R2,8 billion for 1996/7. Investment loans of R4,3 billion were approved to finance 148 projects with an estimated capital cost of R13,5 billion. This is an increase of 87 per cent on the R2,3 billion of new loan commitments entered into during the 1996/7 financial year, while the leverage increased by 981 per cent, reflecting the growth in the annual total project value from R3,2 billion to R13,5 billion.
- The DBSA disbursed R2,176 billion during 1997/8 – a 58 per cent increase on the previous year's disbursement of R1,378 billion. Growth in disbursements is likely to be maintained at an average of at least 10 per cent per annum in the medium term. Provision is being made for a disbursement of more than R2,5 billion during the 1998/9 financial year, reflecting the Bank's growing ability to work with its clients to ensure effective and sustainable utilisation of its funds (see Table 1).

Table 1: Growth in lending operations (R million)

Volume of lending activities per annum	1995/6	1996/7	1997/8
Approval of loan commitments	1 100	2 300	4 305
Project value	1 912	3 151	13 500
Disbursement of loan funds	1 322	1 378	2 176
New loan commitments accepted into the pipeline	1 100	2 800	4 670

The shift in the Bank's focus, in terms of its new mandate, resulted in several new trends:

Rapid growth in investment in urban bulk infrastructure and internal municipal services: The DBSA's funding support for the upgrading and expansion of urban bulk infrastructure and internal services grew most rapidly, involving relatively higher levels of lending to local authorities and public utilities (see Table 2).

Table 2: Sectoral composition of the DBSA's total investment lending

Sector	Loans approved during 1997/8		Cumulative loan approvals up to 31/03/98	
	R million	per cent	R million	per cent
Regional bulk infrastructure	1 726	40	5 097	29
Urban bulk and municipal infrastructure	2 257	52	9 421	53
Educational infrastructure	136	3	979	6
Entrepreneurial support	186	5	2 164	12
Total	**4 305**	**100**	**17 661**	**100**

More investment in other SADC countries: The DBSA approved investment loans of R1,96 billion during the 1997/8 financial year for financing infrastructure and other development projects in the rest of the SADC region. A key feature of this lending portfolio is the relatively small share of DBSA involvement – 21 per cent of the total capital cost of projects, reflecting the DBSA's substantial impact on leveraging other sources of finance.

This investment portfolio will see substantial growth, with projects in seven other SADC countries presently under consideration. This includes loans of R420 million for the next phase of the Lesotho Highlands Water Programme and R438 million for the construction of the Maguga Dam and related works in Swaziland. This brings the cumulative loans approved by the Bank for these two schemes to R697,4 million and R502,3 million respectively. A loan of R329 million was recently approved for the Mozal aluminium smelter in Maputo.

Entrepreneurial support: Investments in the entrepreneurial sector remain well under 10 per cent of the Bank's new loan approvals and are essentially confined to SADC states outside South Africa, where the mandate extends beyond the core business of infrastructure financing. In South Africa, entrepreneurial support has been largely taken over by Khula Enterprises to whom the Bank transferred a part of its SMME portfolio during the year.

Financial overview

The transformation of the DBSA has placed it on a firm and sustainable financial footing. The strong financial results for the year under review and the robust balance sheet strongly support the DBSA's capacity to sustain its development impact.

The Directors' report, on pages 54 to 56, provides a detailed financial overview.

The following salient features augur well for the future financial outlook of the Bank:

Strong capital: The capital base was strengthened by:

- an addition of R812 million into capital employed through the take-over of the net assets/reserves of the Local Authorities Loans Fund (LALF)
- a healthy surplus for the year of R427 million
- the increase of R3 billion in the Bank's callable capital through the promulgation of the DBSA Act in April 1997. The debt-to-equity ratio remains low at 89 per cent compared to the current policy ceiling of 250 per cent.

Asset growth and quality: Total assets grew by 51 per cent (1996/7: 19 per cent) to R12 billion (1996/7: R7,9 billion). Organic growth accounted for most of this, while the acquisition of the LALF loan book added R910 million. The risk quality of the assets also improved significantly during the year. The risk-free portion of total assets improved to 40 per cent (1996/7: 6 per cent) due to the replacement of former homeland governments' loans with government gilt stock of R3,1 billion, and liquidity at year-end increased to R1,6 billion (1996/7: R429 million).

Profitability and tight control of expenses: The net interest income grew by 180 per cent to R785 million. Net interest income after risk provisions and exceptional transactions grew by 152 per cent, despite a significantly increased (373 per cent) charge for risk provisions, made as a result of the 58 per cent growth in disbursements. This higher risk provisioning is in line with the Bank's more conservative risk provisioning methodology. The Bank also prices for risk in all its investments.

Non-interest income grew by 830 per cent to a sustainable R11,2 million. This resulted from the policy of cost recovery for non-lending (as well as lending) activities introduced from October 1996.

Normal operating expenditure of R136 million was contained to an increase of 5 per cent from 1996/7. Total operating expenditure of R158 million reflects a ratio of 11 per cent to total income compared to 21 per cent the previous year.

The Bank lifted its normal surplus for the year by more than 73 per cent to R177 million. Adding the additional R250 million surplus from exceptional transactions brings the total surplus for the year to R427 million. This represents a return of 4 per cent (1996/7: 1,4 per cent) on total average assets.

New interest rate policy: The lending policy, revised during the previous financial year, resulted in the Bank signing its first floating rate loan agreement. So far, a limited number of borrowers have expressed interest in this facility, although the number is expected to grow. In addition, a policy on guarantees was approved, allowing the Bank to attract private capital into infrastructural development projects while providing some level of security to the lender. This enables the Bank to spread its limited resources more effectively.

Improved risk management: The Bank continued to refine and implement the integrated risk management approach introduced in the 1996/7 financial year. During the year under review a proprietary credit rating system and risk pricing methodology were developed. Risk management in the Bank is practised in a manner that ensures the protection of the Bank's financial sustainability while at the same time promoting the development impact of the Bank's activities.

A rigorous and prudent loan loss provisioning methodology augments the proactive risk management practices and was applied to the entire loan book, including loans transferred from the LALF.

Year 2000 (Y2K): The Information and Technology Services Business Unit (ITSBU) has structured a formal programme for the Bank to ensure all hardware and software components are Y2K compliant. The programme is on track in terms of the time- frames laid down.

In order to counter potential risks at client level, the Risk Management and ITSBU are engaged in a detailed risk assessment of the Bank's clients with respect to the Y2K issue.

Innovation in funding and lending instruments: During the year the DBSA was the first ever institution to issue a 30-year coupon Euro-rand bond. The international capital markets hailed the Bank for the success of its innovation.

The new variable interest rate loan option and the new guarantee instruments are but a few examples of the Bank's responsiveness to development and clients' needs.

As a confirmation of the Bank's creditworthiness, the Agence Française de Developpement agreed to lend to the DBSA without a government counter-guarantee.

Premier credit ratings: A strong balance sheet reflected in the strong capital base, a solid loan asset portfolio that performed excellently at a write-off rate of about 0,04 per cent, a robust control and risk management structure and prudent financial practices ensured that the Bank maintained its domestic AAA long-term and A1+ short-term borrowing credit ratings by the independent international rating agency, Fitch IBCA.

Transformation and productivity

One of the most visible effects of transformation has been the refocusing of business activities. The new approaches have resulted in vastly improved productivity. For example, the average total staff days required to approve R1 million decreased by 82 per cent to 21 days. With nearly 8 per cent less staff than the previous year, output more than doubled and productivity per staff member, in respect of approvals, increased by 368 per cent, comparing year on year.

The table below compares the 18-month periods prior to and following the major reorganisation and other transformation implemented on 1 October 1996:

Productivity indicators

	04/95 – 09/96 (18 months)	**10/96 – 03/98 (18 months)**	**Change**
Total value of projects approved (R billion)	2,7	15,7	+487%
Total DBSA contribution to projects approved (R billion)	1,4	6,1	+325%
Gearing ratio (DBSA: other contributions)	1:0,9	1:1,6	+77%
Disbursements (R billion)	1,8	2,9	+61%
R million disbursed/staff member	3,4	5,9	+73%
R million approved/staff member	2,8	12,5	+351%
Total operational cost as a % of disbursements	11%	7%	-32%
Total operational cost as a % of approvals	14%	4%	-74%
Total operational cost as a % of total income	24%	13%	-46%
Projects approved within 6 months of application	24%	56%	+135%
Average amount disbursed per calendar day (R million)	4,8	7,7	+60%
Average amount approved per calendar day (R million)	3,8	16,7	+325%
Number of clients (as at end of each period)	200	545	+173%
Average number of staff members during period	520	490	-6%
Number of units	57	24	-58%
Number of management positions	57	27	-53%
% of managerial positions filled by affirmative action appointments (as at end of period)	36%	76%	+ 83%

Improving the DBSA's development impact

The growth in disbursements and commitments, the direct contribution of approximately R2 billion to the GDP through the year's disbursements (complemented by many indirect effects), the more than 20 000 sustainable jobs created, the emergence of new contractors and a higher quality of management among clients, are indicators of the DBSA's notable development impact over the past year. In 1998/9, the DBSA will contribute over R3 billion to GDP and create approximately an additional 34 000 sustainable jobs.

However, the Bank cannot afford complacency. It is a learning organisation, constantly looking for new ways to become operationally more efficient and effective

in development. As transformation continued to be prominent on the agenda throughout 1997/8, a few observations about its efforts are relevant:

A streamlined project cycle and business approach: The Bank's business processes have systematically been streamlined to ensure rapid and tailor-made responses to specific clients and situations. It allows business units a greater degree of authority to decide on operational strategy and policy and to identify new investment opportunities. At the same time, a greater number of loan approvals can now be handled by business unit managers.

The Board is only involved in projects of more than R7,5 million or, on advice of management, in cases presenting new policy issues.

As a result of the changed decision-making structures, almost two thirds of all approvals are now done within business units and only 24 per cent have to be referred to the Board. The remainder can be approved by the chief executive and executive managers. This has resulted in a major saving on time, with 56 per cent of all projects being approved within six months of application, in comparison with only 24 per cent prior to the transformation.

With these new efficiencies in place, the major focus now is to develop quantifiable impact indicators and further enhance the development impact of the Bank. Work on this will continue in the coming year.

Another of the Bank's priorities is to assist project teams to tailor development support to specific circumstances and to explore new opportunities for innovation with clients. For instance, public-private sector co-financing and the private provision of infrastructure are innovations that extend the scope of development support beyond the Bank's own resource base. Another is programme lending for larger borrowers, which links sets of projects rather than dealing with each in isolation. This is increasingly being used as a mechanism to encourage more cost-effective lending practices and coherent development approaches.

The programme approach has also led to improvements in productivity. The number of loans approved increased by 14 per cent while the total loan amount increased by 87 per cent, mainly due to this greater emphasis on programme lending. It now takes, on average, 3,8 months from receipt of application for loans to be approved – an improvement of 36 per cent. More than 37 per cent (R1,8 billion) of all approvals were integrated into programme loans, which enhanced policy and operational consistency within a set of developmental and appraisal criteria agreed with each client.

Improved project and client appraisal: Conducting prior assessments of the financial position of borrowers and their institutional capacity has significantly reduced the turnaround time of project applications. This also enabled the DBSA to focus its technical assistance programme on strengthening institutional capacity, mitigating risk and optimising socio-economic impact.

During 1997, international and South African experts helped to improve the quality of the Bank's appraisal mechanisms. This entailed reviewing the focus, skills and technical requirements of each appraisal module, developing appropriate guidelines and determining how to redress shortcomings and advance best practice. The establishment of the Bank's Operations Evaluation Unit (OEU) also ensured that the lessons learnt from the Bank's activities are used to enhance its role and effectiveness.

Sustaining development impact

Specific interventions help the Bank to sustain its impact and to develop new approaches.

Risk management: The high-risk environment within which the Bank lends demands particularly prudent risk management. During the Bank's transformation and restructuring, a Risk Management Business Unit and Finance and Risk Management Committee were established to identify and manage this within the project appraisal process.

The DBSA monitors its risk exposures through the review and management of portfolio diversification, single obligor exposure, credit rating of borrowers and concentration of risk (in aggregate) at the lower end of the risk spectrum. Risk management protects the Bank's financial viability, builds the institutional and financial capacity of clients and strengthens the development impact of projects by means of thorough appraisals. Where unacceptable risks are identified at an early stage, risk mitigation frequently enables projects to be approved eventually. Timeous warnings also allow problems to be resolved through advice or mitigation.

Technical assistance: This strengthens the capacity of existing and new borrowers and helps prospective clients to qualify as borrowers. The main thrust of technical assistance is to help overcome constraints influencing the functioning of local governments.

Operations evaluation: The OEU was established in October 1996 to evaluate the impact and efficiency of policies, programmes and projects. Feedback from the evaluation is then used to improve the quality of development interventions and to determine best practice. During 1997, members of the Unit were trained both at the World Bank and in-house by an international evaluation expert.

During the year, the OEU assessed the effectiveness of project completion reports and conducted its first three evaluations, covering environmental impact, community involvement, capacity building, institutional reform, the role of local authorities and the private sector and international co-operation on macro-regional matters.

Management team

Seated (left to right): *M Gantsho (Executive Manager), S Fourie (Corporate Accounting and Budgeting), I Goldin (Chief Executive), M Sindane (AA/Gender), JH de V Botha (Executive Manager)*

Standing (first row left to right): *A Rapea (Human Resources), L Mahlangu (Operations Secretariat), L Musasike (Treasury), J Tyobeka (Eastern Region), F Saib (Western Region), C Golino (Specialists), S Mncube (Development Information), T Wiswe (Corporate Secretariat), G White (Private Sector Investments – Acting), M Tshatsinde (Management Information)*

Back row (left to right): *S Madolo (Corporate Relations), R Rees (Risk Management – Acting), C Heymans (Policy), N Weitz (Internal Audit), D Zimu (Southern Region), R Greybe (General Services), P Mokhobo (Legal Services)*

Not in picture: *G Tate (Information Technology Services), O Mokuena (Strategic and Business Planning), B Maleke (Southern African Region), L Mashaba (Northern Region)*

Policy analysis and support: The DBSA actively seeks to improve its own operational policies and to influence the broader policy environment. The Policy and Specialist Units – supported by Operations and the OEU – conduct policy analysis and provide advice to the DBSA and external clients.

These units are currently testing a set of indicators to measure the Bank's own development impact.

Development information: Information is pivotal to the DBSA's development processes and the Development Information Business Unit (DIBU) provides socio-economic and infrastructure-related information to support the DBSA and its clients. The unit also engages in capacity-building at local and community level, facilitating the development of information networks and databases.

Strategic and business planning: This unit also contributed to an understanding of the critical forces shaping the environment in which the DBSA operates. The unit periodically reviews strategic issues and engages key stakeholders in order to align the DBSA's strategic approach with best practice. It also drives the annual and three-year business planning process and monitors the implementation of agreed business plans.

Human resources: The DBSA's human resource policies and systems were changed substantially during the past year. This has kept the Bank in line with latest employment best practice while streamlining its staff contingent in support of its development mission. Staff were re-graded from a 17-tier structure to five broad bands of job families in terms of the Hay System.

A parallel process was undertaken in collaboration with the Affirmative Action Committee and Women's Forum to rectify anomalies and eliminate all discrimination based on race or gender. Following agreement between management and the representative interest groups, a unique exercise was embarked upon. The principle adopted was that all staff with similar qualifications and experience should have the same job level and, based on no race or gender differences in performance, a similar distribution of remuneration. The period taken was 1 October 1995 to 31 March 1998 and the investigation found that most black and female staff were discriminated against, based on the criteria above.

The amount required to address the anomalies was R5,4 million, but only R2 million was available from savings. Individuals were compensated on a sliding scale, leaving approximately R3,5 million to be worked into salary adjustments from 1 April 1998. To champion and monitor the Bank's continuing AA/Gender transformation, an AA/Gender Unit with representation on executive committee, has been established.

The training budget has been doubled and systematic training programmes to cater for the Bank's needs and to support the career development of individual staff members, are being put in place. Specialist skills development and affirmative action are receiving particular attention.

This year also saw, for the first time, unionisation of the Bank's employees. The South African Commercial, Catering and Allied Workers' Union (SACCAWU) was officially registered and has already negotiated with management on a number of issues that affect staff. Management welcomes this change as it further modernises the organisation's human resource management.

The Bank's affirmative action programme is reflected in its recruitment policies and staff development programmes. By year end, 63 per cent of management was black and 25 per cent female. Of the full staff complement, 42 per cent is black and 44 per cent female. Ongoing monitoring ensures that agreed targets are being met and that each recruitment decision simultaneously bolsters the quality of the Bank's skills.

Much has been achieved in the transformation of the Bank. However, there is much more that still requires attention. Transformation is a continuous process to improve the Bank, both internally and in terms of its development impact.

Conclusion

The Bank has transformed organisationally and operationally while placing itself on an independent and sustainable financial growth path. In the process, it has doubled its disbursements, enhanced its development impact and greatly improved productivity while growing successful partnerships with the public and private sectors throughout the SADC region. Internally and externally, it has been building foundations for development.

MAKING AN IMPACT:
THE DBSA AND DEVELOPMENT

The DBSA's infrastructure funding role occurs against a very challenging backdrop of backlogs (see Table 1). At the same time, concerted efforts are being made by the government, parastatals and the private sector to improve the situation.

The Chairman's report has already noted key aspects of the national and regional policy environment supporting development. The Bank's role within this is to enhance the gearing of the RDP, the evolution of SADC and the implementation of policy initiatives emerging from the series of government white papers.

As far as delivery is concerned, some key indicators emphasise the progress made:

Electrification: The electricity supply industry made considerable progress during 1997 with 424 000 houses electrified. The target is to provide about 60 per cent of all houses with electricity by the year 2000, implying that a further 456 000 need to be electrified within the next year.

Water and sanitation: The government aims to provide a clean, safe water supply of 20 to 30 litres a day within 200 metres reach, plus adequate sanitation facilities, to every person in South Africa. Since 1994 an average of 1 000 more people gained access to clean water every day, and over 1,4 million have benefited.

Telecommunications: Telkom aimed to connect 256 000 lines in under-serviced areas during 1997/8, bringing the total delivery target for the year to 360 000. Doubling the existing number of lines to 8 million over the next five years will require an investment of R53 billion. Telkom also aims to provide a digital network by 2001/2.

Roads: While South Africa has a sophisticated road network, many roads require upgrading and the network does not adequately address needs. Investments of R2,4 billion for primary and R5,5 billion for secondary rural roads are needed each year for 10 years to address the backlog. An additional R4,1 billion is needed to maintain existing roads and another R3,2 billion for new roads.

Housing: Altogether 737 462 housing subsidies were approved up to January 1998. The total number of houses completed or under construction was 482 555, less than half the 1 million houses intended to be built in terms of the housing programme. To clear the backlog and cater for new growth over the next 10 years, 375 000 more houses are required annually. To provide the household infrastructure that goes with this poses a demanding challenge to the DBSA and others in the infrastructure arena.

Education: More than half of the nearly 30 000 schools in South Africa are without electricity and nearly one quarter without water on site. Approximately 12 per cent have no sanitation facilities, about 61 per cent have no access to telephones and 83 per cent are without libraries. The estimated backlogs are: 57 000 classrooms, 10 000 bore-holes, 15 000 electricity connections, 17 000 telephones and 270 000 school toilets.

Table 1: Access to services in South Africa (estimated totals only) – 1997

Service	**Number with access**	**Percentage with access**
Electricity (Households)	4 932 000	58
Water (Population)	22 980 000	59
Sanitation (Population)	18 162 000	47
Telephones (Households)	6 150 000	71
Road network	**(km)**	**% distribution**
Total	488 000	100
National	20 000	4
Provincial	162 000	33
Urban roads	85 000	18
Rural roads (unproclaimed)	221 000	45

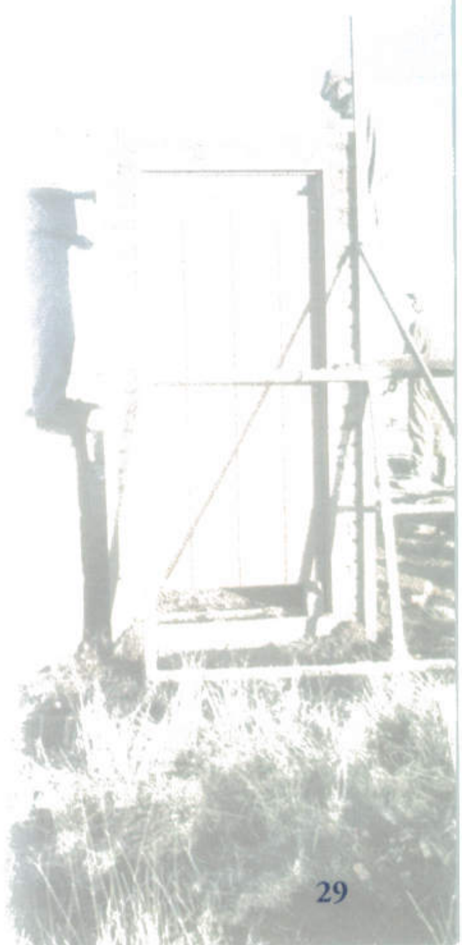
Note: These estimates are based on the CSS 1996 Census population figures of 37,857 million and an average annual population growth rate of 2,3 per cent per annum.

The DBSA's development focus

In line with its new infrastructure-focused mandate, the Bank's priority is to ensure its investments achieve maximum development impact. This focus runs through the organisation's decision-making processes, policy analysis, project appraisals, monitoring and evaluation and project management.

A wide-ranging study on the impact of infrastructure on development will be published in the final quarter of 1998, drawing on theoretical and empirical analyses of the Bank's own and comparative international experience.

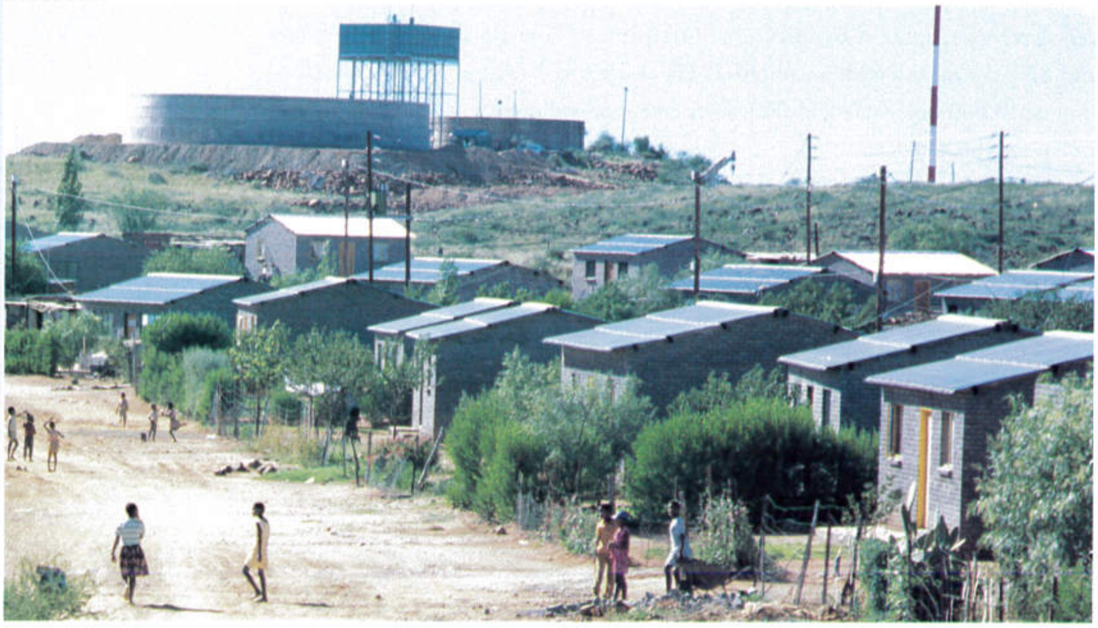
Development impact is a vital indicator that depends on a complex range of issues – for instance, the type, quality, accessibility, affordability and range of infrastructure and related services as well as the manner in which planning, construction and maintenance is managed.



There are three areas in particular in which the Bank strives for maximum impact by planning and structuring its funding innovatively and by complementing it with technical assistance:

Reducing poverty: To achieve this, infrastructure investment must improve the lives and opportunities of poor people while responding to their demands and what they can afford. The provision of services must avoid turning people into passive recipients: they need to be central actors, able to choose and direct their own development according to their own objectives and means.

The right mix of services is vital to maximising development impact. For example, the provision of energy can contribute to a better work and study environ-



ment through lighting, give access to information via the media, free up time for productive activities and improve air quality and safety by reducing smoke pollution and fire hazards. Water infrastructure provides potable water which makes cooking, manufacturing and agriculture easier, also frees up time for other productive activities and reduces communicable diseases.

Economic growth: An initial supply of even basic infrastructure can generate economic growth that in turn creates new demand for infrastructure. Appropriate transport, energy, communications, water and sanitation infrastructure lowers the unit costs on transactions, reduces delivery time and opens access to markets. If such growth is well managed, it holds the promise of more jobs, more income and trade and further investment.

The GEAR strategy anticipates that infrastructure provision and maintenance could generate some 100 000 jobs annually by the year 2000. The green paper on public works estimates that between 11 and 23 permanent jobs could be created for each R1 million invested in infrastructure. Jobs created as part of the crowding-in and multiplier process are likely to be more permanent – for instance, jobs coming out of tourism development as a result of new roads and trade in domestic appliances after electrification.

Capacity-building: South and southern Africa have many institutions providing infrastructure and services, but these often lack the capacity to finalise projects and maximise and maintain their value. Infrastructure projects require, and help shape, viable institutions and offer focal points for development delivery. This means the Bank's financing role must be supported by both careful project and borrower appraisals and technical assistance to ensure that the development is sustainable.

Making a difference

Before analysing the scope of the Bank's impacts, some comments are needed to show that practically all its activities are directed towards enhancing its development impact.

Project and programme finance: The DBSA undertakes its financing in one of four ways:

- Co-funding with the private sector, combined with the packaging of investment finance to leverage resources
- Direct loans to clients that pose too high a risk for the private sector yet are sufficiently credit-worthy to borrow concessional loan finance
- Providing guarantees to mitigate risk and facilitate investment by the private sector
- Taking equity in investment vehicles that finance infrastructure projects.

The Bank's financial impact comes largely from its role as a catalyst: it prefers to invest on at least a R1:R1 basis with other investors. In partnership with major institutions like Eskom, metro councils and private sector financial institutions, the Bank is able to significantly supplement development efforts by adding finance and technical support. For instance, the R4,3 billion worth of projects approved by the Bank in the year under review is less than a third of the financing for these projects. The total value of the projects is about R13,5 billion.

Assisting borrowers: The DBSA financing is preceded by rigorous project and client appraisals. These assess the likely impacts of the project, the financial and institutional capacity of the client and the actions required to make the project viable and its development impact sustainable. All project assessments have to balance how a project fits the policies and implementation programmes of the DBSA, the Government and the client, with the institutional and financial capacity of borrowers. The likely economic, environmental, technical and social impacts of the project are also analysed during appraisals.

Although some projects are inevitably turned down because of unacceptably high risk, the Bank often provides technical assistance through grants and advice to enable clients to become viable borrowers.

For example, many local authorities were helped in 1997/8 to improve their financial and operational management systems and to involve communities in the planning and maintenance of projects. The conditions attached to loans are also developmental. The R585 million loan to the Greater Johannesburg Metropolitan Council illustrates how finance can be linked to reform of a client's financial management.

Policy reform and best practice: The DBSA's policy, risk and evaluation analyses look at policy challenges and explore best practice. This is frequently project specific and related to particular client needs, but some policy endeavours are more broadly strategic – for example, participation in technical teams working on government policies like the RDP white paper, GEAR, the urban and rural development green papers and development frameworks, the local government white paper and sectoral policy papers, specifically those in water and sanitation, energy, transport and municipal infrastructure. Where the Bank has expertise, it contributes to strategic discussions on development.

Because of the direct link to the DBSA's infrastructure mandate, dedicated capacities were put in place to focus on SDIs and PPPs. The Private Sector Investments Unit, for instance, has established the leading African capacity in public-private partnerships in infrastructure.

In the past year, a Municipal Infrastructure Investment Unit (MIIU) was jointly established with the Departments of Finance and Constitutional Development and co-funded by international donors. The MIIU will focus on technical support to municipalities, especially around PPPs. A DBSA-based team of specialists also supported government in the SDI process, focusing on policy analysis, development programming, project management and operational support.

As part of the DBSA's strategic planning, decisions about resource allocation for infrastructure development in every province take cognisance of infrastructure backlogs and priority needs contained in provincial growth and development strategies and local authorities' capital development programmes.

This process culminates in development support strategy frameworks which are agreed to between the DBSA and provincial governments. Such congruency of efforts intensifies the Bank's development impact and promotes the achievement of strategic development objectives for the country.

Operating as a bank: All the Bank's activities are tied to its own financial sustainability. Performing a developmental role while remaining a viable financial institution poses a complex challenge. Viability is ensured through concerted risk analysis and management as well as through genuine collaboration and stakeholder participation at country, client, project and internal organisational level.

The treasury function ensures funds are obtained at the lowest possible cost with maturities to match investments, minimising financial risks. Achieving best practice in terms of sound banking principles and corporate governance requires integrating the Bank's corporate accounting and performance auditing principles throughout the organisation.

Measuring development impact

The DBSA and its co-financiers' investment in bulk infrastructure – upgrading water supply, sanitation, electrical works, roads and storm-water drainage and institutional and social services – covers 72 urban areas. Approximately 987 000 households will benefit through what amounts to an investment of R2 100 per household or about R480 per person (see Table 2).

Table 2: DBSA and co-financiers' investment in urban bulk infrastructure and municipal services projects in South Africa in 1997/8 (R million)

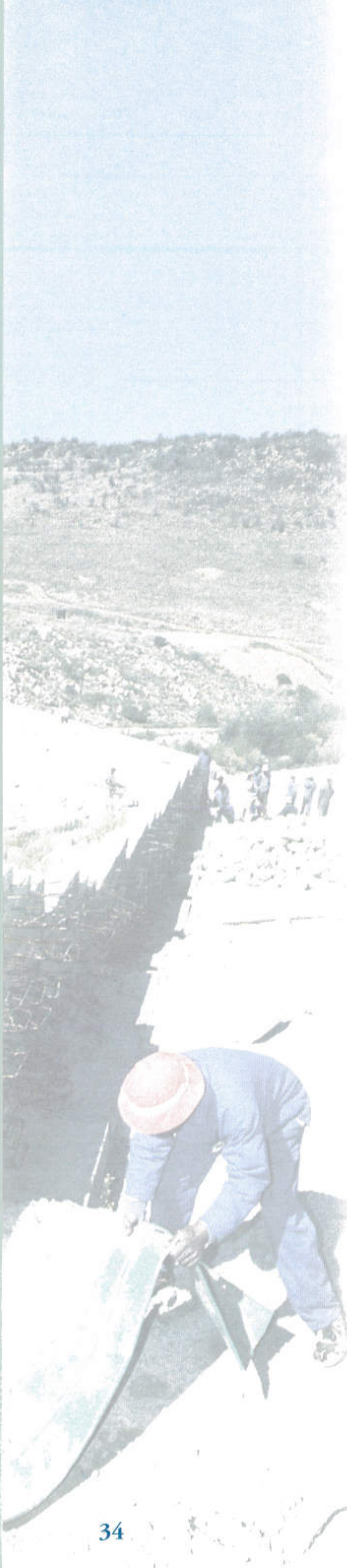
Province	Water and sanitation	Electrical	Roads and storm-water	Institutional and social services	Total project value	Share of project value to be financed by DBSA Amount	%	No of urban areas	No of households benefited
Eastern Cape	21 313	47 080	3 616	1 937	73 946	39 321	53	9	39 880
Free State	62 998	10 620	7 223	0	69 841	73 983	92	13	44 716
Gauteng	806 735	121 944	340 733	12 800	1 282 212	1 175 609	92	6	808 000
KwaZulu-Natal	46 843	40 573	14 000	0	101 416	56 028	55	3	20 000
Mpumalanga	4 010	37 760	3 301	3 474	48 545	39 240	81	5	9 680
North West	138 000	57 457	15 166	8 462	219 085	109 158	50	5	17 725
Northern Province	2 349	2 672	3 931	0	8 952	8 952	100	3	3 000
Northern Cape	29 632	3 595	1 048	0	34 275	29 537	86	7	10 850
Western Cape	104 881	23 025	32 655	67 330	227 891	194 763	85	21	33 090
Total	1 216 761	334 726	421 673	94 003	2 077 163	1 726 591	83	72	986 941

The DBSA gauges its development impact by assessing whether projects are economically justifiable, financially viable, technically appropriate, institutionally manageable, environmentally sustainable and conducive to social equity and empowerment. The Bank's aggregate impact over the past year in these six areas is assessed here:

Economic impact

The DBSA's support for infrastructure programmes and projects has had some reasonably quantifiable economic impacts on GDP and employment. But while estimates of economic impacts do yield important insights, their measurement has many methodological and other shortcomings, especially for development institutions, whose overall impact goes well beyond directly quantifiable economic impacts. The Bank used a variety of techniques to estimate the impact of its support for infrastructure investment and obtained similar results in all of them. In the tables the direct, indirect and other multiplier effects were calculated through input-output and social accounting matrix analysis.

A standard assumption in this type of analysis is additionality. Most of the funds used by the DBSA are additional to the economy. Arguably, without the DBSA's



funding, many of these projects would not have happened. Furthermore, the DBSA's focus on strengthening development impact results in more effective projects with a larger impact on employment and the GDP. Concerning employment, these jobs will not all show up in the employment statistics, partly due to the general contraction in the private construction industry. Without these investments, job losses in this sector would have been far higher. In addition, many of these jobs are in the poorly enumerated SMME sector.

Table 3 shows the impact of the DBSA's disbursements on both projects in South Africa and those with a significant impact on the South African economy *(these are the Lesotho Highlands Water, the Komati River Basin and the Maputo Development Corridor programmes).* Table 4 reflects the impact of such projects in terms of the DBSA's commitments for the 1997/8 financial year. The impact was calculated over a projected project life of 20 years. While most of the impact usually occurs during the construction phase, these figures reflect a recurring average annual effect for each of the 20 years. Given the time lags in the economic repercussions of projects and programmes and the likely changes to the economic structure during that time, it is impossible to provide totally accurate estimates. It is nonetheless projected that:

- The projects on which the DBSA disbursed funds during 1997/8 created or maintained an average of approximately 20 000 employment opportunities per year (defined as employment for a single person-year) throughout the economy. Newly approved DBSA projects should create or maintain an average of an estimated additional 34 000 job opportunities per year. The bulk of these employment opportunities will be created during the construction phase, with employment numbers considerably lower during the operational or maintenance phase.
- The impact on the GDP as a result of domestic investment financed by the DBSA amounts to an average annual figure of R1,6 billion for 1997/8 disbursements and R2,6 billion per year for commitments. These figures constitute about 0,3 per cent and 0,5 per cent respectively of the total GDP generated in 1997.

Table 3: Impact of 1997/8 disbursements[1]

Sector	DBSA loan investment (R million)	GDP (R million p a)	Employment (Number p a)
Water	591	370	4 100
Sanitation	728	450	5 000
Electricity	345	210	2 300
Roads	140	10	200
Human resources	212	20	300
Commercial	71	200	2 000
Agriculture	38	40	1 200
Immediate impact[2]		1 280	15 000
Delayed impact[3]		310	4 700
Total	2 125	1 590	19 700

1. Figures may not add up due to rounding
2. Benefits accrue as soon as the project is implemented
3. Benefits only accrue after a time lag

The above figures are based only on the DBSA's contribution to projects. As stated earlier, the total impact of these projects on the economy is considerably higher. While DBSA-financed or co-financed projects had a total value of at least R5,1 billion in South Africa, cross-border and other SADC investments push this up to R13,5 billion. An investment of R5,1 billion in the South African economy is estimated to contribute R5,5 billion to GDP on an average annual basis over a period of 20 years and create or maintain 77 600 employment opportunities per year, as reflected in Table 5.

Table 4: Impact of 1997/8 commitments[1]

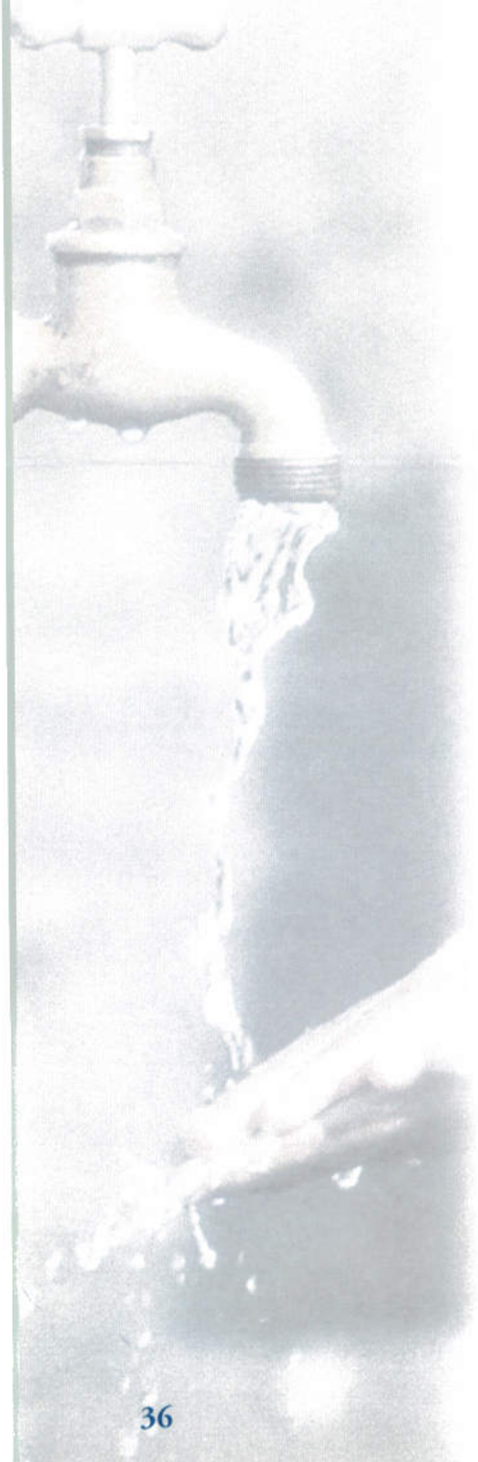
Sector	DBSA loan investment (R million)	GDP (R million p a)	Employment (Number p a)
Water	916	570	6 300
Sanitation	1 057	660	7 300
Electricity	577	350	3 800
Roads	523	40	600
Human resources	65	10	100
Commercial	9	20	200
Agriculture	67	60	2 100
Immediate impact[2]		1 700	20 500
Delayed impact[3]		910	13 900
Total	3 214	2 610	34 400

1. Figures may not add up due to rounding
2. Benefits accrue as soon as the project is implemented
3. Benefits only accrue after a time lag

Table 5: Impact of total capital value of projects financed or co-financed by the DBSA, 1997/8[1]

Sector	Total capital value (R million)	GDP (R million p a)	Employment (Number p a)
Immediate impact[2]		2 030	25 000
Delayed impact[3]		3 450	52 600
Total	5 057	5 480	77 600

1. Figures may not add up due to rounding
2. Benefits accrue as soon as the project is implemented
3. Benefits only accrue after a time lag



Financial impact

This was achieved mainly in five ways:

Promoting sound financial management: Borrower appraisals identified limitations in the financial position of clients and highlighted financial management issues for further attention. Where appropriate, remedial actions were proposed – for instance, good financial systems, sound pricing policies, adherence to budgets, internal financial controls and transparent accountability procedures.

For example, the loan to the Greater Johannesburg Metropolitan Council was conditional on restructuring the borrower's capital programmes and improving its credit control. This included revising capital and operating budgets; amending institutional structures; restructuring capital programmes; improving information systems; structuring tariffs to cover costs; improving accounting practices and investigating outsourcing of certain functions. The DBSA only released instalments once it was convinced that the necessary milestones had been reached.

Project finance: The Bank approved R4,3 billion in new loans while disbursing R2,2 billion, all to projects that were deemed financially viable. The DBSA's contribution to the financial success of such projects was based on the following:

- Sensitivity analysis to identify high-risk areas and determine the short- and long-run financial impact of projects
- Verifying the soundness of the borrower's investment decisions through capital budgeting techniques on a multi-year basis
- Determining the affordability to the beneficiaries
- Ensuring that the client and all stakeholders were committed to the project and the repayment implications
- Structuring project funding to minimise the impact on the borrower's operational budget
- Assisting in building the financial capacity of the borrower.

Policy development: The DBSA has been involved in several initiatives to promote better understanding of key issues and to develop new financial policy guidelines and regulatory frameworks. For instance, it continued research into best practice in development finance and acted as research manager for the Departments of Finance and Constitutional Affairs' study on a *Financial framework for municipal infrastructure investment and reform of the local government fiscal system.*

Capacity-building: While its role is largely supportive, the DBSA's financing mandate enables it to support the country's broader development effort in very specific ways. For example, during the past year a number of provincial governments requested help in introducing and improving public finance management systems and procedures. The DBSA was involved in such programmes in the Free State, Eastern Cape and Northern Cape. These mainly advanced multi-year budgeting, implementation of the medium-term expenditure framework, preparation of annual estimates and computerisation of budgetary and financial management systems.

Broadening awareness of the private provision of infrastructure (PPI): Led by the Private Sector Investments Unit (PSIU), the DBSA continued to focus on technical assistance for the preparation of a number of innovative PPI projects. This included a proposed port and industrial development zone in the Eastern Cape, water and sanitation projects in Mpumalanga and KwaZulu-Natal and a further 15 pilot projects identified as part of the Department of Constitutional Development's Municipal Pilot Projects Programme.

The PSIU also promoted financing opportunities for PPI projects in the southern African region. Two of these, with a total investment of R529 million, were the Witbank-Maputo toll road and the Mozal aluminium smelter in Maputo. The DBSA approved a loan offer to Mozal to the value of US$70 million for the establishment of the first phase of an aluminium smelter and supporting infrastructure near Maputo in Mozambique. This support will include plant-dedicated infrastructure as well as the upgrading of the Maputo harbour and improvements to the road infrastructure.

Opportunities will also be created for optimum SMME involvement in the project – for example, through subcontracting relevant operational activities. The project is sited in an industry-free zone and will directly contribute to the development of this 800 hectares industrial area through the establishment of support industries for the smelter. The bigger Mozal project, supported by major local and foreign investors, will form part of the Maputo Development Corridor and is expected to add at least US$157 million per year to the GDP of Mozambique. It will employ around 2 500 Mozambicans during construction and, once in operation, will employ over 870 people of whom 790 will be locals.

Growth in the PSIU's project pipeline is accelerating. Significant progress was made during the last quarter of 1997/8 and investment proposals for seven major projects and many smaller initiatives are likely to be approved during 1998/9.

Social impact

The Bank's experience underscored the importance of participation by the people affected by programme and project decision-making. This enhances financial and institutional sustainability and training, secures skills transfer and economic empowerment and improves quality of life through greater social, income, gender and racial equity. Three key elements enhanced these development impacts in each of the Bank's projects:

Clear performance criteria and role definitions: In the Dolphin Coast (KwaZulu-Natal) and Nelspruit (Mpumalanga) water and sanitation concessions, for example, the municipalities play regulatory roles, requiring concessionaires to meet well-defined, time-linked performance targets. In Nelspruit, where 60 per cent of the population does not have access to adequate water, a key clause stipulates that a 24-hour supply of water is to be established within a year. In addition to the health and time-saving benefits of the water supply, improved service levels are also expected to trigger an increase in investment, positively impacting on the economy of the region.

The Dolphin Coast request for proposals, like that of Nelspruit, obliges bidders to detail their community empowerment strategies. These will be evaluated according to policies and practices that support black economic empowerment through, for example, equity participation, co-operation agreements, management and service agreements; the employment of persons from local communities and the use of labour-intensive approaches, local suppliers and emerging contractors; and the contribution of the project towards the academic and skills upliftment of the youth in the community.

Participation: Sustained success is built on involvement of the beneficiaries in all facets of a project. Clients and beneficiaries are sensitised to the importance of participation and, where necessary, technical assistance is provided to resolve conflicts and facilitate participation. The Bank's policies aim to ensure that projects are responsive to the needs of the intended beneficiaries and sensitive to a community's history, traditions, values and social organisation. Careful consideration is also given to a project's impact on a community and appropriate compensatory mechanisms are instituted where relocation, loss of assets or other negative results are expected.

Two examples from the past year illustrate the Bank's approach:

- During the social appraisal of a request to provide financing of R1,25 million for general urban infrastructure in Franschhoek, it was found that the disadvantaged community's main priority was housing. However, provision of housing was constrained by unsuitable and insufficient land allocation and by strife, conflict and lack of communication, especially between the statutory bodies and community-based organisations.

  In conjunction with the French development agency, Agence Française de Developpement, the Bank approved a grant of R65 000 to facilitate overall development in Franschhoek by enhancing the community's ability to participate in local development negotiations. As a result, Franschhoek established a social and development accord among all its stakeholders and has applied to the DBSA for a further R1,1 million for infrastructure investment.
- The social appraisal for the Welkom/Thabong Sewage Treatment Works highlighted a considerable amount of friction between the local council, the South African National Civics Organisation (Sanco) and the local development forum. The DBSA facilitated conflict resolution between the council and Sanco. As a result of the new-found collaboration between all parties, residents were more motivated to pay for services.

Gender equity: During the past financial year, four major processes were initiated to improve the impact of the Bank's programmes and projects on gender equity:

- AA/Gender Unit representatives and a number of other social specialists were trained in methodological tools for the application of gender and development principles.

- Gender issues were one focus of the assessment of the social impact of projects financed by the DBSA in 1996/7. The report noted that women in the Bank's typical target communities were often constrained by poverty, multiple roles and inequitable access to opportunities, services and decision-making. While recognising the importance of women in the development process, the Bank holds that gender encompasses the roles of both men and women. Therefore most projects do not specifically target women, but significant numbers of women participate in initiatives such as the North Pondoland sugar project, Kimberley buffer strip development project and Nkomazi rural development project.
- The OEU's assignment on the impact of DFIs on gender used the DBSA as a case study. Six projects were identified at different stages of the project cycle. The assignment's interim findings revealed that while most projects did not explicitly

address gender, women benefited by accessing training, employment opportunities, loans for large-scale farming, temporary employment and even sub-contracting opportunities, as well as participating in project planning and decision-making. Preliminary project gender performance indicators were formulated and a gender sensitivity and impact management model was proposed.

- The Bank was also involved in the Women in Construction (WIC) initiative, jointly organising a national workshop in June 1997 with the University of Pretoria's Gender Resource Centre. The workshop confirmed the need for an interest group to negotiate on behalf of members on issues such as access to jobs, training (mainly tendering and management) and finance. Since the national workshop, several provincial workshops have been held. WIC members are mostly involved in housing, road building and maintenance, health clinics and the schools building programme.

Training: The DBSA builds in the transfer of skills to communities through its infrastructure investment and implementing approach. One example of the Bank's success in this regard is the Bloemwater water supply programme in the southern Free State. The loan agreement for this programme was signed during the 1996 financial year with implementation during the past financial year. A dedicated budget was allocated to facilitate community involvement and officials were appointed specifically to liaise with communities.

Training needs were identified in community workshops and training programmes were designed in consultation with the contractors, consultants and the DBSA. Progress is being monitored to ensure that funds are used as intended. Employment and training statistics are reported at regular project steering committee meetings. The most recent meeting reported that 865 local labourers have been employed to date with wages totalling R5,37 million. Linked to this is a training programme budget of R2 million.

Small business impact

The DBSA promotes the use of small contractor and labour-intensive approaches in all its loan finance. It also uses policy and technical analysis to explore and develop best practice.

- Significant policy and technical design work over the past few years have enhanced the general understanding of labour-intensive approaches. In the past year, involvement in the conceptual development of a public works programme for Namibia offered an opportunity to build on similar support rendered in South Africa between 1994 and 1996.
- The DBSA continued to promote SMMEs through board-level involvement on DFIs and other SMME bodies, including Khula Enterprises, the National Housing Finance Corporation and the Alliance of Micro Enterprise Development Practitioners. It contributed to strengthening the capacity of provincial contractors' associations, illustrated by the recently established Emerging Contractor Councils in the Western and Eastern Cape. The Department of Economic Affairs' SMME desks, such as those in KwaZulu-Natal and the Northern Cape, are also receiving strategic planning support from the DBSA to establish their own emerging contractor development programmes.

  Notable progress was made in mobilising private sector resources – specifically, the establishment of private sector-driven surety funds to support existing development funding. The Emerging Contractors Benefit Trust, launched this year under the auspices of the established business sector and the Northern Province Small Contractors Association, came as a result of these DBSA initiatives.
- Internally, Bank policy favours previously disadvantaged and SMME individuals and companies in its procurement of equipment, services (for example, security and cleaning) and consultants.
- The SDIs offer significant opportunities for emerging contractors. In 1997/8 the DBSA produced a series of guidelines for achieving the principles of SDI investments, notably to create and use opportunities for smaller enterprises. The tourism guidelines describe how different models can contribute to empowerment through equity sharing, sub-contracting or sustainable job creation. The DBSA is also involved in the Fish River and West Coast SDIs that promote selected SMME projects in conjunction with larger investments. Another example is the Maputo Corridor which allows projects other than infrastructure to be identified for investment. In both Mpumalanga and the Northern Province, tourism projects were identified and are being prepared for promotion.

Empowerment can take place through essentially three routes: SMMEs can enter into equity arrangements with larger companies; they can bid directly for smaller portions of projects (either the construction itself or its management); or, they can benefit from downstream opportunities arising from the increased investment in the area.

- In the past year, the DBSA had unique opportunities to promote small contractor involvement in major infrastructure projects. For example:

– The initial assessment of the Driekoppies Dam indicated a sub-optimal return to the community unless the dam could be built in a labour-intensive manner. Due to the scale of the project (R488 million) this was not always practical. However, the DBSA encouraged labour-intensive methods wherever possible – for example, in the construction of 300 houses in the nearby settlement area (R500 000 worth of contracts). The sheer scale of the project expenditure over a five-year period made a substantial impact on the income of the local population as well as injecting money into the local economy.

– The scale of the Maguga Dam project in Swaziland also limited the opportunities for the emerging construction sector. However, the project's housing contract was designed to maximise opportunities for emerging contractors and 20 are engaged in building 140 houses. Each contractor was allowed to tender for one or two houses and could only tender for more, subject to satisfactory execution of the first contract.

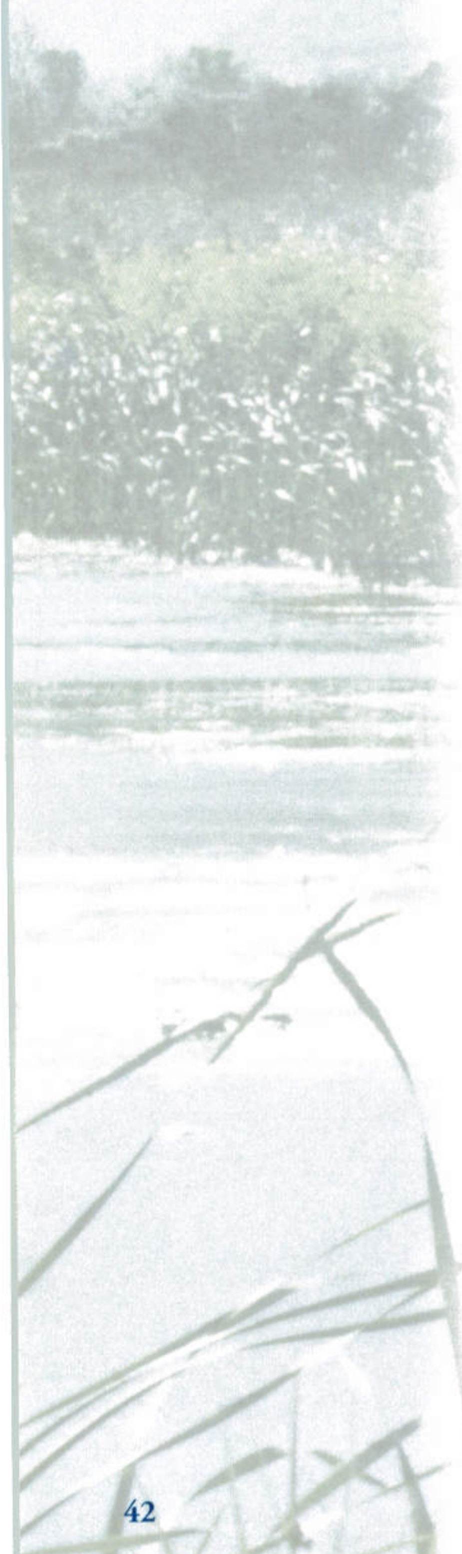
– When the DBSA funded the recently-completed Makhado College of Education in the Northern Province, the project of R32 million was implemented by 11 local emerging contractors supported by an on-site co-ordinator and the Northern Province Provincial Small Contractor Association. The DBSA-funded R19 million KaNgwane Nurses Training College in Kabokweni, Mpumalanga, was constructed entirely by 11 emerging contractors and a consortium of nine small contractors, all drawing their labour from the local inhabitants. Both projects were of acceptable quality and completed on time and within budget. Again, on-site support programmes were important factors in the success of the projects.

- In response to the institutional needs within the SADC region, the DBSA has also taken on rural and entrepreneurial development projects outside South Africa. In 1997/8, loans of R110 million were approved to support SMME's through the Namibia and Malawi Development Corporations and the Bank is currently considering a number of new SMME applications from the SADC region.

Institutional impact

International experience emphasises the critical role of institutional capacity in sustainable infrastructure development. To address the challenges in this area the DBSA has:

- Improved its appraisal of local authorities and organised a special in-house course in municipal management for institutional specialists, supported by an external panel of experts to ensure institutional challenges are rigorously identified and risks reduced.
- Participated in the drafting of the new local government green and white papers.
- Established the Municipal Infrastructure Investment Unit (MIIU) with the Departments of Constitutional Development and Finance, to provide technical assistance in project preparation for municipal infrastructure and services involving private sector delivery and investment.



- Embarked on a strategic management and planning project for local government in partnership with the National Business Initiative. Based on four case studies, a comprehensive manual on strategic planning and management is being developed. It will comply with the new legal requirements for integrated development planning in the municipal sphere.
- Supported the Parliamentary Portfolio Committee for the Public Service and Administration by mobilising donor funding and expertise for its work to ensure more effective service delivery by the public sector.
- Offered a training programme in development management for senior representatives from government, the private sector and non-governmental organisations from across southern Africa with the Southern Africa Regional Institute for Policy Studies in Harare.

Environmental impact

The DBSA's environmental management strives to apply local and international best practice. This includes ensuring that borrowers work actively towards the reduction and/or mitigation of negative impacts of development on air, land, water and people and that they meet relevant legislation and in-house requirements. Developments of note in this regard over the past year include:

- Assisting clients to understand and implement the procedures stipulated in new environmental regulations that require environmental permits from provincial authorities for most development projects.
- Ensuring that the impact of the Krugersdorp K13 road project on a strategically important wetland was mitigated and that a long-term management plan was put in place to secure the maintenance of this wetland.
- Making a grant available to the Durban Metro to assist with the development of an environmental policy, implementation guidelines and environmental by-laws.
- Being instrumental in getting an environmental audit of the Nkomazi irrigation project: the audit identified various actions required to ensure the long-term sustainability of the programme.
- Facilitating the development of a sludge-drying plant and the rehabilitation of sludge ponds in the Cape Flats sewerage works project.
- Assisting with the environmental planning of a new dam in the Western Cape, constructed in the same valley as the Ceres Nature Reserve. This required an extensive environmental impact assessment, rehabilitation of the access road with fynbos, containing the site works within the area to be flooded and planning for the entire quarry to be covered by water once the dam was full.
- Facilitating relocation of a planned sewerage plant for the coastal town of Cintsa Bay (Eastern Cape) to a more distant site where it will have a smaller impact on sensitive coastal ecology and the adjacent community.
- Providing a ground-breaking grant towards establishing an environmental management system in Uitenhage, a town expecting a large increase in industrial growth.

The DBSA financed 148 projects during the 1997/8 financial year. To illustrate the Bank's development role, a small sample of these projects warrant mention (a full list of DBSA projects approved in 1997/8, together with their descriptions, may be found in the separately distributed annex to this report, Projects for 1997/1998, or on our web-site: http://www.dbsa.org).

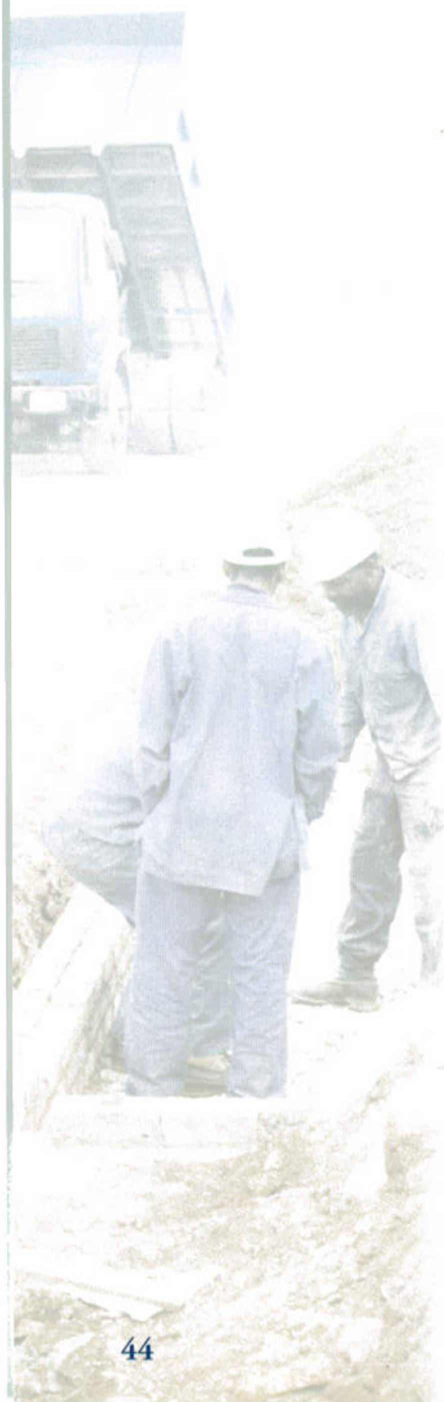
Botswana north-south carrier water project and Gaborone interface works

This is the first loan agreement the DBSA has extended to a Botswana agency since the Bank started operating in the SADC region outside South Africa. The Bank provided financing to construct 239 kilometres of raw water pipeline at an estimated cost of R242 million between Letsibogo Dam and the outskirts of Botswana's capital, Gaborone. The project fits within Botswana's national water

master plan and the SADC water protocol. It aims to address the dire water shortages that face Gaborone and the settlements in its vicinity where more than a quarter of Botswana's 1,5 million inhabitants live. Existing ground and surface water resources in the area are insufficient to meet the needs of the growing population and the expected industrial and commercial growth from the Trans-Kalahari Transport Corridor. Water from the Letsibogo Dam will thus remove a serious constraint to socio-economic development.

The DBSA's development role revolved around:

- **Social and environmental impacts:** The integrated environmental management plan also covered the social aspects of the project. Fourteen households were successfully resettled in terms of international best practice. Appropriate



communication structures were put in place to ensure ongoing consultation with affected communities. Negatively affected communities were compensated before construction commenced.

- **Institutional support:** The Botswana Water Utilities Corporation (WUC) is the implementing and operating agent for the project. In its totality, the project triples the asset base and doubles the responsibility of the Corporation. To cope with the complexities involved, a special project co-ordinating unit was established, consisting of external specialist management consultants, international consulting engineers and a panel of experts. The project co-ordinating unit is transferring its skills to the WUC and will be dissolved once the project is fully implemented. Further efforts to enhance the institutional capacity of the WUC involve departmental restructuring, change management and training.
- **Job creation:** In addition to its positive socio-economic impact, the project is expected to create about 300 permanent jobs in the management, operation and maintenance of the north-south carrier and the water treatment plants. Further jobs will result from the proposed tourist and recreational developments around the dam. About 1 216 people were temporarily employed during construction.

The Witbank-Maputo toll road (N4)

In 1995 the governments of Mozambique and South Africa agreed to co-operate to improve the link between Gauteng, the industrial heartland of South Africa, and Maputo, the capital of Mozambique. The Maputo Development Corridor comprises a multi-sectoral spatial development initiative aimed at enhancing the economic reconstruction and development of both countries. It will increase their global competitiveness through regional economic integration and will maximise social development, particularly for the disadvantaged communities along the corridor. A critical element of this is the Witbank-Maputo toll road.

The 440-kilometre toll road links Witbank and Maputo and entailed selective rehabilitation and upgrading of the 390 kilometre existing route from Witbank to Moamba and the construction of a new 50-kilometre road from Moamba to Maputo. The total estimated costs for the first three years of the project are R1,4 billion, of which the DBSA financed R200 million. The South African Department of Transport and its Mozambican counterpart awarded a 30-year Build-Operate-Transfer (BOT) concession for the road to Trans-African Concessions, a consortium comprising Bouygues, Basil Read and Stocks & Stocks. The DBSA, in addition to being the home of the SDI team and a significant financier of the project, played a facilitating role between the lenders and the concessionaire and ensured that negotiations focused on development issues. The development impact will be:

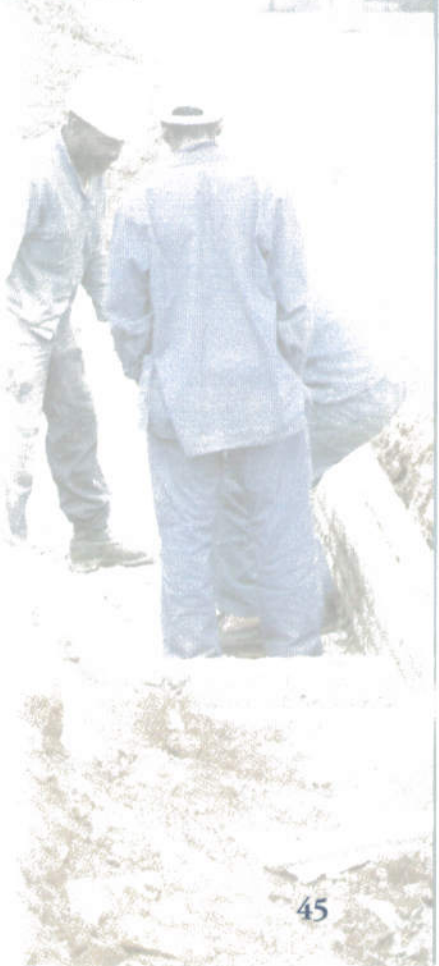
- **Economic:** Besides its macroeconomic benefits, the involvement of emerging contractors and other SMME's from Mpumalanga in the project resulted in a major spin-off for smaller entrepreneurs. Specific agreements enabled these contractors and businesses, represented by the Mpumalanga Small Contractors Association, to acquire up to 20 per cent of the value of the design and construction work in South Africa. This amounted to more than 600 small contracts.
- **Technical:** The technology used to construct the road was not conducive to labour intensification, but much of the ancillary work such as service areas, grass cutting, fencing and signage was given to smaller contractors. The num-

ber of jobs created is uncertain, but experience on other toll roads in South Africa suggests a rule of thumb of 20 jobs per R1 million invested. This implies that construction could create 1 000 jobs for three years. Thereafter, this number should stabilise at about 230 direct and 500 indirect permanent jobs.

It was also agreed to reserve up to 30 per cent of the value of operations and maintenance work for the first 15 years of the concession for SMMEs in South Africa and up to 50 per cent in Mozambique. From year 15 onwards, up to

80 per cent of the operation and maintenance work could benefit the SMME sector. The DBSA also facilitated implementation of the requirements set by both governments for the effective participation for SMMEs.

- **Social:** A needs assessment for the communities along the corridor was conducted through a workshop out of which representative working committees were established to continue consultations with the implementing agents and other interested parties.
- **Environmental:** The DBSA is satisfied with the environmental requirements in the concession agreement. An advisory body comprising the concessionaire, the implementing authority, the contractor, the engineer and the lender's technical adviser will be established to ensure that sound environmental management principles and policies are adhered to. The DBSA will monitor the process. An environmental sinking fund of R1,5 million will be established to guarantee environmental mitigation and rehabilitation.



Jouberton electrical reticulation project – phase 2

The DBSA disbursed financing for the electrification of 4 500 houses in Jouberton in the North West Province. There are a number of development implications:

- **Institutional:** The DBSA facilitated the participation of the Jouberton community leadership in the planning and its involvement is now well embedded in the development management approach of the local authority. Since the project was designed to meet the needs and affordability levels of the community, a high level of payment for services has been achieved.
- **Technical and social:** Labour-intensive construction with training, the development of community-based contractors and community empowerment and commitment underpin the project. The materials contract, awarded to a consulting firm, was separated from the labour contract, which was awarded to the Community Upliftment Network. During the construction phase, the project created about 200 jobs of which 120 were also training opportunities. Of the trainees, 60 were trained in electrical reticulation, 48 in house wiring and 12 in appliance repair with funding provided by the DBSA and the Department of Labour. Greater reliance on electrical appliances and less use of fossil fuels has reduced pollution in Jouberton and its environs.

- **Economic:** Six of the 200 persons who received training are now full-time entrepreneurs, employing their own teams to continue with the electrical reticulation initiated during the project. Other tangible results include several new businesses. For instance, some 60 people are engaged in brick-making and five new butcheries, five surgeries, a sizeable number of tuck shops, night-clubs, liquor outlets, dry cleaners, electrical appliance shops and mortuaries have been established.

White River urban infrastructure upgrading

The merging of the low-income area, Kabokweni, and White River after the 1994 elections created a new local authority with severe infrastructure and services backlogs. The White River Local Council was able to access funding from the Municipal Infrastructure Programme (MIP), but this only provided RDP standard services – gravel roads and ventilated improved pit latrines. This needed to be topped up since Kabokweni's difficult topographical terrain required hard-topped roads and some of its residents could afford higher levels of services, like water-borne sewerage. The Bank agreed to enhance the MIP contribution on the basis of the following development impacts:

- **Economic and social:** Some 20 local people who received accredited training were employed during the 15-month construction of the roads. Four contractors, of whom two were emerging, were used for the sewers and water projects. Between them they employed about 100 local people, including some 15 women, for nine months. The project also benefited the community by using locally manufactured bricks.

  In the longer term, the community will benefit from secure tenure and housing with access to acceptable services. The construction of proper roads coupled with efficient storm-water drainage will also save on future maintenance costs. It will also largely eliminate the flood damage to houses, power lines and sewage systems caused by high storm-water run-off from steep hills in the past. This better access will also stimulate the local economy by opening up the area to suppliers and service providers.
- **Environmental:** Environmental mitigation measures, such as proper rehabilitation of damage caused by construction activities, have been stipulated and budgeted for in the contracts.
- **Technical and financial:** The project met appropriate norms and standards and the needs of the communities who are willing to pay for the services.

Duiwelskloof/Ga-Kgapane urban development

The Duiwelskloof/Ga-Kgapane Transitional Local Council (TLC) involved the amalgamation of Duiwelskloof, a historical white town, and Ga-Kgapane, a settlement in the former Lebowa homeland. Shortly after its establishment in 1994, the new TLC surveyed the needs of its citizens. This showed that more than 5 000 families needed housing and a TLC request for a subsidy to cover 500 houses was approved. These houses were restricted to first-time homeowners with a household income of less than R3 500 a month. However, this did not address the needs of people with a slightly higher income and the TLC approached the DBSA to assist with the development of a residential area for them.

The DBSA agreed to lend R7,4 million of which R4,4 million was for water reticulation, sewerage, internal gravel roads and storm-water drainage on 457 residential stands. The balance of R3 million will be used to upgrade access roads and tarred bus routes. It is estimated that the DBSA's R7,4 million investment will lead to private sector investment of approximately R82,6 million. This will finance the superstructures for the 457 dwellings and the future tarring of roads, extensions to the storm-water drainage system and street lighting.

The project includes the following development impacts:

- **Economic:** Duiwelskloof/Ga-Kgapane is an agricultural service centre supported by manufacturing and tourism and the local economy is showing positive growth trends that will be strengthened by the improved infrastructure. The TLC is also part of two important development corridors linked with the Maputo Corridor. The first is Pietersburg/Tzaneen/Phalaborwa and the second is the smaller urban concentration of Duiwelskloof/Ga-Kgapane/Nkowankowa/Lenyenye/Letsitele. Further investment in urban infrastructure

will support residential development in the area and enhance the quality of life of the community.

- **Institutional and social:** The Duiwelskloof TLC is innovative and development-minded and is using the transition period to maximise the upgrading of Ga-Kgapane with government and other funds. It subscribes to RDP principles and intends promoting labour-intensive construction and entrepreneurial opportunities and training for the members of its communities. The community forum that gives input into development decisions and provides feedback to its citizens highlights the healthy relationship between council administration and community. Working with the DBSA team has assisted them to plan and manage local development systematically within a longer-term framework. The monthly meetings held by block committees with feedback to the community and the Kgoro (Council of Traditional Leaders), will ensure extensive community involvement in future local development.

Conclusion

The provision of appropriate infrastructure provides one of the single most significant development impacts and can benefit the economy as a whole by mobilising local and international private investment. It can improve the quality of life of poorer communities and draw people into the mainstream economy by supporting training and employment. However, poorly planned investments can also burden the economy with infrastructure that is inappropriate to local economic conditions and expensive to maintain. This can even contribute to further marginalisation of poor communities.

Much of the impact of infrastructure investment depends on the way in which it is planned, implemented and managed. During the past year, the DBSA's business processes and its operational and policy outputs have systematically attempted to support such development. The DBSA has achieved considerable success in enhancing its development impact, but it believes the agenda for further improvement is substantial.

In order to achieve development impact, the Bank often operates in an environment where risks are higher than in normal commercial situations, making prudent management a necessity.

The Audit Committee of the Board conducts a thorough analysis of all risk management policies and monitors their implementation on behalf of the Board. In addition, executive management has established the Finance and Risk Management Committee, which initiates the risk management policies and submits them to the Audit Committee for consideration. This Committee also oversees the implementation of all risk management processes.

Risk inherent to the Bank

The risk management framework, developed to address risk in an integrated manner, covers the following:

- **Portfolio concentration**

This has increasingly become a carefully monitored risk category. The financial position of local authorities, and the size of loans to some large institutions, require careful management of portfolio concentrations to ensure adequate risk spread and balance in development impact. Geographical allocations, major transactions and institutional targeting are also elements of portfolio concentration prudently managed by the Bank.

Since the DBSA's support to SADC countries has grown exponentially, loans to these countries draw attention to country risk and the cross-border allocation of investment funds. Distinctions have been drawn between regional, bilateral and national projects in this context and portfolio concentrations are monitored continuously and reported on quarterly.

- **Credit risk**

Losses on the loan book (counter-party default) represent the greatest potential risk exposure. In order to address this threat, an internal credit rating system has been developed, the services of commercial credit rating agencies are used locally and internationally, a risk pricing policy has been adopted and the entire project appraisal process has become oriented to the measurement and mitigation of risk. A country risk assessment methodology has also been introduced to manage the cross-border activities and a risk mitigation policy is in place for specific client categories.

All projects include a risk assessment, priced through the transparent allocation of an interest rate margin for risk. The Bank will not approve projects with risks beyond a strict tolerance level. Where necessary, risks have to be addressed and mitigated down to an acceptable level.

- **Market risk**

This covers risks in interest rates between assets and liabilities, in prices of investment assets and foreign currency borrowing.

The Bank eliminates currency risks, as far as possible, by entering into appropriate forward exchange contracts or currency swap agreements with reputable counter-parties.

Price risk is controlled by limiting investments to particular markets, instruments and periods. This portfolio has been created as a liquidity buffer and is managed in close relationship with the borrowing portfolio.

A state of the art asset/liability management software system has been acquired to manage the mismatches between the Bank's asset and liability portfolios. The Bank carefully monitors the spread between the return on its asset portfolio and the cost of borrowings while controlling the risk associated with generating a sustainable spread.

- **Liquidity risk**

This is managed by maintaining liquidity levels within a given range of outstanding commitments. Emergency credit lines are available in addition to surplus liquidity. The Bank has a wide range of instruments through which to access funds over a wide maturity spectrum.

- **Project and development risk**

The DBSA has developed comprehensive project appraisal techniques and methodologies to address this risk.

Technical project failure as well as risks involved in procurement and in environmental and development impacts, are some of the areas in this category addressed by the project team's appraisal process and monitored during project implementation and post-completion. Loan agreements ensure that the borrower attends to identified risk issues and provides the DBSA with information to monitor developments.

- **Internal operational risk**

All human resources systems and information risks fall in this category. The functional management of these risks rests with the relevant departmental managers. Most of these risks are managed through procedures and system requirements and compliance through management control is supported by internal and external audits. For this purpose, a comprehensive risk analysis framework has been developed and is in operation. A fraud risk prevention and response programme is being developed with trained fraud investigators.

IT contingency plans are in place to cover situations where mission-critical systems would be affected for prolonged periods of time by some or other natural or unnatural disaster. Necessary equipment and software licences were acquired to set up a disaster recovery system for the five key mission-critical systems identified in order to continue functioning in the event of a disaster. This contingency plan is constantly being updated as our technological environment changes and the risks to the organisation vary.

At present, all financial organisations face some degree of operational risk due to the Year 2000 (Y2K) problem. This originates from time-dependent devices and software written for two digits rather than four to cope with the year aspect of dates. The Bank is no exception and we are currently attacking this problem on two fronts.

Internally, significant progress has been made in replacing hardware and software: this process is on course for completion by 31 December 1998. It includes an audit of in-house systems that are technically compliant but still potential risks.

Externally, the Bank is actively participating with the government's National Year 2000 office to quantify this risk and is on two national task teams as well as launching its own interventions to identify and mitigate supplier, client and market Y2K risk.

- **External business/event risk**

Natural disasters, legal and insured risks as well as regulatory, reputation and currency convertibility risks, fall in this category. As far as possible, provision is made for structured and planned mitigation, such as insurance cover for pure risk exposures.

Progress in risk management

When the Risk Management Unit was established, much attention was given to the development of the basic risk management framework and to drawing up specific policies where gaps were identified. The following require specific attention – implementation of policies, procedure and skills transfer to line functionaries, compliance monitoring and management reporting.

Risk mitigation

Risk mitigation policy determines the circumstances under which risk reduction measures should be applied for loans advanced. Project appraisal, the nature of the project and the type of the client's assets will determine what mitigation instrument should be used. Cross-border lending, with inherent additional country risk elements, often requires different mitigators but also offers different mitigation opportunities. Risk mitigation instruments fall into the following categories:

- Those imposed on borrowers by means of conditions attached to a specific transaction (implemented by the borrower and monitored by the lender), such as guarantee requirements and mortgage security.
- Those undertaken as part of the Bank's financial strategy to hedge risk through the use of financial derivatives. Examples would be the hedging of foreign exchange exposure or portfolio concentration policies. This type of mitigation is implemented by the lender independent of the borrower and is not normally a condition attaching to a loan.
- Institutional and financial capacity-building, alternative delivery systems and regulatory frameworks, designed to enhance a borrower's ability to repay, are developmental risk mitigators often used by the DBSA and other DFI's as elements of projects.
- Risk pricing policy determines a risk level for each project, consistently priced to compensate for the probability of credit loss.
- A fraud risk-prevention programme has been put in place after an assessment of fraud risk in the Bank.
- Internal audit operates a fully staffed and trained service and is accountable directly to the Chief Executive, external auditors and the Audit Committee of the Board.
- The application of best practice in corporate governance throughout the organisation, including the introduction of codes of ethics and business conduct.

Development impact of risk management

Risk management ensures that:

- The Bank's financial viability is protected and its ability to serve development needs secured.
- The institutional and financial capacity of clients to continue managing development projects is maintained.
- The quality of a project is assured in the appraisal of its social, institutional, technical, financial, economic and environmental modules.
- When unacceptable risks are identified, risk mitigation is considered and applied before or during project implementation to make sure the aims are achieved.
- The development objectives are not only achieved but are sustained. A timeous warning of possible failure should provide an opportunity to resolve the problems through advice or intervention and preserve the development impact intended.

The transformation of the legal status of the Bank was concluded by the promulgation of the Development Bank of Southern Africa Act (Act no 13 of 1997) on 23 April 1997 (DBSA Act). In terms of this Act, the development organisation, previously established by a Treaty concluded between the South African homeland governments and the central government, continues to exist but as a statutorily transformed body.

On 19 November 1997, regulations were issued by the Minister of Finance in terms of the provisions of the DBSA Act. The regulations deal with various corporate governance and administrative matters such as share-holding, borrowing powers, capitalisation, financial reporting requirements and procedures of meetings. The DBSA Regulations specifically provide that the principles of company law will be applicable to the Bank as if it has been incorporated in terms of the Companies Act (Act no 61 of 1973) and that best endeavours shall be made to ensure that accounting practices are in line with acceptable international corporate practice.

Subsequent to the promulgation of the DBSA Act, and the regulations issued in terms of it, the Bank began putting in place systems to ensure that it complies with the requirements of the legislative framework that regulates its operations.

Listing in terms of the Reporting by Public Entities Act

During 1997, the Bank was listed in terms of the Reporting by Public Entities Act with effect from 1 April 1998. There are links between the DBSA Act and this Act.

Corporate governance audit

In order to deal with the requirements of the DBSA Regulations on the application of best international corporate practice, an audit of the systems of control and practices in the Bank has been approved. This three-year project will focus on adherence to control measures and the effectiveness of dissemination of information in line with practices in the national and international arena and government initiatives on corporate governance.

Code of preferred ethics and business conduct

The Bank has adopted a code of conduct as part of its conditions of service. The code requires that staff maintain the highest levels of professionalism and integrity and was re-endorsed by the Bank in January 1998, when the conditions of service were updated in line with developments in human resources management.

In November 1997, the Board's Audit Committee underwrote a code of business conduct, largely focused on the business practices of the Bank and subscribing to best international norms in this regard. The Bank has also committed itself to engage with staff to determine the current values and ethics the organisation espouses and to develop a set of preferred values and ethical norms. The code of business conduct is being discussed with the representative staff structures in order to develop an integrated code of ethics and business conduct for the Bank.

Directorate and corporate governance

The Bank, through the Board, is accountable to the South African Parliament, through the Ministry of Finance in terms of the DBSA Act, read with the provisions of the Reporting by Public Entities Act.

The Minister of Finance, as the representative of the Government of South Africa as sole shareholder, directs the mandate of the Bank and holds the Board accountable to manage and control its operations in line with the strategic direction presented through the set mandate.

The Board meets at least six times in a calendar year and controls the operations of the Bank by approving the application of strategic human resources management, investment and finance policies and directing the overall operations. The Committees listed below have been constituted to ensure the Board operates effectively and efficiently. The chairpersons of the Board and of all the committees are non-executive members of the Board. Membership of the committees is reflected in the list of the Board members.

Audit Committee

The Audit Committee has been in existence since the establishment of the Bank in 1983 and meets at least three times a year. It facilitates systematic interaction between the Board and the Bank's external and internal auditors and is responsible for internal controls in the Bank. Its responsibilities also include the monitoring of risk management policies and procedures on behalf of the Board. Specialised expertise on treasury and audit matters has been secured by the co-option of two external experts onto the Committee in January 1998, namely Tim Sewell and Len Konar.

Employment Equity Committee

The Employment Equity Committee was established in 1995 with the specific task of overseeing the transformation of the internal structure and human resources. The committee focuses on continuing transformation and on personnel matters. The committee meets at least four times a year.

Remuneration Committee

A Remuneration Committee was constituted in February 1998 to deal with remuneration matters related to the Board and the executive management. The committee meets as required and comprises the Chairman of the Board and the Chairmen of the Audit and Employment Equity Committees.

Investment Committee

In October 1997 an Investment Committee was constituted by the Board to approve projects with the following investment values:

- within South Africa, between R25 million and R100 million
- in other SADC countries, between R7,5 million and R100 million.

Board approval is required for projects with investment values above these levels.

For projects with values below these amounts, the Managing Director has delegated approval authority. The Committee meets on a bi-monthly basis.

Managing Director

Other than Dr Ian Goldin, who was appointed the DBSA's first Managing Director in 1997 (following his appointment as Chief Executive in May 1996), the Board consists of non-executive directors. The executive management attends the meetings of the Board and the Committees, as required by the Board.

Secretary

In terms of the requirements of the DBSA Regulations, a secretary was formally appointed by the Board.

Employee participation

During the year under review the Bank was unionised. Negotiations between staff representative bodies such as the Staff Association, which was established in 1991, the Affirmative Action Committee and the Women's Forum, established in 1995, have commenced to streamline the manner in which employee participation takes place in negotiations with Bank management.

Provident fund

The term of the employee-elected trustees on the Board of Trustees of the DBSA Provident Fund terminated in November 1997 and new representatives were elected.

Report of the independent auditors to the shareholders of the Development Bank of Southern Africa

We have audited the annual financial statements on pages 54 to 75 which have been prepared on the basis of the accounting policies set out on pages 61 to 62.

Respective responsibilities of directors and auditors

The directors are responsible for the annual financial statements. It is our responsibility to form an independent opinion, based on our audit, of these annual financial statements and to report our opinion to you.

Basis of opinion

We conducted our audit in accordance with generally accepted auditing standards issued by the South African Institute of Chartered Accountants.

These standards require that we plan and perform the audit to obtain reasonable assurance that in all material respects fair presentation is achieved in the financial statements. The audit included an evaluation of the appropriateness of the accounting policies, an examination, on a test basis, of evidence that supports the amounts and disclosures included in the financial statements, an assessment of the reasonableness of significant estimates and a consideration of the appropriateness of the overall financial statement presentation. We consider that our auditing procedures were appropriate in the circumstances to enable us to express our opinion presented below.

Opinion

In our opinion, these financial statements fairly present the financial position of the Development Bank of Southern Africa at 31 March 1998 and the results of its operations and cash flow information for the year then ended in conformity with generally accepted accounting practice and in the manner required by the South African Companies Act.

Ernst + Young

Ernst & Young
Chartered Accountants (SA)
Johannesburg
25 June 1998

The directors take pride in presenting their annual report which forms part of the audited financial statements of the Development Bank of Southern Africa for the year ended 31 March 1998.

Nature of business

The nature of the business is reflected in the Corporate Profile on page 2 of the annual report.

Acts and legislation

This report is compiled in compliance with the Development Bank of Southern Africa Act, Act No 13 of 1997. In terms of the Regulations to this Act annual financial statements must comply with Sections 284 to 299 of the Companies Act (Act No 61 of 1973).

General review of operations

A review of the Bank's operations is presented in the Chief Executive's report on pages 18 to 27.

Financial review

The year under review has been a year of encouraging financial results for the Bank. The improved outlook on the results for the year and balance sheet at year-end, which was anticipated in last year's annual report, materialized and the premier credit ratings were maintained.

Significant exceptional transactions

A number of significant exceptional transactions occurred during the year under review. These are discussed first, and the operating results and the financial position of the Bank are then discussed subsequently in the context of such transactions.

- The restructuring of the former homeland governments' loan book of R3,1 billion. This transaction increased the current results with approximately R414 million, of which R80 million is normal. The loans were replaced with risk-free government gilt stock (R150's) effective on 1 April 1997. Consequently, the deferred interest in respect of the replaced loans, totalling R334 million, was released to the income statement. The return of 12 per cent on the government stock is higher than that of the 8,6 per cent weighted average return on former homeland governments' loans and amounts approximately to R80 million per annum.
- The DBSA Act promulgated in April 1997 provided for a R3 billion increase in the callable capital. This strengthened the capital base of the Bank.
- The LALF was dissolved on 31 December 1997 as part of the government's rationalization of development finance institutions. Reserves of R812 million, loans amounting to R910 million and liabilities of R155 million were taken over by the DBSA with effect from January 1998. This further strengthened the capital base of the Bank. The expected return on these loans is approximately 13 per cent or R120 million per annum.
- Proactive risk management and prudent loan provisioning are imperative principles for the financial sustainability of the Bank.

  In line with this, an even more prudent loan loss provisioning methodology was adopted this year. Consistent with previous years, a rigorous and thorough assessment of the loan book was undertaken with a view to determining loans against which specific provisions should be raised. In the past, an overall provision of 4 per cent of loan book, including specific provisions, was maintained. This year's refinement seeks to maintain a 4 per cent general provision in addition to specific provisions. If this revision was applied in the previous year, an additional general provision of R64 million would have been made, hence an exceptional item for this current year.

  As a result of this new approach, the total loan loss provision increased to R491 million from R287 million in 1996/7 and provisions against investments equal R50 million (1996/7: Rnil). This resulted in an income statement charge of R208 million. The provision accounts for 7 per cent although defaulters have been held to 0,4 per cent of the loan book.
- The liability in respect of post-retirement medical benefits of staff has been quantified and the past service component of R21 million recognized. Although approximately 80 per cent of the amount relates to previous financial years, the full expense is carried in 1998 as no actuarial valuation of the liability in previous years is available.

Surplus for the year

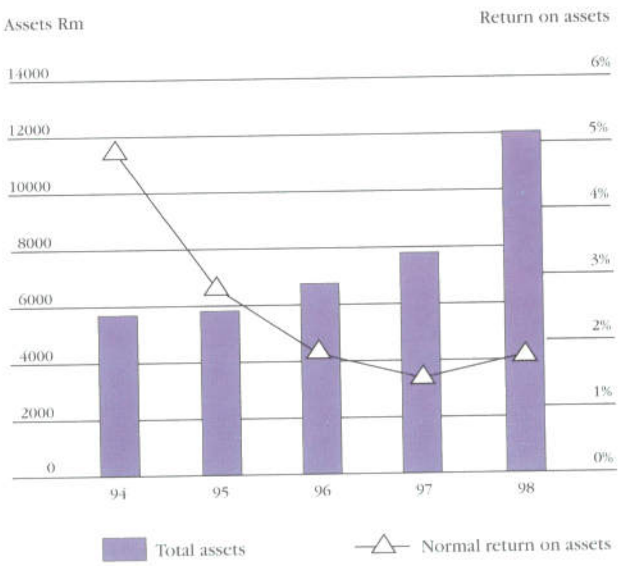
The Bank lifted its normal surplus for the year by more than 73 per cent to R177 million compared to R103 million the previous year. The impact of exceptional transactions, outlined above, was an additional R250 million surplus, bringing the total surplus for the year to R427 million. The improved normal surplus is primarily attributable to:

- The new lending policies of the Bank whose intention is to ensure its long-term financial sustainability by protecting capital and pricing for risk. The normal net interest income (excluding R334 million one-off release of deferred interest in respect of the former homeland loans) increased by 61 per cent to R450,7 million.

- The restructuring of the former homeland governments' loan book of R3,1 billion, resulting in a normal additional reprising margin of 3 per cent.
- The new cost recovery policy, yielding an additional 830 per cent of non-interest income of R11,2 million. This income is mainly in respect of advisory services rendered by the Bank to third parties. The incremental cost of rendering such services is deducted from income while the sunk costs (such as salaries, administration services, etc) are included in operating expenses.
- A higher return on increased liquidity levels. The Bank maintained high levels of liquidity and benefited from the inverse yield curve from its money market investments. Interest income from such investments increased by 144 per cent to R103 million.
- A tight control on operating expenses. The normal expenditure of R136 million reflects a 5 per cent increase from the previous year and represents 23 per cent of net income compared to 56 per cent in the previous year.

Asset growth and yield

Total assets



Total assets grew by 51 per cent (1996/7: 19 per cent) to R12 billion in 1998. The main components of this growth are:

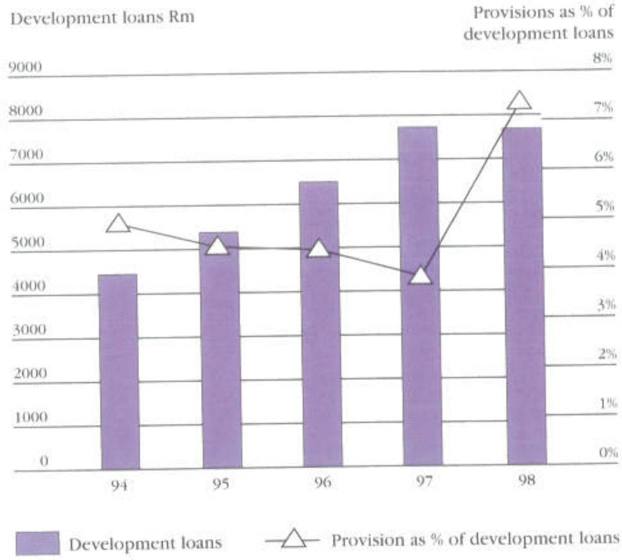
- disbursements on development loans of R2,2 billion (1996/7: R1,4 billion)
- liquidity levels higher than in 1996/7 by R1,1 billion
- ex LALF loans amounting to R910 million.

These increases were partly offset by the increase of R271 million in provisions against loans and investments. Of this amount, R68 million was transferred from the LALF.

The total surplus for the year of R427 million represents a return of 4 per cent on assets.

The surplus from normal operating activities of R177 million for the year represents a return of 1,8 per cent on average assets compared to 1,4 per cent in the previous year. This improvement is as a result of the restructuring of the former homeland governments' debt and the new lending policies.

Loan loss provisions



Quality of assets

The replacement of the former homeland governments' debt of R3,1 billion with government gilt stock increased the risk free portion of assets to 40 per cent (1996/7: 6 per cent).

Loan loss provisioning is rigorous and all loans, including the loans taken over from the LALF, were subjected to the new methodology.

Furthermore, credit risk is hedged and managed by obtaining and monitoring security for loans in various forms.

Equity gearing

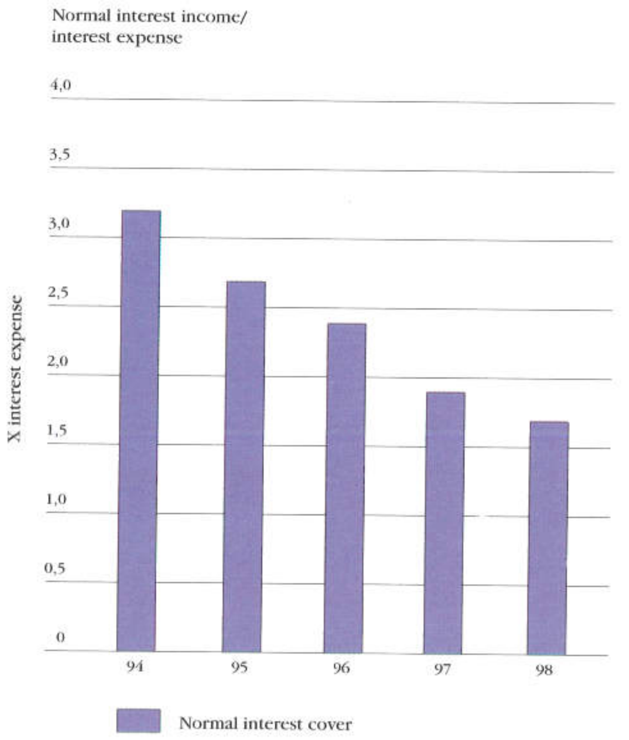
The debt-to-equity ratio is 88,6 per cent (1996/7: 54,5 per cent) against the approved maximum of 250 per cent.

Debt has increased substantially by R2,76 billion to meet the funding needs generated by the higher level of disbursements. Funds were drawn from the local capital market as well as international sources. The DBSA led the financial markets by issuing the first ZAR 30-year coupon Euro-rand bond in February 1998. A 30-year zero coupon Euro-rand bond was also issued earlier in the year.

Shareholders' equity increased by 25 per cent to R6,1 billion with the contributing factors being the exceptionally high surplus for the year of R427 million and R812 million net asset value taken over from LALF.

The capital base of the DBSA was further strengthened by the increase in callable capital.

Normal interest cover



The record funding of R2,76 billion for the year resulted in an increase of 88 per cent in the interest expense. The interest income deteriorated from 3,2 times interest expense in 1994 to 1,7 times in 1998. This downward trend is stabilising and is expected to bottom out in the next financial year as the weighted average return on the outstanding loan commitments of R5,44 billion is higher than in previous years. This improvement is indicative of the success of the new interest rate policy and the restructuring of the former homeland governments' debt.

Credit rating

The DBSA maintained its domestic AAA long-term and A1+ short-term credit ratings by the independent international rating agency, Fitch IBCA.

Other relevant information

Information relating to the members of the Board of Directors is set out on pages 16 and 17 of this document.

The secretary of the Bank, Ms Tinka Wiswe, was appointed on 19 February 1998 after acting since the commencement of the financial year.

Registration number: 16/0015800

Registered office:
1258 Lever Road
Headway Hill
Halfway House
1685

Postal address:
PO Box 1234
Halfway House
Midrand
South Africa
1685

Home page:
http://www.dbsa.org

DIRECTORS' RESPONSIBILITY
AND APPROVAL OF FINANCIAL STATEMENTS

The preparation and presentation of the annual financial statements of the Development Bank of Southern Africa and all other information included in this annual report, which must be accurate and consistent with the financial statements, are the responsibility of the directors. The financial statements set out in this report have been prepared in accordance with Generally Accepted Accounting Practice (GAAP) and include amounts based on judgements and estimates made by management.

In discharging their responsibilities, both for the integrity and fairness of these statements, the directors rely on systems of internal control and risk management procedures applied by management. The systems of control further adequately safeguard, verify and maintain accountability of its assets.

The Audit Committee meets periodically, with management, the internal auditors and external auditors, to review the financial statements and accounting policies, and the effectiveness of management information and systems of internal control. Nothing has come to the attention of the directors to indicate that any material breakdown in the systems of internal control has occurred during the year under review.

The going-concern basis has been adopted in preparing the financial statements. Based on forecasts and available cash resources, the directors have no reason to believe that the Bank will not be a going concern in the foreseeable future.

The financial statements have been audited by the Bank's external auditors, Ernst & Young, who were provided unrestricted access to all financial records and related data. The directors believe that all representations made to Ernst & Young during their audit were valid and appropriate. The auditors' report appears below.

The financial statements, presented on pages 58 to 75, were approved by the Board of Directors on 25 June 1998 and are signed on its behalf :

W Nkuhlu
Chairman of the Board

I Goldin
Managing Director

RA Plumbridge
Chairman of the Audit Committee

BALANCE SHEET
AT 31 MARCH

	Notes	1998 R'000	1997 R'000
Funds employed			
Share capital	2	**200 000**	200 000
Development fund	3	**3 792 344**	3 792 344
Reserves	4	**2 139 014**	899 318
Shareholders' interest		**6 131 358**	4 891 662
Donor contribution funds	5	**2 184**	1 121
Medium- and long-term financing	6	**5 431 633**	2 667 523
Short-term financing		**305 125**	347 653
		11 870 300	7 907 959
Employment of funds			
Property and equipment	7	**39 778**	40 563
Development loans	8	**7 013 592**	7 337 057
Development investments	10	**93 863**	85 980
Other investments	11	**3 192 840**	27 463
Net current assets		**1 530 227**	416 896
Current assets		**1 661 531**	458 370
Cash, deposits and tradable securities	12	**1 573 225**	428 605
Receivables	13	**88 306**	29 765
Current liabilities			
Accounts payable	14	**131 304**	41 474
		11 870 300	7 907 959

INCOME STATEMENT
FOR THE YEAR ENDING 31 MARCH

	Notes	1998 R'000	1997 R'000
Interest income	15	**1 405 426**	608 938
Cost of funding	16	**620 742**	329 069
Net interest income		**784 684**	279 869
Specific and general risk provisions	17	**207 943**	44 000
Non-interest income	18	**11 289**	1 213
Operating income		**588 030**	237 082
Technical assistance grants	19	**2 936**	4 437
Net income		**585 094**	232 645
Operating expenditure		**157 706**	130 031
Depreciation	7	**2 739**	1 776
Foreign exchange gains		**(143)**	482
Post-retirement medical benefits	20	**21 000**	–
Other operating expenses	21	**134 110**	127 773
Surplus for the year		**427 388**	102 614

	1998 R'000	1997 R'000
Analysis of surplus for the year		
Normal surplus for the year	**177 404**	102 614
Adjustment for exceptional items	**249 984**	–
Early release of deferred interest on former homeland governments' debt	334 668	–
Increase in general provision	(63 684)	–
Provision for post-retirement medical benefits	(21 000)	–
Surplus for the year	**427 388**	102 614

CASH FLOW STATEMENT
FOR THE YEAR ENDING 31 MARCH

	Notes	1998 R'000	1997 R'000
Net cash inflow from operating activities		**837 526**	129 626
Interest received from development activities	22.1	**982 793**	457 271
Interest received on investments	22.2	**425 874**	42 072
Interest paid	22.3	**(441 794)**	(234 189)
Other operating expenditure paid	22.4	**(129 347)**	(135 528)
Net cash inflow from development activities		**886 198**	(1 138 165)
Development loan disbursements	8	**(2 172 779)**	(1 377 712)
Development loan principal repayments	22.1	**3 073 001**	249 386
Development investments		**(7 883)**	(4 687)
Donor contribution funds disbursed	5	**(3 205)**	(715)
Technical assistance grants paid		**(2 936)**	(4 437)
Net cash outflow from investment activities		**(3 161 954)**	(31 219)
Purchase of fixed assets		**(1 954)**	(5 273)
Proceeds from sale of fixed assets		–	163
Investments made		**(3 160 000)**	(26 109)
Net cash inflow from financing activities		**2 458 078**	1 078 517
Donor contribution funds received	5	**4 268**	1 760
Short-term financing repaid		**(42 529)**	307 452
Medium- and long-term financing repaid		**(478 438)**	(293 399)
Medium- and long-term financing raised		**2 974 777**	1 062 704
Local Authorities Loans Fund transferred to the DBSA	22.5	**124 772**	–
Net increase in cash, deposits and tradable securities		**1 144 620**	38 759
Cash, deposits and tradable securities at beginning of year		**428 605**	389 846
Cash, deposits and tradable securities at end of year		**1 573 225**	428 605

1. Accounting policies

1.1. Basis of accounting

The financial statements are prepared on a historical cost basis, except for certain investments as set out in the investment policy note. The policies on which the annual financial statements are based conform with South African generally accepted accounting practice and the international accounting standards in all material aspects. The following are the principal accounting policies used by the Bank, which are consistent with those used in the previous year, except for the treatment of the post-retirement medical benefits.

1.2. Property and equipment

The head office was constructed on land donated to the Bank by the South African government. The land is stated at nil value. The building is stated at cost, including improvements, and is not depreciated. Other fixed assets are stated at cost and are depreciated on a straight-line basis over their expected useful lives. The rates used to depreciate these assets are as follows:

Computer equipment	33,3%
Furniture and fittings	10%
Motor vehicles	20%
Other equipment	20%

1.3. Development loans

Development loans are stated at carrying value which comprises the principal amount outstanding and unpaid interest. Interest that accrues during the moratorium period is deferred and does not form part of the carrying value.

Development loans are classified as non-performing when the payment of principal and interest has become 180 days past due or, when in the opinion of the directors, the recovery of the whole loan or a portion thereof becomes doubtful. Once these loans are identified as doubtful, a specific amount is raised against the entire amount outstanding. Interest is suspended on non-performing development loans.

1.4. Provision against development loans

Development loans are stated net of specific and general provisions. Specific provisions against development loans represent management's judgement as to identifiable potential non-recovery of outstanding balances on development loans including loans placed on a non-accrual status, i e where interest is not accrued. Risk mitigating factors, like the presence of securities, are taken into consideration.

In addition, a general provision is raised to cover potential losses that may be present in the portfolio of development loans, although not specifically identified.

The provisions, both specific and general, made during the year, are charged to the income statement. Development loans written off, as well as subsequent recoveries, are recorded against the provision for development loans.

1.5. Investments

Investments comprise investment, trading and hedging portfolios.

The investment portfolio contains development investments, which are investments held in development entities, and other investments which do not meet the criteria for subsidiaries or associates. These are accounted for using one of the following applicable principles:

- Investments with a fixed redemption date, held as part of the investment portfolio and development investments, are stated at book value, and profits and losses are recognised on realisation. The book value of these investments represents original cost plus accrued interest, where applicable. Premiums and discounts arising on purchase are amortised on the yield to redemption method. Where the directors are of the opinion that a permanent diminution in the value of the investment has occurred, the investment is written down and the related diminution charged to the income statement.
- Investments which do not have a fixed redemption period, are stated at cost unless in the opinion of the directors a permanent diminution in the value of the investment has occurred. In these circumstances the related diminution is written off in the income statement.

Investments in the trading portfolio are stated at market value, and any surplus or deficit arising thereon is recognised in the income statement.

Investments in the hedging portfolio are valued on a basis consistent with the instruments or exposures being hedged.

1.6. Repurchase agreements

Where the Bank sells investments from its portfolio, agrees to repurchase these at future dates and the risk of ownership remains with the Bank, the consideration received is included in current liabilities.

Conversely, investments purchased under an agreement to resell these at future dates and the risk or ownership does not pass to the Bank, are therefore excluded from investments. The consideration paid is included in current assets.

1.7. Income recognition

Interest on development loans is recorded as income on an accrual basis. The Bank does not recognise income on development loans that have been classified as non-performing. Interest capitalised during the moratorium period of the loan is recorded as deferred interest and credited to income when it becomes due and payable or when it is received per the loan agreement.

Interest on other investments is recorded as income on an accrual basis, except where in the opinion of the directors the interest will not be received.

Donor contribution funds received are recorded as non-interest income. The expenditure incurred relating to these funds is netted off against the income.

Income received for non-banking services rendered to third parties is recognised in income when the services are rendered.

1.8. Capital market bonds and Eurobonds

Capital market bonds and Eurobonds are stated at the carrying value which is the issue price net of the unexpensed portion of discounts, premiums, other bond costs and financing costs as at the balance sheet date.

The discount or premium on the issue of registered bonds is amortised over the term of these bonds using the yield-to-redemption method. Other bond issue costs are amortised over the term of these bonds using the straight-line method. Discounts, premiums, other bond costs and financing costs are amortised and recorded as an element of interest expenditure.

1.9. Financial instruments

Secondary market positions held for hedging purposes are stated at market value and are set off against the underlying position. Profits and losses relating to these transactions are included in interest expense.

In the normal course of business the Bank is party to off-balance sheet financial instruments. The Bank follows the same credit policies in considering conditional obligations as it does for balance sheet instruments. The premiums received or paid on financial instruments entered into for trading purposes are stated at market value. The resultant profit or losses are accounted for in the income statement. Where not designated as trading transactions, the instruments are stated at cost and premiums are amortised over the term of the instruments.

1.10. Foreign currencies

Transactions in foreign currencies are recorded at the spot rates ruling at the transaction date.

Assets, liabilities and commitments in foreign currencies are translated to South African rand at the rates of exchange ruling at year-end unless covered by forward exchange contracts or other financial instruments. Assets, liabilities and commitments covered by forward exchange contracts are recorded at the initial cash amount, with interest and forward exchange premium or discount accrued at the effective interest rate, less payments made.

Discounts and premiums on forward exchange contracts entered into to hedge specific foreign currency assets, liabilities and commitments are recognised over the term of such contracts at the effective interest rate. These discounts or premiums are identified by comparing the fixed forward rate for the purchase or sale of foreign currency to the spot exchange rate at the time the forward exchange contract is entered into.

1.11. Donor contribution funds

Grants received from donors are carried in the balance sheet. As costs relating to these grants are incurred, amounts are transferred to non-interest income, and the costs are netted off against the income.

1.12. Post-retirement medical benefits

The Bank provides for the liability in respect of post-retirement medical benefits of eligible employees and pensioners. The liability is assessed in accordance with actuarial principles and recognised on a systematic basis over the years of service. Although this constitutes a change in the accounting policy, no prior year adjustment was effected as there was no actuarial valuation of the liability as at 31 March 1997.

1.13. Cash, deposits and tradable securities

The Bank's liquid assets comprise money and capital market instruments. Capital market assets are valued at market value. The Bank classifies the cash, deposits and tradable securities portfolio as an element of liquidity in the balance sheet and the cash flow statement in accordance with the Bank's policies governing the level and use of such investments.

	1998 R'000	1997 R'000
2. Share capital		
Authorised and subscribed		
500 000 (1997: 200 000) shares at a par value of R10 000 each	**5 000 000**	2 000 000
Callable capital		
480 000 (1997: 180 000) shares at a par value of R10 000 each	**4 800 000**	1 800 000
Paid-up capital		
20 000 shares at a par value of R10 000 each	**200 000**	200 000

The Board may, with the approval of the shareholder previously given at a shareholder's meeting, increase the share capital of the Bank.

3. Development fund

The fund represents capital provided by the South African government and remains part of the permanent capital of the Bank. No funds have been received since March 1994.

	1998 R'000	1997 R'000
Received to date	**3 792 344**	3 792 344

	1998 R'000	1997 R'000
4. Reserves		
General reserve		
Retained surplus		
Balance at beginning of year	**899 318**	796 704
Transfer from income statement	**427 388**	102 614
Retained income in respect of Local Authorities Loans Fund transferred to DBSA	**812 308**	–
Balance at end of year	**2 139 014**	899 318

	1998 R'000	1997 R'000
5. Donor contribution funds		
Balance at beginning of the year	**1 121**	76
Grants received	**4 268**	1 760
Grants disbursed : transferred to income statement (note 18)	**(3 205)**	(715)
Balance at end of the year	**2 184**	1 121

The purpose of the financial contributions is exclusively to support specific projects and assignments. At the end of the projects certain unspent amounts will be refunded to the respective donors.

	1998 R'000	1997 R'000
6. Medium- and long-term financing		
Registered bonds	**4 389 844**	2 075 132
Balance in issue	**11 966 386**	2 260 684
Unamortised issue discounts on registered bonds	**(7 576 542)**	(185 552)
Other loans	**1 041 789**	592 391
Balance outstanding	**1 042 943**	592 391
Unamortised issue discounts on other loans	**(1 154)**	–
	5 431 633	2 667 523

The registered bonds and related unamortised discounts are set out in schedule A, while the other loans and related unamortised discounts are contained in schedule B.

7. Property and equipment

7.1. Summary of property and equipment

	R'000	R'000	R'000	R'000	R'000	R'000
		1998			1997	
	Cost	Accumulated depreciation	Net book value	Cost	Accumulated depreciation	Net book value
Buildings	**35 781**	**–**	**35 781**	35 604	–	35 604
Computer equipment	**11 673**	**8 526**	**3 147**	10 078	6 092	3 986
Furniture and fittings	**320**	**90**	**230**	281	50	231
Motor vehicles	**364**	**166**	**198**	364	93	271
Other equipment	**1 064**	**642**	**422**	920	449	471
Total	**49 202**	**9 424**	**39 778**	47 247	6 684	40 563

7.2. Movement in property and equipment

	1996/1997 R'000 Net book value	R'000 Additions	R'000 Disposals	R'000 Depreciation	1997/1998 R'000 Net book value
Buildings	**35 604**	**177**	**–**	**–**	**35 781**
Computer equipment	**3 986**	**1 592**	**–**	**2 432**	**3 146**
Furniture and fittings	**231**	**40**	**–**	**40**	**231**
Motor vehicles	**271**	**–**	**–**	**73**	**198**
Other equipment	**471**	**145**	**–**	**194**	**422**
Total	**40 563**	**1 954**	**–**	**2 739**	**39 778**

	1995/1996 R'000 Net book value	R'000 Additions	R'000 Disposals	R'000 Depreciation	1996/1997 R'000 Net book value
Buildings	35 218	386	–	–	35 604
Computer equipment	1 382	4 160	163	1 393	3 986
Furniture and fittings	184	57	–	10	231
Motor vehicles	222	77	–	28	271
Other equipment	223	593	–	345	471
Total	37 229	5 273	163	1 776	40 563

7.3. Valuation

The buildings were erected in 1987 at a cost of R35,2 million. Improvements to the value of R0,2m were effected during the 1998 financial year (1997: R0,4 million).

The buildings are valued every three years and were last valued at R81 million on a replacement value basis by Farrow Laing, an independent valuer, on 31 March 1996.

The land on which the buildings are constructed is Erf 3, Headway Hill, and measures 24,6 ha.

8. Development loans

8.1. Analysis of development loans

	1998 R'000	1997 R'000
Total loan book	**8 013 725**	8 332 028
Balance at beginning of year	**8 332 028**	7 040 336
Movements during the year:		
Loans disbursed	**2 172 779**	1 377 712
Local Authorities Loans Fund loans taken on	**910 202**	–
Interest capitalised	**658 060**	656 536
Development loans written off	**(3 550)**	(35 899)
Repayment of former homeland governments' debt as at 31 March 1997	**(3 159 336)**	–
Gross repayments	**(896 458)**	(706 657)
Deferred interest	**(441 953)**	(707 870)
Balance at beginning of year	**(707 870)**	(603 976)
Movements during the year:		
Interest capitalised	**(85 597)**	(136 347)
Transferred to income statement – homeland governments' debt as at 31 March 1997	**334 667**	–
Transferred to income statement	**16 847**	32 453
Gross development loans	**7 571 772**	7 624 158
Provision against development loans (note 9)	**(558 180)**	(287 101)
Net development loans	**7 013 592**	7 337 057

The Local Authorities Loans Fund was transferred to the Bank on 1 January 1998.

8.2. Expected future transfer from deferred interest to interest income:

	1998 R'000	1997 R'000
0-1 year	**19 864**	16 847
1-3 years	**45 407**	85 696
Thereafter	**376 682**	605 327
	441 953	707 870

Deferred interest is transferred to the income statement when it becomes due and payable per the loan agreement or when it is received.

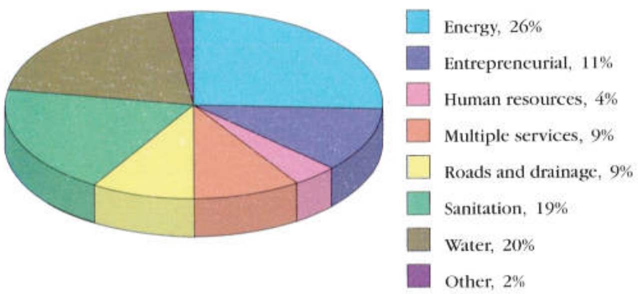
8.3. Maturity analysis

	1998 R'000	1997 R'000
0-1 year	**580 676**	634 832
1-3 years	**671 633**	835 794
Thereafter	**6 761 416**	6 861 402
	8 013 725	8 332 028

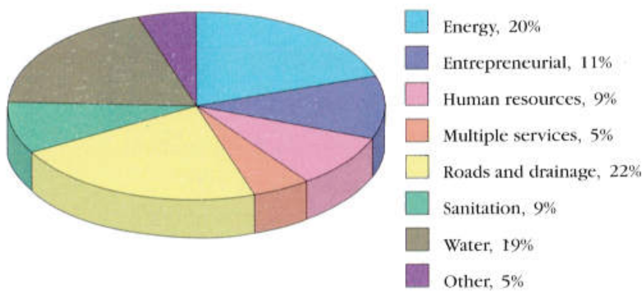
The maturity analysis is based on the remaining period from the year-end to the contractual maturity date.

	1998 R'000	1997 R'000
8.4. Sectoral analysis		
Energy	**2 089 822**	1 650 323
Entrepreneurial	**848 960**	921 753
Human resources	**286 378**	713 028
Multiple services	**681 718**	390 823
Roads and drainage	**760 897**	1 927 183
Sanitation	**1 546 644**	750 216
Water	**1 599 077**	1 541 497
Other	**200 229**	437 205
	8 013 725	8 332 028

Sectoral analysis 1997/8

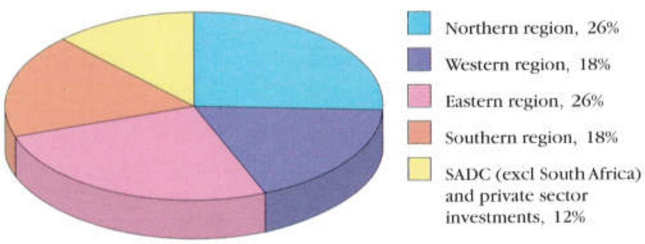


Sectoral analysis 1996/7

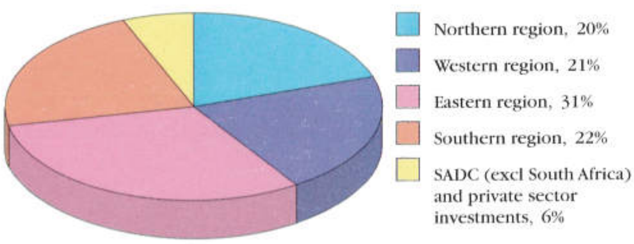


	1998 R'000	1997 R'000
8.5. Geographical analysis		
South Africa		
Northern region	**2 125 567**	1 706 332
Western region	**1 418 520**	1 737 606
Eastern region	**2 138 676**	2 539 363
Southern region	**1 401 984**	1 856 724
Southern Africa Development Community (excl South Africa) and private sector investments	**928 978**	492 003
	8 013 725	8 332 028

Geographical analysis 1997/8



Geographical analysis 1996/7



	1998 R'000	1997 R'000
9. Provision against development loans		
Balance at beginning of year	**287 101**	279 000
Transfer from Local Authorities Loans Fund	**67 505**	–
Amounts written off during the year	**(3 398)**	(35 899)
Income statement charge	**206 972**	44 000
Balance at end of year	**558 180**	287 101
Comprising:		
Specific provision	**152 243**	149 872
General provision	**405 937**	137 229
	558 180	287 101
10. Development investments		
Unlisted investments:		
Northern Water Board	**80 543**	80 543
Franchise Fund	**3 250**	750
Commonwealth Africa Investments Limited	**10 070**	4 687
Unlisted investments at cost	**93 863**	85 980
Directors' valuation of unlisted investments	**93 863**	85 980

Investments comprise the following:

	1998 R'000	1997 R'000
10.1. Northern Water Board Capital Project Bills of R80,5 million (nominal value R244,1 million) with maturities varying from 30 April 1998 to 31 October 2005.	**80 543**	80 543
10.2. Franchise Fund	**3 250**	750
32 500 (1997: 7 500) ordinary shares at cost	**32**	8
1 105 000 (1997: 255 000) 8% redeemable cumulative preference shares at cost	**1 105**	255
2 112 500 (1997: 487 500) 15% redeemable debentures at carrying value	**2 113**	487
10.3. Commonwealth Africa Investments Limited	**10 070**	4 687
200 (1997: 100) ordinary shares at cost	**1**	1
200 (1997: 100) redeemable preference shares at cost	**10 069**	4 686

	1998 R'000	1997 R'000
11. Other investments		
Total Other Investments	**3 192 840**	27 463
Other investments comprise the following:		
11.1 Listed investments:		
Government stock	**3 160 000**	–
Market value	**3 056 635**	–
11.2 Unlisted investments:		
Long-term derivative financial instrument	**32 840**	27 463
Directors' valuation	**32 840**	27 463

Government stock was issued to the Bank in settlement of the former homeland governments' debt of R3 159 million as at 1 April 1997

The long-term derivative financial instrument serves as a hedge for the Agence Française de Developpement loan (Refer to schedule B). Interest is capitalised at a rate of 18,04 per cent p a.

	1998 R'000	1997 R'000
12. Cash, deposits and tradable securities		
12.1. Analysis of cash deposits and tradable securities		
Fixed deposits	**100 000**	–
Call deposits	**123 670**	161 184
Tradable securities	**1 043 348**	266 828
Cash at bank	**306 207**	593
	1 573 225	428 605
12.2. Maturity analysis		
0-1 year	**1 063 197**	261 008
1-3 years	–	–
Thereafter	**510 028**	167 597
	1 573 225	428 605
13. Receivables		
Accrued income on deposits and securities	**74 246**	23 894
Other receivables	**15 038**	5 878
Provision for bad debts for the above balances	**(978)**	(7)
	88 306	29 765
14. Accounts payable		
Trade creditors and accruals	**15 826**	13 184
Accrued interest	**94 478**	28 290
Post-retirement medical benefits (note 20)	**21 000**	–
	131 304	41 474

	1998 R'000	1997 R'000
15. Interest income		
Development loans	**923 824**	552 642
Development investments	**967**	14 003
Listed investments		
Government stock	**377 555**	–
Other interest received	**103 080**	42 293
	1 405 426	608 938
16. Cost of funding		
Registered bonds	**398 360**	172 680
Other loans	**210 937**	151 810
Other interest paid	**11 445**	4 579
	620 742	329 069
17. Specific and general risk provisions		
Specific provisions		
Movement relating to specific provisions are in respect of other debtors	**971**	–
Movement relating to general and specific provisions in respect of development loans (note 9)	**206 972**	44 000
	207 943	44 000
18. Non-interest income		
Fees and sales	**10 995**	1 102
Grants transferred from balance sheet (note 5)	**3 205**	715
Less: Incremental expenses	**4 082**	885
Salaries	**211**	715
Consultants	**2 948**	–
Travel and subsistence	**407**	138
Other	**516**	32
	10 118	932
Other non-interest income	**1 171**	281
	11 289	1 213
19. Technical assistance grants		
Technical assistance grants disbursed	**2 936**	4 437

Technical assistance is provided in the form of grants to complement the Bank's investment activities. Policy co-operation grants to assist government and development institutions in policy-making decisions are also included. These are achieved by supporting capacity-building processes aimed at enhancing development delivery.

20. Post-retirement medical benefits		
Charge for the year	**21 000**	–

The recognition of the liability in respect of post-retirement medical benefits constitutes a change in accounting policy. No prior year adjustment was made because no actuarial valuation of the liability in previous years is available. The charge in the income statement represents the past service component of the liability, and the balance of the liability will be recognised over the remaining work life of employees. The Bank has decided to pre-fund this liability.

	1998 R'000	1997 R'000
21. Other operating expenses		
Auditors' remuneration		
Audit – current year	**717**	650
Audit – previous year	–	100
Other services – current year	**323**	182
Expenses – current year	**35**	34
Expenses – previous year	–	4
Directors' emoluments	**1 205**	499
Consultants' fees	**906**	4 726
Communication costs	**2 079**	1 904
Information technology	**4 494**	3 520
Remuneration	**104 316**	105 166
Subsistence and travel	**9 368**	6 234
Other	**10 667**	4 754
	134 110	127 773
22. Cash flow statement		
22.1. Interest received from development activities		
Gross development loan repayments (refer note 8)	**4 055 794**	706 657
Principal repayments	**(3 073 001)**	(249 386)
	982 793	457 271
22.2. Interest received from investments		
Accrued interest at the beginning of the year	**7 206**	6 985
Accrued interest (per note 13)	**23 894**	11 025
Accrued interest on development investments	**(18 043)**	(4 040)
Accrued interest included in investments	**1 355**	–
Charged to income for the year	**480 635**	42 293
Accrued interest at the end of the year	**(61 967)**	(7 206)
Accrued interest (per note 13)	**(74 246)**	(23 894)
Accrued interest on development investments	**19 010**	18 043
Accrued interest included in investments	**(6 731)**	(1 355)
	425 874	42 072

	1998 R'000	1997 R'000
22.3. Interest paid		
Accrued interest at the beginning of the year	**246 239**	140 715
Current liabilities (Note 14)	**28 290**	13 809
Medium- and long-term liabilities	**217 949**	126 906
Charged to income for the year	**548 992**	311 808
Interest expense per income statement	**620 742**	329 069
Amortisation of issue discount	**(71 750)**	(17 261)
Accrued interest element of funding	**44 171**	27 905
Accrued interest at the end of the year	**(397 608)**	(246 239)
Current liabilities (Note 14)	**(94 478)**	(28 290)
Medium- and long-term liabilities	**(303 130)**	(217 949)
	441 794	234 189

22.4. Reconciliation of surplus for the year to other operating expenditure paid		
Surplus for the year	**427 388**	102 614
Adjustments for:		
Provision against development loans	**206 972**	44 000
Technical assistance grants paid	**2 936**	4 437
Interest expense	**620 742**	329 069
Interest received on investments	**(480 635)**	(42 293)
Interest received on development activities	**(924 790)**	(566 645)
Depreciation	**2 739**	1 776
Increase in receivables (refer note 13)	**(8 189)**	(3 251)
Increase/(decrease) in accounts payable	**23 490**	(5 235)
	(129 347)	(135 528)

22.5 Local Authorities Loans Fund transferred to DBSA		
Development loans (refer note 8)	**(910 202)**	–
Provision for loan loss (refer note 9)	**67 505**	–
Medium- and long-term financing	**155 009**	–
Creditors	**152**	–
General reserves (refer note 4)	**812 308**	–
	124 772	–

	1998 R'000	1997 R'000

23. Provident fund and medical aid benefits

The Development Bank of Southern Africa provident fund was established on 1 June 1994.

As a condition of employment, all eligible employees are required to join as members.

The fund, which is governed by the Pension Funds Act, 1956 (Act no 24 of 1956), is a defined contribution plan for employees in the permanent employ of the Bank.

	1998 R'000	1997 R'000
The Bank's contributions to retirement and medical aid funds amount to:		
Provident fund	**5 925**	5 936
Average number of employees: 480 (1997: 510)		
Medical aid fund	**6 576**	6 278
Average number of members: 480 (1997: 492)		
	12 501	12 214

24. Taxation

The Bank is exempted from normal taxation in terms of the Income Tax Act (Act no 62 of 1961), and no provision for normal taxation is made. The Bank is currently consulting with the South African Revenue Services regarding the phasing-in of normal taxation, while other local levies and taxes are being paid.

25. Commitments

At balance sheet date the Bank had the following commitments.

	1998 R'000	1997 R'000
25.1 Loan commitments		
Loans approved by the Board of Directors but not signed	**1 992 817**	1 083 289
Loans signed but not disbursed	**3 451 126**	2 278 230
	5 443 943	3 361 519

As the disbursement pattern for loans committed but not disbursed is a primary function of individual borrowers' implementation and administrative capacities, this pattern is not quantifiable.

The Bank's view of the expected disbursements for these commitments is 46% in 1998 and 54% thereafter.

These commitments are to be financed from funds generated by operating activities, local financial markets and foreign sources.

	1998 R'000	1997 R'000
25.2. Technical assistance grants		
Grants approved by the Board of Directors but not signed	**639**	70
Grants signed but not disbursed	**4 552**	5 840
	5 191	5 910

	1998 R'000	1997 R'000

25.3. Forward exchange contracts
Commitments in respect of inflow of funds:

Foreign amount	Rate	Maturity date
US$ 7 339 000	5,032	April 1998

Commitments in respect of outflow of funds:

Foreign amount	Rate	Maturity date
US$ 7 339 000	5,056	April 1998

25.4. Development investment
The Bank has a commitment to take up 300 units in Comafin (one ordinary share and one 8 per cent redeemable preference share per unit) at a value of $10 000 per unit over a period not exceeding 4 years (commencing July 1996) in tranches of not less than 10 per cent and not more that 25 per cent of the agreed amount.

26. Contingent liabilities

26.1. Employee loans
The Bank has entered into agreements with financial institutions whereby it stands surety for housing and micro loans of its employees.

	1998 R'000	1997 R'000
Loan balances secured	**1 549**	1 616

26.2. Guarantees

	1998 R'000	1997 R'000
The Bank has approved and issued guarantees on behalf of borrowers amounting to:	**65**	3 724

27. Funds administered on behalf of third parties
The Bank has entered into agreements with a number of development entities to administer funds on their behalf. The activities of these entities relate to development and include development research, policy formulation and loans.

	1998 R'000	1997 R'000
Balance at beginning of the year	**4 651**	1 144
Funds received	**1 297 346**	131 541
Funds disbursed	**(1 275 994)**	(128 034)
Funds at the end of the year	**26 003**	4 651

28. Comparative figures
Comparative figures have been restated, where appropriate, to provide more meaningful information.

SCHEDULE A
REGISTERED BONDS AS AT 31 MARCH 1998

	Authorised value 1998 Rm	1997 Rm	Coupon rate	Repayment date	Balance in issue 1998 Rm	Unamortised discount 1998 Rm	Balance in issue 1997 Rm	Unamortised discount 1997 Rm
(i) Local								
DV06	**3 000**	1 000	10,0%	2001	**1 292**	**167**	654	109
DV07	**5 000**	3 000	14,5%	2010	**2 012**	**76**	1 132	76
LL06 transferred from LALF			14,0%	2005	**163**	**8**	–	–
Sub-total	**8 000**	4 000			**3 467**	**251**	1 786	185
(ii) Foreign								
German bonds	**497**	497	10,0%	1998	**–**	**–**	475	–
Euro-rand bond	**7 500**	–	0%	2027	**7 500**	**7 276**	–	–
Euro-rand bond	**1 000**	–	13,5%	2028	**1 000**	**49**	–	–
Sub-total	**8 997**	497			**8 500**	**7 325**	475	–
Total	**16 997**	4 497			**11 967**	**7 576**	2 261	185

SCHEDULE B
OTHER LOANS AS AT 31 MARCH 1998

	1998 Rm	1997 Rm	Interest rate %	Commencement date of capital repayment	Number of instalments	Loan currency
Chiao Tung Bank Co Ltd	**34**	31	3,0	March 2000	15 Equal annual	USD
Agence Française de Developpement loan 1	**85**	80	3,5	April 2004	26 Equal semi-annual	FFR
Agence Française de Developpement loan 2	**124**	–	3,5	October 2000	12 Equal semi-annual	FFR
Export-Import Bank of Japan	**552**	481	3,5	March 2000	20 Equal semi-annual	JPY
OECF loan	**98**	–	2,5	May 2003	37 Equal semi-annual	JPY
European Investment Bank loan 1	**100**	–	14,95	April 2002	1	ZAR
European Investment Bank loan 2	**50**	–	14,30	August 2007	1	ZAR
Total	**1 043**	592				
Unamortised discount – EIB 1 & 2	**1**	–				

Rand denominated loans are disclosed with South African interest rates, while others are disclosed with foreign interest rates.

The OECF and Agence Française de Developpement loan 2 are covered by currency and interest rate SWAP agreements. In these instances the net positions are disclosed, as it is not practical to comply with all the disclosure requirements of IAS32.

Other foreign currency liabilities are covered by foreign exchange contracts.

Development Bank of Southern Africa

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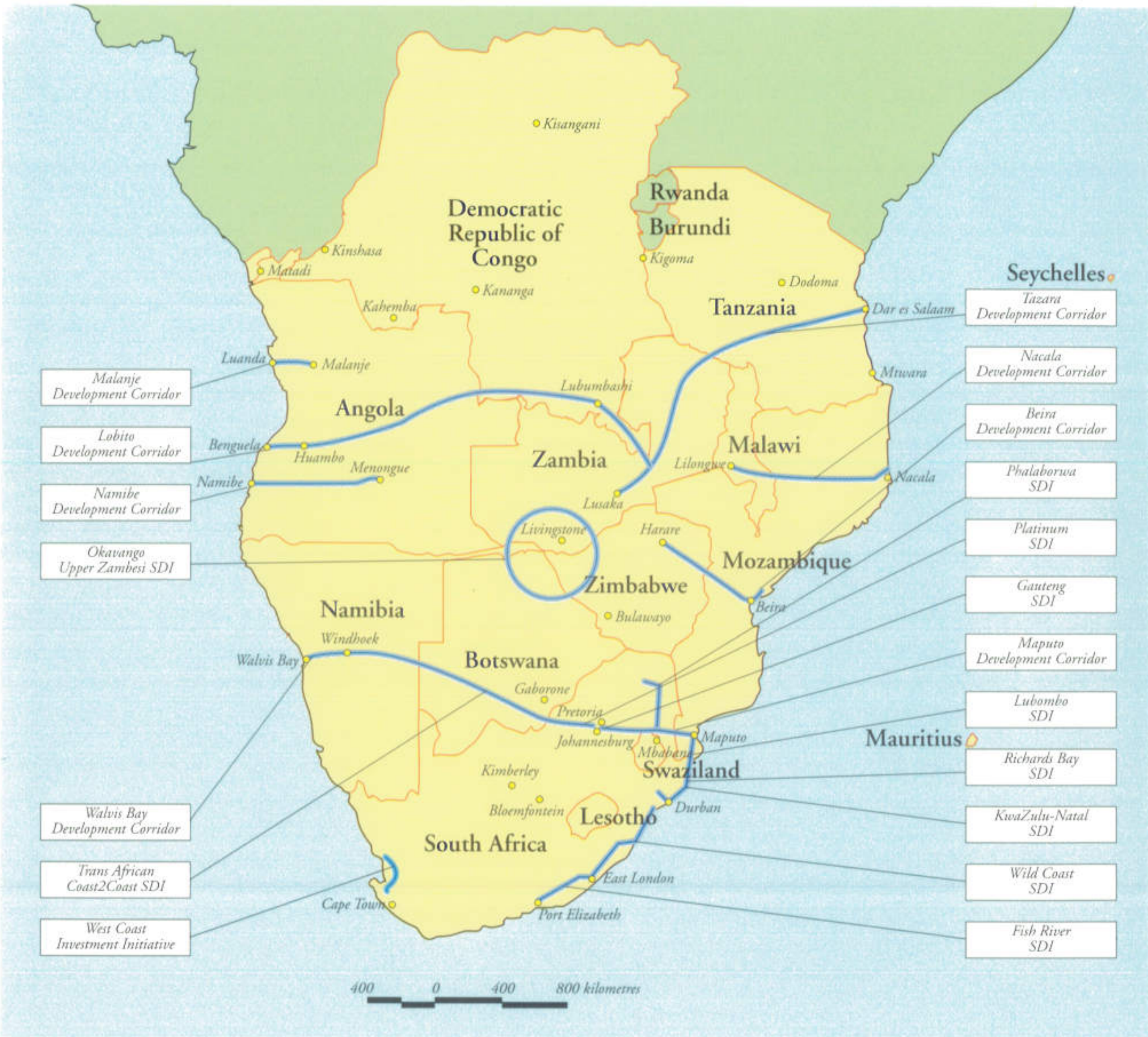
DBSA's countries of operations, showing spatial development initiatives (SDIs)



DBSA's countries of operations (Southern African Development Community)

Angola
Botswana
Democratic Republic of Congo
Lesotho
Malawi
Mauritius
Mozambique
Namibia
Seychelles (still to tender its Instrument of Accession)
South Africa
Swaziland
Tanzania
Zambia
Zimbabwe

DBSA's operational regions

Northern region
Gauteng, Northern Province

Western region
Free State, North West, Northern Cape

Eastern region
KwaZulu-Natal, Mpumalanga

Southern region
Eastern Cape, Western Cape

Southern African region
SADC countries excluding South Africa