

**AFRICAN DEVELOPMENT BANK GROUP**



**ZAMBIA**

**THIRD AND FOURTH LINES OF CREDIT TO  
DEVELOPMENT BANK OF ZAMBIA**

**Project Performance Evaluation Report (PPER)**

**OPERATIONS EVALUATION DEPARTMENT  
(OPEV)**

**17 June 1998**

## TABLE OF CONTENTS

CURRENCY EQUIVALENTS .....	iii
LIST OF ABBREVIATIONS.....	iv
PREFACE.....	v
BASIC PROJECT DATA .....	vi
CHAPTER 1.        EVALUATION SUMMARY .....	1
CHAPTER 2.        BACKGROUND.....	3
2.1    Country Economic Context.....	3
2.2    History of Operations.....	4
2.3    Formulation.....	6
2.4    Project Rationale.....	6
2.5    Objectives and Scope at Appraisal .....	6
2.6    Financing Arrangements .....	7
2.7    Evaluation Methodology and Approach .....	7
CHAPTER 3.        PROJECT IMPLEMENTATION .....	9
3.1    Loan Effectiveness .....	9
3.2    Changes in Project Scope .....	9
3.3    Implementation Schedule.....	9
3.4    Reporting.....	10
3.5    Procurement .....	10
3.6    Project Costs .....	10
3.7    Disbursements and Financial Sources .....	10
3.8    Compliance with Loan Conditions and Covenants .....	11
CHAPTER 4.        PERFORMANCE EVALUATION .....	12
4.1    Operating Performance .....	12
4.2    Financial Performance .....	13
4.3    Economic Performance .....	15
4.4    Institutional and Social Performance.....	15
4.5    Women in Development.....	16
4.6    Environmental Performance .....	16
4.7    Performance of Consultants, Contractors, Suppliers and Borrower.....	16
4.8    Bank Group Performance .....	16

CHAPTER 5.	PROJECT SUSTAINABILITY .....	17
CHAPTER 6.	PERFORMANCE RATINGS .....	18
CHAPTER 7.	CONCLUSIONS AND RECOMMENDATIONS.....	18
	7.1 Overall Assessment .....	18
	7.2 Feedback and Recommendations .....	19
	7.3 Follow-up Action.....	20

## APPENDICES

### LIST OF APPENDICES

		<u>N°. of Pages</u>
I	Projects financed under LOC III and IV	2
II	Retrospective Logical Framework Matrix	1
III	Performance Rating for LOC III and LOC IV	3
IV	Recommendations and Follow-up Matrix	1

---

This Project Performance Audit Report was prepared by G. Yirga-Hall, Principal Evaluation Officer (OPEV) and G. E. Okurume, Industrial Economist (Consultant) following a post-evaluation mission to Zambia in January/February 1997.

CURRENCY EQUIVALENTS  
(Fourth quarter 1996)

Currency Unit		ZK (Zambia Kwacha)*
UA 1	=	ZK 1854.14
UA 1	=	US\$ 1.44462

---

\* as per ADB rates

Evolution of Exchange Rates\*  
(ZK/US\$)

<u>Year</u>	<u>Annual Average Rate</u>	
1980	ZK	0.80
1981		0.87
1982		0.93
1983		1.25
1984		1.79
1985		2.71
1986		7.30
1987		8.89
1988		10.10
1989		21.10
1990		44.00
1991		90.00
1992		322.00
1993		570.00
1994		677.50
1995		873.30
1996		1207.39
1996 (December)		1282.56

---

\*\* Source: Bank of Zambia

Fiscal Year

GOZ : Calendar Year  
DBZ : April 1 to March 31

LIST OF ABBREVIATIONS

ADB	African Development Bank
ADF	African Development Fund
BADEA	The Arab Bank for Development in Africa
DBZ	Development Bank of Zambia
DEG	Germany Finance Company
EIB	European Investment Bank
FMO	Netherlands Development Finance Company
GDP	Gross Domestic Product
GOZ	Government of the Republic of Zambia
LOC	Line of Credit
PCR	Project Completion Report
PPAR	Project Performance Audit Report
SOE	State-owned Enterprise

## PREFACE

This Project Performance Audit Report (PPAR) covers the third and fourth lines of credit to Development Bank of Zambia (DBZ). The third line of credit of UA 10 million was approved on 16 March 1982, the related loan agreement signed on 05 May 1982 and its disbursement was completed in May 1989. As regards the fourth line of credit of UA 15 million, approval and loan signature were on 25 June, 1987 and 30 September, 1987 respectively while disbursement was completed in February 1992. A Project Completion Report covering both lines of credit was completed in March 1994.

In spite of considerable implementation problems, the outcome of LOC III was generally satisfactory. In contrast, LOC IV was unsatisfactory largely as a result of exogenous factors beyond the control of the Executing Agency and sub-project promoters. The changes in the macroeconomic environment were unprecedented in magnitude and speed and many sub-projects are still suffering from their effects. A full PPAR is necessary to take a closer look at some of the issues, even though the PCR dealt adequately with many aspects of the LOCs. The purpose of the PPAR is therefore to review and supplement the findings and recommendations of the PCR, re-evaluate the sustainability of the benefits of the LOCs and highlight the lessons learnt.

The PPAR is based on the findings of a post-evaluation mission that visited Zambia in January/February 1997 and on the Appraisal Reports of February 1982 and April 1987, the PCR and other Bank documents. The mission held discussions with officials of DBZ, relevant Government ministries and the Bank of Zambia and visited a sample of the sub-projects financed under the LOCs in Lusaka area and the copperbelt.

The PPAR describes the background of the lines of credit, including the country economic context, examines the soundness of the project rationale and formulation and assesses various aspects of the completed project, particularly the performance of DBZ, the sub-projects financed and the Bank. On this basis, it summarizes lessons derivable from the projects and makes recommendations that may help to enhance the effectiveness of DBZ's ailing sub-projects and the Bank's future lines of credit in Zambia and elsewhere.

BASIC PROJECT DATA

1.	Country	Republic of Zambia
2.	Project	Third Line of Credit
3.	Loan Number	DBZ/Z/IND/AGR/TR/82/010
4.	Borrower	Development Bank of Zambia (DBZ)
5.	Guarantor	Government of Zambia (GOZ)
6.	Beneficiary	DBZ
7.	Executing Agency	DBZ

**A. LOAN**

	<u>APPRAISAL</u>	<u>ACTUAL</u>	
1.	Amount (UA Million)	10.00	8.93
2.	Interest Rate	7.50%	7.50%
3.	Repayment Period	10 years	10 years
4.	Grace Period	5 years	5 years
5.	Loan's Approval Date		16/03/82
6.	Loan's Signature Date		05/05/82
7.	Loan Effectiveness Date	Nov. 1982	02/11/82

**B. PROJECT DATA**

1.	Total LOC (UA Million)	10.00	8.93
2.	Financing Plan (UA Million)		
	ADB	10.00	8.93
3.	Effective Date of 1st Disbursement	30/06/83	30/03/83
4.	Effective Date of last Disbursement	31/12/87	31/12/89

**C. PERFORMANCE INDICATORS**

1.	Cost Overrun/Underrun on ADB loan	-10%
2.	Time Overrun/Underrun	+24 months
	-Slippage of Effectiveness	-
	-Slippage of Last Disbursement	+24 months
	-No. of Extensions of Last Disbursement	2
3.	LOC Implementation Status	Complete

4. Implementation Performance & Project Outcome

- Implementation Performance	:	Satisfactory
- Bank Performance	:	Satisfactory
- Project Outcome	:	Satisfactory

D. MISSIONS

	<u>No. of Missions</u>	<u>No. of Persons</u>	<u>Date</u>	<u>Man-days</u>
Identification	-	-	-	-
Preparation	-	-	-	-
Appraisal	1	2	Dec. 1981	28
Supervision	1	2	N.I.*	28

---

\* Not indicated in files.

E. DISBURSEMENT (UA Million)

<u>Year</u>	<u>Appraisal*</u>	<u>Actual</u>
1983		1,666,038.60
1984		936,390.32
1985		3,352,259.13
1986		986,558.86
1987		91,604.39
1988		1,095,064.10
1989		803,136.17
Total	10,000,000	8,931,051.57
Amount Cancelled		1,068,948.43

---

\* No breakdown was given year by year; but a total duration of 4 years was estimated for the LOC to be utilized fully.

BASIC PROJECT DATA

1.	Country	Republic of Zambia
2.	Project	Fourth Line of Credit
3.	Loan Number	B/ZAM/IND/LC/87/016
4.	Borrower	Development Bank of Zambia (DBZ)
5.	Guarantor	Government of Zambia (GOZ)
6.	Beneficiary	DBZ
7.	Executing Agency	DBZ

**A. LOAN**

	<u>APPRAISAL</u>	<u>ACTUAL</u>	
1.	Amount (UA Million)	15.00	14.81
2.	Interest Rate	7.64%	7.64%
3.	Repayment Period	10 years	10 years
4.	Grace Period	4 years	4 years
5.	Loan's Approval Date		25/06/87
6.	Loan's Signature Date		30/09/87
7.	Loan Effectiveness Date	March 1988	16/03/88

**B. PROJECT DATA**

1.	Total LOC (UA Million)	15.00	14.81
2.	Financing Plan (UA Million)		
	ADB	15.00	14.81
3.	Effective Date of 1st Disbursement	31/12/88	20/06/88
4.	Effective Date of last Disbursement	30/06/94	Feb. 1992

**C. PERFORMANCE INDICATORS\***

1.	Cost Overrun/Underrun on ADB loan	-1.3%
2.	Time Overrun/Underrun on ADB loan	-
	-Slippage of Effectiveness	-
	-Slippage of Last Disbursement	-28 months
	-No. of Extensions of Last Disbursement	-
3.	LOC Implementation Status	Completed

4. Implementation Performance & Project Outcome

- Implementation Performance	:	Satisfactory
- Bank Performance	:	Satisfactory
- Project Outcome	:	Satisfactory

D. MISSIONS

	<u>No. of Missions</u>	<u>No. of Persons</u>	<u>Date</u>	<u>Man-days</u>
Identification	-	-	-	-
Preparation	-	-	-	-
Appraisal	1	1	Feb. 1987	21
Supervision	1	2	Dec. 1990	28

E. DISBURSEMENT (UA Million)

<u>Year</u>	<u>Appraisal*</u>	<u>Actual</u>
1988		1,963,464.49
1989		7,451,584.56
1990		4,961,010.61
1991		382,223.52
1992		51,384.68
Total	15,000,000	14,809,667.86
Amount Cancelled		190,332.14

\* No breakdown was given year by year; but a total duration of 6 years was estimated for the LOC to be utilized fully. The actual duration to disburse the committed portion was about 4 years (20/06/88 - 10/02/92).

## 1. EVALUATION SUMMARY

### Objectives and Scope

1.1 The goals and objectives of the two lines of credit are summarized in the retrospective logical framework (Appendix 2). The principal objective of LOC III was rooted in one priority identified in the third national development plan, namely, the need to diversify the economy. LOC III was therefore aimed at providing medium-term and long-term foreign currency financing for DBZ's agricultural, agro-industrial, manufacturing and transportation projects. The emphasis was to be on small-scale and medium-scale projects and on minimum use of imported raw materials. These objectives were in line with those of the manufacturing sector which included import-substituting and export-oriented production based on maximum use of domestic raw materials and agro-industrial production targeted at national self-sufficiency. Besides continuing the objectives of LOC III, LOC IV was to give priority to rehabilitation, modernization and expansion of existing enterprises.

1.2 The scope of the third and fourth LOCs as appraised did not change appreciably. The net loan amount for LOC III was UA 8.93 million as a result of the cancellation of UA 1.07 million or 10.7% of the approved amount. The approved amount of UA 15 million for LOC IV was fully disbursed except for UA 190,332 or 1.3% of the total, which was promptly cancelled. Disbursements under the LOCs were thus within the approved amounts.

1.3 The post-evaluation report is based on a desk review of the Appraisal Report, the Project Completion Report and other relevant background documents available in the Bank and statistical data and other information collected during a one-week field mission to Zambia. Information collected in the field came from documents supplied by DBZ, the Executing Agency, and discussions with the management and staff of DBZ, officials of relevant Government ministries and the Bank of Zambia and a sample of sub-projects visited. The approach was to compare the achievements of the LOCs with expectations at the time of appraisal and to interpret them in the context of changes in the environment during implementation.

### Implementation Performance

1.4 LOC III and LOC IV financed 17 and 15 sub-projects respectively. Loan conditions and covenants were satisfied early and loan effectiveness was prompt. The disbursement of LOC III progressed rapidly until it was interrupted by ADB sanctions on Zambia for poor debt-servicing. As a result, the last disbursement was made two years after the scheduled deadline. In spite of initial interruption by sanctions, the disbursement of LOC IV was completed ahead of schedule on account of the general scarcity of foreign exchange. However, the effects of radical macroeconomic reforms impeded the physical implementation of most sub-projects some of which are yet to be commissioned.

### Institutional Aspects

1.5 Initially, the two LOCs increased employment, as was expected at appraisal, but some have reduced their work force over time under pressure from the competition unleashed by trade liberalization reforms. As regards DBZ, the Bank helped to improve appraisal capacity, even though recommendations for strengthening financial analysis capability were not implemented.

### Project Impact

1.6 The LOCs financed non-mining investments exclusively and thus enhanced efforts to diversify the Zambian economy away from copper and contributed to the survival of Zambia's manufacturing sector by providing foreign exchange which was in short supply. They also created employment in operating greenfield sub-projects and saved jobs in going concerns that may have ceased to operate or reduced production.

### Sustainability

1.7 Sub-projects under LOC III are largely sustainable and their benefits are likely to continue, even after the loan has been repaid. In contrast, the LOC IV sub-projects are largely unsustainable in their present state due to cost overruns and other problems arising from economic reforms that transformed the operating environment radically. DBZ's sustainability is also fragile as a result of the poor performance of sub-projects and its own heavy dependence on foreign lines of credit.

### Conclusions

1.8 LOC III was satisfactory in meeting its objectives in spite of delayed implementation. On the other hand, the sustainability of LOC IV sub-projects is at risk on account of their crushing debt burden and competition from imports.

### Feedback

1.9 One important feedback is that each Executing Agency should be required and, if necessary, assisted to install a system for tracking current and past sub-projects to facilitate learning from their achievements and failures. Another is that radical changes in the macroeconomic environment are not normal commercial risk and Government, as guarantor, should be required to provide a temporary cushion against some of the risk, especially the foreign exchange risk, entailed in its actions and generally provide safeguards to facilitate adaptation to the new operating environment. Other feedbacks are summarized in the last chapter of this PPAR.

## 2. BACKGROUND

### 2.1 Country Economic Context

2.1.1 At the time of appraisal of the third line of credit to DBZ, the Zambian economy was characterized by pervasive state ownership and government controls. During the 1970s, large-scale nationalization of manufacturing enterprises in Zambia increased the number of parastatals ten-fold to 147 and practically all the large-scale industrial enterprises became Government-owned directly or indirectly through parastatals. These developments resulted from the pursuit of the Government's development strategy of the 1970s, which was to accelerate industrialization and increase employment and domestic control of the main economic sectors. Government's strategy for achieving these goals included accelerated government ownership in the major sectors of the economy, major public sector investments in the production of intermediate goods and consumer durable, elimination of foreign competition through import licensing and tariffs and elimination of domestic competition through restrictive investment licensing.

2.1.2 The above situation had been facilitated and sustained by a boom in the price of copper in the early years of the decade. In this connection, it is important to note that copper was and remains the mainstay of the Zambian economy and that economic activity in other sectors of the economy are very sensitive to developments in the mining industry.

2.1.3 As a result, the changing fortunes of the copper industry have compelling economy-wide repercussions. For instance, manufacturing, which accounted for 11.7 per cent of real GDP in 1980, depended heavily on imports made possible by the foreign exchange earnings of the mining industry. The mining industry, which was and remains virtually synonymous with copper, contributed about 23% of real GDP and over 90% of total export earnings during 1972-76. This dominant position of copper in the Zambian economy has remained unchanged.

2.1.4 Accordingly, in spite of some recovery in 1979/80, collapsing copper price beginning in the mid-1970s reduced the Government's revenue base substantially, resulting in annual budget deficits averaging 16% of GDP during 1975-82. Similarly, balance of payments deficits emerged in the current and capital accounts, which the Government of Zambia (GOZ) initially financed by running down its external reserves and increasing its international borrowing and external debt burden. The impact on real GDP was a steady decline averaging 1.3% a year from 1974 to 1980 as compared with a corresponding average annual population growth rate of 3.1%, implying a steady fall in per capita GDP. Eventually, GOZ had to resort to comprehensive import licensing, exchange control and currency devaluation.

2.1.5 In search of more effective policies, GOZ made attempts to restructure the economy during 1982-87. Implemented half-heartedly, the measures, which included liberalization and diversification of the economy, proved abortive and the ratio of budget deficit to GDP remained high, averaging 14% during the period while national investment declined from about 24% of GDP in 1980 to 14% in 1987. Despite a modest recovery of

copper prices and the economy in 1988, the trend of the national economy continued to be negative during 1987-92.

2.1.6 GOZ had become aware of the need to change the policy framework and create an enabling environment. In 1991, therefore, it introduced far-reaching economic reforms aimed at creating a free market and a liberalized environment considered necessary for reviving the economy. Following the launching of the privatization programme in December 1991, all interest rates and the foreign exchange rate became fully market determined. Increasing reliance on market forces for the allocation of foreign exchange, especially following the introduction of the foreign exchange auction system in 1985, had already resulted in a steady erosion of the external value of the Kwacha at a pace that accelerated to unprecedented levels as from 1989.

2.1.7 Thus, the third and fourth lines of credit were approved when the Zambian economy had been declining for some years and foreign exchange was desperately needed to enhance investment and stimulate aggregate economic growth. It was a period when the economy was very vulnerable to the fortunes of copper in the world market. LOC III was approved during the Third National Development Plan (1979-84), an important objective of which was the diversification of the economy from dependence on copper towards increased agricultural production, domestic resource-based industrialization and development of non-copper minerals. LOC IV was approved during the Fourth National Development Plan (1984-90) which was aimed primarily at tackling the balance of payments gap by diversifying exports and embarking on an aggressive import substitution drive in the area of food, raw materials and capital goods. It is noteworthy that the unprecedented continuity and magnitude of the depreciation of the Kwacha in subsequent years were not foreseeable at the time of approval and disbursement of these LOCs.

2.1.8 DBZ had been established in December 1972 in response to these national development priorities to enhance economic and social development in Zambia by promoting and providing foreign and local currency financing on medium-term and long-term basis for development oriented projects consistent with national development objectives. The Bank has only a token equity interest in DBZ and is not represented on the Board of Directors. DBZ's foreign exchange resources have so far consisted of what it mobilized from the international donor community and the terms of its assistance to promoters were guided by the terms on which it obtained its own funds. The beneficiaries of LOCs pay lower interest rates than those applicable to local currency loans but these sub-projects bear the full foreign exchange risk of their loans.

## 2.2 History of Operations

2.2.1 Before LOC III the Bank had already implemented one line of credit to DBZ successfully and a second was ongoing. LOC I was approved on 28 June, 1973 to finance DBZ operations to 1976 and LOC II on 22 May, 1980 to finance the operations of 1980-83. The first two LOCs financed mainly projects in the manufacturing sector. Accordingly, the Bank Group was already quite familiar with the manufacturing sectors and the Executing Agency when LOC III was approved. A post-evaluation report on the first and second lines of credit was completed in August 1985. The main lesson learnt from the 1st and 2nd lines of

credit relates to the need to reorient future financing to local resource-based industries in order to minimize the effects of foreign exchange risk. A fifth line of credit to DBZ, approved in 1991, is ongoing and has had a significant positive impact on the capital base of DBZ as well as the financing of the recent expansion of non-traditional exports. This reorientation responds to the lessons learnt from previous lines of credit as it contributes to foreign exchange earnings which is increasingly required for capital investment and debt servicing.

2.2.2 Considering that the Bank has granted LOC to DBZ for the fifth time, it is appropriate to briefly present the main findings and recommendations of the Impact Study on Lines of Credit (Phase I) which was conducted by the Bank in 1993. The study assesses the effects of LOCs as development instruments in some 12 regional member countries including Zambia.

2.2.3 According to the Study findings, between 1969 and 1986, the period when a large portion of the Lines of Credit were granted by the Bank to Development Finance Institutions (DFIs) in most of the Regional Member Countries, the macroeconomic environment was heavily protected by the Government policy as it relates to duties, tariffs, exchange controls, etc. Lending operations have often been subject to government interference. During the same period, the ADB intervention was not backed with industrial and private sector policy documents and little consideration was given on macroeconomic and institutional constraints in extending the LOCs. Since 1986 the ADB has defined an intervention policy for the industrial sector, including LOC lending and developed a private sector support strategy. However, LOC financing in recent years has been to few countries that have already come successfully through the process of structural adjustment. Subproject tracking and follow-up by ADB has remained to be very limited.

2.2.4 Resource mobilization has been limited to DFI borrowing from international development finance institutions and state governments. Services offered by DFIs have been limited to partial financing; no other financial services have been furnished and other support to entrepreneurs has been limited. Local monitoring procedures have been generally limited to the subloan disbursement period, going beyond it only in cases of repayment of arrears.

2.2.5 At sub-projects level, most which benefited from the LOCs were relatively large size and the investments were capital intensive. The survival rate of subprojects was very low due to high import dependency and adverse impact of market liberalization following structural adjustment programmes implemented in these countries.

2.2.6 A few of the main recommendations of the Study includes the following:

- there is need to support the development of micro, small, and medium-scale enterprises with the primary aim of poverty alleviation and promotion of the role of women in development.
- issue a detailed policy for Small and Medium Enterprise promotion and specific guidelines for LOC management, subproject selection and supervision; and develop basic impact indicators for subprojects.

- encourage local savings mobilization to reduce dependence on development assistance funding and exposure to exchange risk

2.2.7 Most of the findings of the study are still valid and the recommendations have yet to be realized. Currently the Bank is engaged in developing a policy and guidelines for micro enterprise financing and extending its LOC operations to private sector financial intermediaries established in the Regional Member Countries.

### 2.3 Formulation

Preparatory work was evidently less than comprehensive as there was no pre-appraisal mission. The indications are that the projects were formulated solely on the basis of ongoing familiarity with the objectives and priorities of Zambia and DBZ as a result of previous Bank Group operations in Zambia. The explanation appears to be that they were follow-up projects and the problems that the first two LOCs were to help to solve had not changed materially and remained relevant except for the size of DBZ's operations and the implicit foreign exchange requirements.

### 2.4 Project Rationale

The rationale for granting the third and fourth lines of credit was essentially the same, namely, to help solve the problems outlined in paragraph 2.1.7 above. They were specifically aimed at advancing production and export diversification and import substitution. This rationale was derived from identified national objectives and priorities which had also constituted the justification for the two earlier lines of credit to DBZ. The LOCs were particularly needed at a time when there was little investor confidence in Zambia.

### 2.5 Objectives and Scope at Appraisal

2.5.1 The goals and objectives of the two lines of credit are summarized in the retrospective logical framework (Appendix 2). The principal objective of LOC III was rooted in one priority identified in the third national development plan, namely, the need to diversify the economy. LOC III was therefore aimed at providing medium-term and long-term foreign currency financing for DBZ's agricultural, agro-industrial, manufacturing and transportation projects. The emphasis was to be on small-scale and medium-scale projects and on minimum use of imported raw materials. These objectives were in line with those of the manufacturing sector which included import-substituting and export-oriented production based on maximum use of domestic raw materials and agro-industrial production targeted at national self-sufficiency. Besides continuing the objectives of LOC III, LOC IV was to give priority to rehabilitation, modernization and expansion of existing enterprises.

2.5.2 It is significant to note that the project design did not indicate how project impact, especially as regards diversification, was to be measured or otherwise assessed. Attainment of diversification in the Zambian context required investment outside the mining sector but that action did not guarantee diversification as an outcome. One reason for this is that some non-mining activities may be directly dependent on mining or otherwise positively

correlated with developments in the mining industry. In any case, the volume of investment arising from the LOCs is so small relative to the overall economy that its effect on major macroeconomic aggregates is easily swamped by effects of other factors. It would therefore be easy, in the absence of specially designed performance indicators, to draw unwarranted conclusions from macroeconomic indicators.

2.5.3 LOC III and LOC IV for UA 10 million and UA 15 million respectively were for on-lending towards the foreign exchange needs of all development oriented projects eligible for DBZ financing. Only projects with total assets not exceeding UA 2.0 million and Zambian ownership of at least 51% would qualify for financing under LOC III and ADB participation in any individual project would be limited to UA 1.0 million. As a result of the continuing foreign exchange constraint of the economy, DBZ modified its strategy at the time of appraisal of LOC IV and shifted emphasis to rehabilitating and rationalizing existing industrial projects while limiting new projects to those that were domestic resource-based and likely to have a positive impact on the foreign exchange position.

## 2.6 Financing Arrangements

2.6.1 At the time of appraisal of LOC III, DBZ had an estimated foreign exchange resource gap of ZK 9.9 million or UA 9.7 million, representing about 22% of total foreign exchange requirements for the operations of the following three years. The remaining ZK 34.6 million or 78% of the total was expected to come from BADEA, KfW and the World Bank and negotiations to that end were already in progress. Of this latter amount, ZK 22.0 million or 63.6% was expected from the World Bank, 25.1% from BADEA and 11.3% from KfW. The third line of credit, which had been requested by DBZ, was intended to cover the above gap.

2.6.2 Complementary local currency requirements for LOC III were expected to be adequately met through borrowing from domestic financial institutions and the net earnings of DBZ from its operations. To this end, negotiations had been concluded with the Zambian National Provident Fund and the major local commercial banks while negotiations were in progress with the Bank of Zambia and the Zambia State Insurance Corporation.

2.6.3 As regards LOC IV, the foreign exchange requirement for the five-year period ending in 1991/92 was estimated at ZK 572.9 million or UA 36.9 million, of which ZK 365.3 million or 63.8% was to be covered by already approved lines of credit from IDA (22.2%), EIB (23.7%), KfW (5.7%) and FMO (12.1%). LOC IV amounting to UA 15 million, which was equivalent to ZK 233.2 million was to finance the foreign currency gap of ZK 207.6 million. Some arrangements were made for financing the local currency resource gap but they did not provide fully for the estimated gap.

## 2.7 Evaluation Methodology and Approach

This post-evaluation report is based on a review of relevant background documents available in the Bank and statistical data and other information collected during a two-week field mission to the host country, Zambia. The documents reviewed included the Appraisal Reports for the two lines of credit, the joint Project Completion Report and other

documents available in project files. Information collected in the field came from documents supplied by DBZ, the Borrower and Executing Agency, and discussions with the management and staff of DBZ, officials of relevant Government ministries and the Bank of Zambia and a sample of sub-projects in the Lusaka and Ndola (copperbelt) regions. Although only a small sample of these sub-projects was visited on account of the short duration of the mission, the information gathered is considered adequate for understanding the state of affairs. The approach was to compare the achievements of the two LOCs with expectations at the time of appraisal and to interpret them in the context of changes in the environment during implementation.

### 3. PROJECT IMPLEMENTATION

#### 3.1 Loan Effectiveness

The conditions for loan effectiveness appear to have been realistic as no problems were experienced in satisfying them. The conditions for LOC III were expeditiously met and the loan was declared effective in November 1982, as indicated in the PCR, and consequently first disbursement was made in March 1983, three months ahead of schedule. Similarly, the conditions for LOC IV were promptly met, the loan was declared effective in March 1988 and first disbursement was made in June 1988 which was ahead of the scheduled deadline of 31 December, 1988.

#### 3.2 Changes in Project Scope

The scope of the third and fourth LOCs as appraised did not change appreciably. The net loan amount for LOC III was UA 8.93 million as a result of the cancellation of UA 1.07 million or 10.7% of the approved amount. The approved amount of UA 15 million for LOC IV was almost fully disbursed, leaving only UA 190,332 or 1.3% of the total, which was promptly cancelled. Disbursements under the LOCs were thus within the approved amounts.

#### 3.3 Implementation Schedule

3.3.1 In spite of a good beginning, the implementation schedule for LOC III could not be kept. As amply demonstrated in the PCR (see PCR, Section 4.2), the implementation of LOC III was progressing satisfactorily until 1986 when Zambia ran out of foreign exchange, which eventually led to the suspension of disbursement of the loan on account of ADB sanctions on Zambia for non-payment of loans due. By the end of 1985, that is, within 30 months of the deadline for first disbursement, two-thirds of the net loan had been disbursed, but the disbursement of the remaining one-third took about three and a half years, as a result of sanctions and the reported administrative delays at the Bank in processing disbursement requests. As a result of the break in disbursement, implementation of most sub-projects was delayed for long periods and the deadline for last disbursement had to be extended by two years to 31 December, 1989. The last disbursement was eventually made in May 1989, that is, about six years after the first disbursement. Implementation delays continued, even after sanctions had been lifted, because of other problems that emerged as a result of the disbursement delays. (See paragraph 3.6.1 below).

3.3.2 With respect to LOC IV, it was approved in June 1987, became effective in March 1988, and disbursement started in June 1988 which progressed smoothly until the last disbursement processed in February 1992 well ahead of the estimated deadline of 30 June 1994. However, implementation suffered mainly due to adverse impact of the changes in economic policy that resulted in drastic and continued devaluation of the Kwacha which increased the cost of the sub-projects as well as the cost of debt servicing as the entire foreign exchange risk is born by the promoters. This situation severely delayed the commissioning of most of the sub-projects; while a few are still not ready for commissioning.

### 3.4 Reporting

There are no indications that reveals the shortcomings or otherwise of the Executing Agency's reporting practices with the Bank. However, it should be noted that tracing progress reports on the implementation status of sub-projects within the Bank has remained to be difficult.

### 3.5 Procurement

Under both lines of credit, procurement of goods and services for sub-projects was to be in member countries and in accordance with procedures acceptable to the Bank. There is no indication that the Bank was at any time dissatisfied with the Executing Agency on this score.

### 3.6 Project Costs

3.6.1 Physical implementation delays arising from disbursement delays caused most sub-projects to experience considerable cost overruns. These cost overruns were due partly to price increases by suppliers who had not been paid and more importantly to the massive and persistent depreciation of the Zambian Kwacha as from 1986. The situation has deteriorated continuously ever since on account of the continued collapse of the Kwacha and liberalization of the economy, especially since 1991 when radical economic reform measures began to be implemented earnestly by the present GOZ.

3.6.2 The Zambian Kwacha/US dollar exchange rate which had fallen by 50% annually during the previous three years plummeted further from 90 to 322 in 1992 and to 570 in 1993. By December 1996, it had exceeded 1,200 but appeared to be stabilizing. The net effect of this development was to increase the debt burden of most sub-projects continually to unsustainable levels, even before they were commissioned, since they bore the entire foreign exchange risk of the loan. The situation was particularly severe for sub-projects under LOC IV. Competition from imports following trade liberalization, which was introduced rapidly before the necessary regulatory controls were put in place, made the environment even more difficult. Consequently, although there are a few notable exceptions, most sub-projects experienced protracted implementation delays mainly due to cost overruns. These enterprises have generally not found satisfactory ways of financing their cost overruns and appear to be in dire need of some form of debt relief without which their liquidation would be highly probable.

### 3.7 Disbursements and Financial Sources

3.7.1 The major problems regarding disbursement arose from sanctions imposed on Zambia by the Bank and other donors at various times, as has been noted in Section 3.3 above. However, disbursements by the Bank also reportedly suffered from administrative delays. The Executing Agency and some promoters reported that disbursements were often delayed unduly even in the absence of sanctions and when all conditions had been met. Accordingly, it is claimed that they incurred expenses in following up their disbursement

requests and covering additional cost resulting from price escalation imposed by suppliers as a result of delayed payment. Evidently, effective desk and field supervision of on-going projects could reduce such administrative delays appreciably where they exist. Although no evidence was produced to substantiate the above claims, it may be useful to re-examine the Bank's disbursement practices with a view to removing any built-in weaknesses discovered, especially in administrative procedures. There is need for an administrative mechanism capable of automatically highlighting administrative lapses that may occur from time to time.

3.7.2 The only other sources of financing for the sub-projects financed under LOC III and LOC IV were DBZ and the sub-project promoters. This means that the LOCs had limited impact in terms of leveraging local resource mobilization. In these circumstances, DBZ's portfolio remains fundamentally dependent on foreign LOCs and highly vulnerable, like its sub-projects, to the foreign exchange risk they entail.

### 3.8 Compliance with Loan Conditions and Covenants

The PCR indicates correctly that neither of the two lines of credit experienced any problems regarding compliance with loan conditions and covenants. The loan conditions and covenants therefore appear to have been sufficiently clear, relevant and realistic. However, this was not followed by timely disbursement or physical implementation of sub-projects.

#### 4. PERFORMANCE EVALUATION

##### 4.1 Operating Performance

4.1.1 The approved loan amount under the third line of credit was committed to 19 sub-projects, as reported in the PCR and listed in Annex 3.10 of the Appraisal Report for LOC IV. The total net disbursement of UA 8,931,051 eventually benefitted only 17 sub-projects all of which except one were in the manufacturing sector, as can be seen from Annex 2. The exception was an agricultural (livestock) project. Ten of these sub-projects were greenfield projects while five were concerned with the expansion or rehabilitation of on-going enterprises.

4.1.2 These sub-projects generally performed satisfactorily in terms of their survival rate and prosperity and ten of them, which have paid off their loans, are reportedly still operating. Three on-going projects have problems and are in arrears of principal and interest; one has been put up for sale, another is under litigation and the third, which has never been commissioned, has not operated since 1989. It is noteworthy that early loan redemption is not necessarily evidence of a sub-project's successful performance. Some promoters indicated that, in order to be rid of their foreign exchange risk burden, they refinanced their DBZ loans with commercial bank loans at higher interest rates.

4.1.3 Constrained by its own financial problems, DBZ has welcomed all repayments and played a limited role in finding development-oriented solutions to the real problems of sub-projects. For instance, DBZ's role has been to provide partial financial assistance and has offered little else in the form of other client services. There appears to be a pressing need to re-think the role and set-up of DBZ. To this end, there has recently been a proposal to turn DBZ into an apex institution and transfer its retail lending activities to other financial institutions. The proposal remains under active discussion and DBZ could contribute to its outcome by undertaking a study to determine to what extent, if any, it should be transformed.

4.1.4 Similarly, the total amount of UA 14,809,655 disbursed under the fourth line of credit financed 15 sub-projects, as indicated in Annex 2. All except one transport and haulage enterprise were directly productive manufacturing enterprises. The emphasis under this line of credit shifted appreciably in favour of existing enterprises as indicated by the fact that eight of these were new and seven were expansion, rehabilitation or diversification exercises. However, they are generally experiencing varying degrees of difficulties as a result of which debt-servicing is very poor and 11 of them are in arrears with DBZ. It appears that only two have paid off their loans. Four or five sub-projects that are domestic resource-based and export-oriented or have adapted their production to the changing needs of the domestic market are operating satisfactorily and have the potential to overcome their problems if given appropriate assistance, including restructuring and debt re-scheduling.

4.1.5 It is remarkable that DBZ has little information on the current status of its former sub-projects, presumably on account of their non-cooperation with DBZ after loan redemption. This state of affairs is unsatisfactory as it would conceal most of DBZ's success stories as well as potentially valuable lessons from past mistakes. The Bank should require

each Executing Agency to install a system for tracking current and past sub-projects and should give technical assistance is necessary in this regard.

4.1.6 The sectoral distribution of the sub-projects under the two lines of credit was in line with the appraisal objectives which were themselves embedded in national development objectives. The distribution is evidently consistent with the objective of diversifying away from copper but, as has been indicated in paragraph 2.5.2, it is difficult to say to what extent it resulted in diversification on the ground. In any case, agriculture did not benefit much from the LOCs, as the emphasis was on import substitution and, to a lesser extent, export production. Moreover, there was little geographical diversification, as nearly all the sub-projects were in the Lusaka area and the copperbelt as was the case before these lines of credit.

4.1.7 The survival and relative prosperity of LOC III sub-projects was most probably due to the fact that most of them were implemented and operational before the suspension of disbursement to Zambia and before the rapid macroeconomic reforms that created large and unforeseen problems of transition in the Zambian business environment. Moreover, the remaining sub-projects under LOC III were implemented when the reform measures were new and their effects were still relatively manageable. It should be noted that LOC IV was disbursed during the period when the continuous and precipitous decline of the exchange rate of the Zambian Kwacha had gone out of control. A major factor was the heavy and growing debt burden arising from massive foreign exchange losses due to the fact that sub-projects bore the foreign exchange risk of the loans fully. Promoters' plans proved inadequate for coping with the consequences of the unprecedented magnitude and pervasiveness of the reform measures and the speed of their implementation.

4.1.8 The number of sub-projects financed under the LOCs is remarkably small for the loan amounts involved as compared with the experience in some other countries. This situation reflects the fact that DBZ can finance up to 75% of total sub-project cost implying that a promoter's contribution can be as little as 25%. Such little stake can hardly generate adequate commitment on the part of a promoter faced with difficulties. It is hardly surprising that some sub-project promoters informed the post-evaluation mission of their readiness to surrender the enterprises concerned as full settlement of their indebtedness to DBZ. Promoters with a high stake are more likely to see a project to a successful end and focusing on them would encourage broad-based development.

4.1.9 The two lines of credit have had a positive but limited impact on DBZ as a development finance institution, as the PCR has pointed out. The spread of five percentage points between the borrowing and lending rates of DBZ augmented its financial viability to some extent while their implementation has served as a training facility for its management and staff regarding operations.

## 4.2 Financial Performance

4.2.1 Like its sub-projects, DBZ has suffered considerably from foreign exchange losses as a result of its bearing the full foreign exchange risk of the foreign lines of credit which finance about 90% of its portfolio. As the PCR demonstrates, its foreign exchange losses due to the depreciation of the Kwacha weakened its capital base considerably, although the poor performance of the sub-projects was the main cause of the erosion of that capital

base. Apart from the nation-wide foreign exchange scarcity, the poor servicing of DBZ loans was also reportedly due to the inability of DBZ to make the necessary Kwacha resources available to Government. DBZ was not generating adequate profits from its operations to service its foreign exchange debts satisfactorily. Its grossly deteriorated arrears situation identified by the PCR has not improved and indeed experienced a sharp deterioration reaching as high as 58% in 1995 and slightly lowering to 38% of its portfolio in 1996.

4.2.2 The shrinking equity base led to increasing difficulty in DBZ staying within its statutory maximum debt-equity ratio of 7:1 above which DBZ loses its power to incur further debt-financing. The trend has been reversed in the last few years and the latest year debt-equity ratio is about 3:1 partly as a result of Government's injection of new equity funds part of which came from the ADF component of ADB's fifth line of credit to DBZ. Other sources of new equity funds were the revaluation of DBZ assets and profits realized by DBZ in recent years.

4.2.3 Although its ability to incur further debt was drastically curtailed by this debt-equity situation, DBZ succeeded in mobilizing some foreign lines of credit in the last few years, and remains highly dependent on such LOCs. The lines obtained from PTA Bank and African Export-Import Bank in 1995 and 1996 respectively were for financing trade rather than development projects. Table 4.1 shows details of resources mobilized by DBZ since 1982.

Table 4.1: Resource Mobilization by DBZ

<u>Line of Credit</u>	<u>Year</u>	<u>Amount (million)</u>	<u>Currency</u>
ADB III	1982	10.0	UA
BADEA	1982	10.0	USD
OPEC	1982	3.0	USD
FMO I	1984	6.0	DFL
FMO II	1986	12.0	DFL
ADB IV	1987	15.0	UA
EIB III	1987	10.0	ECU
DEG	1990	2.0	DEM
ADB SMSE	1991	10.0	UA
ADF SMSE	1991	10.0	FUA
IFAD 2	1993	1.2	SDR
IDA	1994	15.9	USD
PTA Bank	1995	20.0	USD
African Exim Bank	1996	5.0	USD

Source: PCR and DBZ

4.2.4 In an effort to play its development role, some of the lines of credit granted by IFAD and FMO were restricted to finance rural and small industries development projects. However, DBZ could not mobilize resources from the domestic market because of the tight monetary policy of the Government and the high cost of money. This has limited the operation of the DBZ and its profit earning capacity. However, the expected stabilized macro-economic climate in the coming years may enable DBZ to improve its performance particularly if it continues in its trade financing activities.

4.2.5 A financial internal rate of return for the Bank's third and fourth lines of credit was not estimated at appraisal or by the PCR and such an exercise remains rather impracticable for a line of credit as adequate data are not maintained regarding the sub-projects. Nevertheless, the satisfactory performance of most of the sub-projects under LOC III suggests that the probable rates of return to them - and hence to the entire project - would have been acceptably high and may have contributed to the satisfactory and sustained debt-servicing by them. As regards sub-projects under LOC IV, the cost overruns that created implementation, operational and debt-servicing problems for them suggest negative or at least lower than expected rates of return to both themselves and DBZ itself.

#### 4.3 Economic Performance

The difficulty indicated in the case of calculating the financial rate of return applies equally to the calculation of an economic internal rate of return and no such calculation was done at appraisal. The indirect production and employment effects of the dependence of sub-projects on domestic raw materials most probably augmented the economic impact of LOC III but these would have been largely, if not totally, offset by the protracted implementation delays and harsh market conditions in the case of LOC IV.

#### 4.4 Institutional and Social Performance

4.4.1 The two LOCs were expected to increase employment through the sub-projects but this appears to have been a subsidiary objective, as no quantitative targets were set at appraisal. The PCR indicates (see paragraph 6.1.3) that substantial employment was generated. However, some sub-projects had to reduce their work force over time under pressure from competition that was unleashed by trade liberalization. Under these pressures, some textile enterprises even had to sell some equipment to improve their liquidity position. Thus, total employment created was inadequate to prevent total manufacturing employment from stagnating throughout the decade.

4.4.2 Institution building was not an objective of the project but DBZ benefitted from the Bank's experience with other development finance institutions as a result of interaction during the implementation of the projects. The Bank also strengthened DBZ's appraisal capacity by requiring the recruitment of two financial analysts under LOC IV. The current organizational structure is shown in Annex 1. At the end of the fiscal year of 1996, the manpower strength of DBZ stood at 84; and 19 staff were sponsored for short-term training in various relevant fields conducted locally or abroad. Nevertheless, the financial analysis capability of DBZ appears to be less than it should be as there was no financial analyst at the Ndola Regional Office, which handles most of DBZ's projects, and the posts of internal audit manager, financial analyst, accountant and assistant accountant at Lusaka headquarters were vacant at the time of the post-evaluation mission.

#### 4.5 Women in Development

Gender issues did not arise at the time of appraisal regarding DBZ or its sub-projects. However, it is noted that in DBZ only one senior position was occupied by a female at the time of the post-evaluation mission. The position of DBZ on gender equity is rather passive. In the absence of a deliberate policy to increase the employment of women, there is a clear readiness to employ women on the same terms as men, with merit being the overriding consideration in personnel recruitment. Attitude towards gender equity was similarly passive in the sub-projects.

#### 4.6 Environmental Performance

Environmental issues were also not raised at appraisal or by the PCR. These issues are relevant at the sub-project level and some of those visited had taken some measures to protect the environment and the health of their workers. While the lines of credit themselves had no direct adverse effects on the environment, both the Bank and DBZ should become more actively involved in ensuring that the sub-projects financed with lines of credit are environment-friendly or that adequate measures are taken to make them so.

#### 4.7 Performance of Consultants, Contractors, Suppliers and Borrower

4.7.1 Consultants and contractors did not feature prominently in the implementation of the LOCs and no problems were encountered with suppliers once adequate payment arrangements were made and honoured. In fact, many sub-projects experienced long delays in the supply of machinery and equipment, but these were generally traceable to delays in honouring payment arrangements and arguments regarding price increases arising from the delays.

4.7.2 DBZ did the best it could in the circumstances and cannot be held wholly responsible for the poor results achieved, especially under LOC IV. The LOCs and their sub-projects had been approved when Zambian industry was highly protected and a policy reversal was not envisaged. When GOZ reversed its policy and introduced reform measures that transformed the economic environment radically, it should have provided safeguards to facilitate the transition of sub-projects to the new operating environment. GOZ, as guarantor, would have enhanced borrower performance considerably if it had provided a mechanism for cushioning the adverse effects of the foreign exchange risk, as it should have, considering that it was responsible for changing the rules.

#### 4.8 Bank Group Performance

The two lines of credit were follow-up projects emerging from the Bank's earlier LOC operations and the Bank may therefore be regarded as having been adequately involved in their identification and preparation, even though no pre-appraisal mission took place. Only one supervision mission appears to have taken place during implementation of each LOC. The frequency of supervision was thus inadequate to avert or resolve problems encountered during implementation and after. Such missions would have enabled the Bank to react promptly and appropriately when the problems of the sub-projects were beginning. In addition, the Bank would have been in a position to facilitate the performance of DBZ in its effort to salvage its borrowers during a most difficult period. Both promoters and DBZ

consider the Bank of being rather rigid and aloof when unforeseen fundamental developments were threatening the implementation and operating performance of the enterprises it financed.

## 5. PROJECT SUSTAINABILITY

5.1 The preceding analysis indicates that, on the whole, the sub-projects under LOC III are largely sustainable and that their benefits will continue even after the loan has been repaid. The factors contributing to their sustainability include the project objectives being embedded in national priorities and objectives as well as the domestic resource base and export orientation of the sub-projects. Equally important is the fact that the sub-projects were mostly implemented when the decline in the exchange value of the Kwacha was still manageable and the cost of imported equipment and other inputs had not become prohibitive.

5.2 In contrast, the sub-projects under LOC IV are largely unsustainable in their present state due to cost escalation resulting from local currency depreciation and price increases arising from tardiness in paying overseas suppliers as well as to import competition which limits their ability to raise product prices. Unless they are appropriately restructured and their debts re-scheduled where necessary, they appear to be mostly headed for liquidation. With a little encouragement, some of them would be prepared to hand over the enterprises concerned in full settlement of their indebtedness to DBZ. What is important about these projects is not so much lessons for the future as the need to salvage the present situation. Most of them would be sustainable in the absence of their current debt burdens.

5.3 As regards DBZ, sustainability is threatened by the continual erosion of its capital base. The capital base has improved recently as a result of measures implemented (see paragraph 4.2.2 above), but could not be sustainable. If more enduring solutions are not found soon, DBZ may have to ensure its survival by moving increasingly into commercial activities at the expense of its development role. It is remarkable that DBZ now engages in trade financing.

5.4 DBZ's sustainability could be enhanced by some adjustments in its sub-project selection preferences. The analysis in paragraph 4.1.8 suggests an emphasis on larger sub-projects which are typically foreign currency intensive. Their continued domination of the portfolio therefore helps to perpetuate the dependence of DBZ on foreign LOCs and their attendant foreign exchange risk. It should be noted that some of the promoters have multiple business interests which they manage simultaneously. Such sub-projects are likely to produce similar effects as large sub-projects. Moreover, they suggest an ever present danger that the resources of sub-projects could be diverted to a promoter's other businesses that are not committed or answerable to DBZ. Although most promoters have genuine cost problems, as has been indicated earlier, there is need to find ways of guarding against that risk which could undermine the sustainability of an Executing Agency like DBZ.

## 6. PERFORMANCE RATINGS

As regards LOC III, implementation performance, Bank performance and project outcome rate as satisfactory, as can be seen in Appendices 3 - 6. In the case of LOC IV, implementation performance was unsatisfactory, in spite of the commendable efforts of DBZ and sub-project promoters, as a result of exogenous factors beyond their control. Here also Bank performance was satisfactory even though supervision was inadequate. The net result was an unsatisfactory project outcome. (See Appendices 7 and 8). The Bank's main weakness was its aloofness at a most unusual time that made pre-emptive action imperative. DBZ, on its part, was severely limited regarding what it could do in the circumstances by the conditions of the lines of credit which sustain its portfolio.

## 7. CONCLUSIONS AND RECOMMENDATIONS

### 7.1 Overall Assessment

7.1.1 Even though its implementation schedule was not kept, the third line of credit performed satisfactorily on the whole by financing sub-projects that were consistent with its declared objectives. None of them has been liquidated and most have paid off their loans and remained operational. This performance was largely due to the fact that most of them were operational before the radical reform measures were introduced or while their effects were still relatively manageable. In contrast, disbursement of LOC IV was ahead of schedule, in spite of initial problems, but physical implementation of most sub-projects was obstructed by the effects of radical macroeconomic reforms. The performance of LOC IV sub-projects has therefore been unsatisfactory and their sustainability is at risk. The main findings and recommendations are summarized in the Recommendations and Follow-up Matrix in Appendix 9.

7.1.2 The sectoral distribution of sub-projects under both LOCs reflects diversification away from copper, as prescribed by the national development plan, but did not pay much attention to agriculture. The objective of geographical diversification was also not met. Moreover, those based on import substitution found it increasingly difficult to operate profitably when the protection they had relied on was removed by trade liberalization policies and other reform measures.

7.1.3 The above developments have seriously undermined the financial viability of DBZ and its ability to carry out its development role. It has been buoyed up with periodic injection of new equity funds by GOZ and its debt-equity ratio is currently at an acceptable level. However, this situation is unsustainable and there is a need to re-think the role and set-up of DBZ in a macroeconomic environment that has changed radically since its establishment.

## 7.2 Feedback and Recommendations

The lessons emerging from this PPAR are consistent with those of the PCR. The most important ones are outlined below.

### Feedback (Lessons):

- (i) Early compliance with loan conditions and covenants is important but does not guarantee a smooth future for disbursement or physical implementation of sub-projects unless it is accompanied by adequate and timely supervision and monitoring of project implementation (para. 3.8.1)
- (ii) Radical changes in the macroeconomic environment can seriously undermine the performance of the borrower and sub-project promoter when the local currency depreciates rapidly (para. 4.7.2)

### Recommendations:

- (i) There should be supervision missions during disbursement and physical implementation as this would enable the Bank to react promptly and appropriately to implementation problems. (paras. 3.7.1, 4.8.1)
- (ii) The circumstances of each early loan repayment should be closely examined, as they may point up fundamental problems rather than satisfactory performance. (para. 4.1.2)
- (iii) An Executing Agency should be required to install safeguards to ensure that, wherever a promoter with multiple business interests is involved, the resources of the sub-project are not diverted to the promoter's other businesses that are not answerable to the Executing Agency.
- (iv) ADB's disbursement practices should be reviewed with a view to installing an administrative mechanism capable of automatically highlighting lapses when they occur. (para. 3.7.1)
- (v) Each Executing Agency should be required and, if necessary, assisted to install a system for tracking current and past sub-projects to facilitate learning from their achievements and failures. (para. 4.1.5)
- (vi) Radical changes in the macroeconomic environment resulting from reversal of government policies, are not normal commercial risk; and Government, as guarantor, should be required to assume some of the risk, especially the foreign exchange risk entailed in its actions and generally provide safeguards to facilitate adaptation to the new operating environment. (para. 4.7.2)
- (vii) As development finance institutions, ADB and DBZ should work out ways of providing leeway for some of the adverse effects of major unforeseen macroeconomic developments on sub-projects and not remain aloof like ordinary financial institutions. (para. 4.8.1).

### 7.3 Follow-up Action

The findings of the post-evaluation mission suggest the follow-up actions below:

#### For DBZ

- (i) Undertake a study to find out which paid-up sub-projects are operational and sustainable;
- (ii) Carry out a diagnostic study to assess the liquidation prospects of sub-projects in arrears with DBZ and make proposals for appropriate action in each case;
- (iii) Conduct a study to establish DBZ's requirements for a more effective development role in the current macroeconomic environment and make appropriate recommendations for consideration by GOZ and donors.

#### For GOZ

- (iv) Find ways to help in salvaging potentially viable sub-projects that are at risk on account of the reversal of government policies without transition safeguards.

#### For ADB

- (v) Ensure that disbursement problems of past LOCs are not repeated in the ongoing LOC V.

Projects Financed Under LOC III to DBZ

Sub-project	Location	Description	Net Loan (UA '000)
1. Antelope Wholesalers	Luanshya	Manufacturing; rehabilitation.	1,147
2. Sun Pharmaceuticals	Lusaka	Manufacturing, new	747
3. BRR Industries	Kabwe	Manufacturing, new	953
4. Hardware Manufacturers	Livingstone	Manufacturing; new	526
5. Indeco Milling	Mansa	Manufacturing, new	489
6. Sopelac Fishing Enterprise	Mpulungu	Manufacturing, new	222
7. Naluta Engineering	Lusaka	Manufacturing, new	203
8. Canta Engineering	Mufulira	Manufacturing expansion	193
9. Amish Industries	Lusaka	Manufacturing	109
10. African Properties	Lusaka	Agriculture (livestock)	72
11. Roan Construction	Ndola	Manufacturing expansion	1,110
12. Mukuba Textiles	Ndola	Manufacturing expansion	380
13. Chisokone	Ndola	Manufacturing, new	253
14. Ital Terrazzo	Ndola	Manufacturing expansion	957
15. Alloy Metal Products	Lusaka	Manufacturing, new	391
16. Industrial Equipment	Kitwe	Manufacturing, new	187
17. Nisha	Kitwe	Manufacturing	991
All Sub-projects			8,930

Projects Financed Under LOC IV to DBZ

	Sub-project	Location	Description	Net Loan (UA '000)
1.	Menco/Merco	Ndola	Manufacturing expansion	281
2.	Zaffico	Ndola	Forestry expansion	1,389
3.	Copperbelt Weaving	Ndola	Manufacturing, new	331
4.	Zarnus Marble & Terrastone	Lusaka	Manufacturing/Quarrying, new	622
5.	Gamma Pharmaceuticals	Ndola	Manufacturing, diversification	1,431
6.	Siaza Industries	Kitwe	Manufacturing, new	1,301
7.	Swarp Spinning Mills	Ndola	Manufacturing, rationalisation	1,552
8.	Century Packages	Ndola	Manufacturing, diversification	468
9.	Mukuba Textiles	Ndola	Manufacturing, expansion	1,529
10.	Greenhouse Transport [Unihaul (Chingola)]	Chingola	Transport/Haulage, new	192
11.	Polythene Products	Lusaka	Manufacturing, new	734
12.	Ronie Chemicals	Ndola	Manufacturing, new	761
13.	Match Corporation	Luanshya	Manufacturing, new	1,665
14.	Inshimbi Iron & Steel (Inshimbi Copper)	Ndola	Manufacturing, new	1,525
15.	Ndola Knitting Mills	Ndola	Manufacturing, Modernization	1,029
	All Sub-projects			14,810

## ZAMBIA: PROJECT PERFORMANCE AUDIT - 3RD AND 4TH LINES OF CREDIT TO DBZ

## RETROSPECTIVE LOGICAL FRAMEWORK MATRIX

COUNTRY: ZAMBIA  
 PROJECT: 3RD AND 4TH LOCs TO DBZ  
 DATE OF PCR: MARCH 1994  
 DATE OF PPAR: APRIL 1997  
 EVALUATION TEAM: G. YIRGA-HALL and G. OKURUME

NARRATIVE SUMMARY	OBSERVABLE INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS & RISKS
<b>GOALS</b> 1.1. Sustainable macroeconomic growth; 1.2. Diversification of the national economy; 1.3. Improvement of the balance of payments.	-Contribution to GDP; -Non-traditional exports; -Balance of trade.	-Appraisal report; -Bank of Zambia reports; -DBZ and sub-project reports.	No major risk was envisaged at appraisal. But, in actual fact both the economy suffered from major policy changes
<b>OBJECTIVES</b> 2.1. Rehabilitate, modernize and expand existing productive base; 2.2. Promote domestic resource-based small-scale and medium-scale enterprises; 2.3. Expand operational base of DBZ.	-DBZ portfolio; -Sub-projects financed; -Sub-sectoral distribution of sub-projects. No measurable indicators provided at appraisal	-DBZ reports; -Supervision missions; -PCR mission.	-enabling macroeconomic environment; -capable promoters. But both the DBZ and promoters suffered from drastic policy changes
<b>OUTPUT</b> 3.1. Sub-projects implemented; 3.2. Growth of non-traditional exports; 3.3. Increased capacity of DBZ to provide term loans.	-Sub-projects financed; -DBZ portfolio; -Merchandise exports. No measurable indicators provided at appraisal.	-DBZ reports; -supervision reports; -PCR mission.	-local currency financing available; But increasing funds required to cope up devaluation of the Kwacha
<b>INPUTS</b> 4.1. Foreign exchange mobilized; 4.2. Funds disbursed to sub-projects; 4.3. Technical assistance to sub-projects.	-ADB financing- Foreign Exchange (in UA million) LOCIII LOCIV App. 10.0 15.0 Act. 8.9 14.8	-Progress reports; -financial/disbursement statements.	-efficient suppliers and contractors; -timely disbursement by ADB and DBZ. But delays reported in this regard

ZAMBIA: PROJECT PERFORMANCE AUDIT - THIRD AND FOURTH LOCs TO DBZ  
IMPLEMENTATION PERFORMANCE RATING FOR LOC III

No.	COMPONENT INDICATORS	MARK (1 to 4)	REMARKS
1.	Adherence to time schedule	1	LOC completion delayed two years.
2.	Adherence to cost schedule	3	Over 10% of approved amount cancelled; Cost overruns in later sub-projects.
3.	Compliance with covenants	4	Well ahead of schedule.
4.	Adequacy of supervision & reporting	4	Gave rise to no special problems.
5.	Satisfactory operations	2	Ten sub-projects have paid off loan; some others in arrears.
	Overall assessment of implementation performance	2.80	Satisfactory

ZAMBIA: PROJECT PERFORMANCE AUDIT - THIRD AND FOURTH LOCs TO DBZ  
IMPLEMENTATION PERFORMANCE RATING FOR LOC IV

No.	COMPONENT INDICATORS	MARK (1 to 4)	REMARKS
1.	Adherence to time schedule	2	Last disbursement timely, but physical implementation of sub-projects stalled.
2.	Adherence to cost schedule	2	Under 2% of approved loan cancelled; major cost overruns for sub-projects.
3.	Compliance with covenants	4	Well ahead of schedule.
4.	Adequacy of supervision & reporting	1	Made no impact on sub-project problems.
5.	Satisfactory operations	1	Most sub-projects delayed and in arrears.
	Overall assessment of implementation performance	2.00	US

**ZAMBIA: PROJECT PERFORMANCE AUDIT - THIRD AND FOURTH LOCs TO DBZ**  
**BANK PERFORMANCE RATING FOR LOC III**

No.	COMPONENT INDICATORS	MARK (1 to 4)	REMARKS
1.	At identification	2	Follow-up on previous LOCs.
2.	At preparation of project	2	No pre-appraisal mission.
3.	At appraisal	4	Covered all the usual aspects.
4.	At supervision	2	Inadequate frequency.
	Overall Assessment of Bank Performance	2.50	Satisfactory

**ZAMBIA: PROJECT PERFORMANCE AUDIT - THIRD AND FOURTH LOCs TO DBZ**  
**BANK PERFORMANCE RATING FOR LOC IV**

No.	COMPONENT INDICATORS	MARK (1 to 4)	REMARKS
1.	At identification	2	Follow-up on previous LOCs.
2.	At preparation of project	2	Did not ensure adequate provision for local currency requirements.
3.	At appraisal	2	Made inadequate provision for possible macro reforms in view of continuing macroeconomic imbalances.
4.	At supervision	1	Bank was relatively aloof when the economic situation demanded close supervision.
	Overall Assessment of Bank Performance	1.75	Unsatisfactory

**ZAMBIA: PROJECT PERFORMANCE AUDIT - THIRD AND FOURTH LOCs TO DBZ**  
**PROJECT OUTCOME FOR LOC III**

No.	COMPONENT INDICATORS	MARK (1 to 4)	REMARKS
1.	<b>Relevance and Achievement of Objectives</b>	3.00	HS
i.	Macroeconomic Policy	3	Supportive of industrial sector but not sustainable.
ii.	Sector Policy	4	Fully consistent with national development goals.
iii.	Financial	4	Adequate provision made.
iv.	Poverty Alleviation & Social and Gender	2	Social and gender issues were incidental.
v.	Environmental	2	Environmental issues were incidental.
vi.	Private Sector Development	3	No deliberate policy; SOEs were also financed.
2.	<b>Institutional Development</b>	3.67	HS
i.	Institutional framework	4	Established and sound.
ii.	Financial and MIS	3	Adequate for current needs.
iii.	Staffing by qualified persons and Training	4	Highly qualified personnel sustained through training.
3.	<b>Sustainability</b>	2.62	S
i.	Continued Borrower commitment	4	Could be extrapolated from handling of previous LOCs.
ii.	Policy Environment	2	Became unstable.
iii.	Institutional Framework	3	Established and sound.
iv.	Technical Viability & Staffing	3	Satisfactory
v.	Financial Viability	2	No FIRR was calculated.
vi.	Economic Viability	3	No EIRR was calculated.
vii.	Environmental Viability	2	Incidental but acceptable.
viii.	O & M facilitation (availability of recurrent funding, forex)	2	Large and unexpected local currency cost increases due to massive depreciation.
ix.	Economic Internal Rate of Return	1	EIRR was not calculated at appraisal or for the PCR; and was not possible to determine it for this PPAR due to lack of historical data on sub-projects
	<b>Overall Assessment of Outcome</b>	2.57	Satisfactory

APPENDIX 4

ZAMBIA: PROJECT PERFORMANCE AUDIT - 3RD AND 4TH LINES OF CREDIT TO DBZ  
RECOMMENDATIONS AND FOLLOW-UP MATRIX

MAIN FINDINGS & CONCLUSIONS	RECOMMENDATIONS	FOLLOW-UP ACTIONS	RESPONSIBILITY
<p><b>Formulation &amp; Project Rationale</b></p> <p>1. Both LOCs were follow-up projects in a country and sectors well-known to the Bank and were formulated on basis of experience-based knowledge;</p> <p>2. Rationale was to continue the efforts of previous LOCs to DBZ;</p> <p>3. Project objectives derived from national and sector goals.</p>	<p>Project rationale should be rooted in relevant national and sector goals and priorities;</p> <p>Project formulation should be based on full familiarity with the project background.</p>	<p>Bank should be fully satisfied with the rationale of a project early to ensure that its involvement is worthwhile.</p>	<p>ADB</p>
<p><b>Project Implementation</b></p> <p>1. Two-thirds of LOC III disbursed fast but ADB sanctions on Zambia delayed balance for two years;</p> <p>2. Last disbursement of LOC IV was early despite delays by sanctions;</p> <p>3. Physical implementation of LOC IV sub-projects undermined by negative effects of radical reforms resulting in huge cost overruns and debt burdens.</p>	<p>1. Supervision mission to Executing Agency and sub-projects necessary during disbursement and during physical implementation.</p> <p>2. Government should cushion sub-projects against adverse effects of major government policy reversals.</p>	<p>Announcement of loan effectiveness should include that of supervision schedule during disbursement and physical implementation.</p>	<p>ADB</p>
<p><b>Compliance with Loan Conditions &amp; Covenants</b></p> <p>Expediently satisfied for both LOCs, but this did not guarantee smooth implementation.</p>	<p>Monitor sub-projects closely after loan effectiveness to be able to identify and address operational and unforeseen problems early.</p>	<p>Ensure that disbursement problems of past LOCs are not repeated in the ongoing LOC V.</p>	<p>ADB</p>
<p><b>Performance Evaluation &amp; Project Outcome</b></p> <p>1. LOC III sub-projects performed satisfactorily and 10 out of the 17 have repaid their loans;</p> <p>2. LOC IV sub-projects have performed poorly and 11 of the 15 are in arrears with DBZ;</p> <p>3. DBZ's financial situation has improved recently but remains precarious due to huge arrears of sub-projects.</p>	<p>Find ways to relieve sub-projects of part of the foreign exchange risk of LOCs</p>	<p>Undertake a study to establish what is needed to salvage deserving sub-projects, especially under LOC IV.</p>	<p>DBZ and ADB</p>
<p><b>Sustainability</b></p> <p>Most sub-projects under LOC III are operational and appear sustainable;</p> <p>Most under LOC IV have heavy debt burdens and face possible liquidation;</p> <p>Sustainability of DBZ depends on the performance of sub-projects.</p>	<p>Bank should require Executing Agencies to install a tracking system for sub-projects.</p> <p>Find out which paid-up sub-projects remain operational and sustainable.</p>	<p>1. Carry out necessary study and install tracking system.</p> <p>2. Assess the liquidation prospects of sub-projects in arrears with the Bank and propose action.</p>	<p>DBZ</p> <p>DBZ</p>