

SUSTAINING DEVELOPMENT FINANCING

Introduction

Managing Director, Mr Luke Eta, Conference Convenor, Mr Peter Forau, Managers and OICs of DBSI branches and sub-branches in the provinces, Ladies and Gentlemen.

I am greatly honoured to be invited to say a few words at this important gathering in DBSI's annual calendar. I will not deliver a speech but I wish to make a few remarks about the *importance and relevance of the theme of this conference in view of the changes taking place in Solomon Islands and the world outside, its importance for the future existence of this institution and how we, as managers and responsible officers in DBSI can play a role in ensuring the viability of the Bank. Only by doing this would we fulfil the responsibilities entrusted on us and achieve the developmental objectives for which this institution was established.*

Most of the issues I will cover are not new. These are issues you are all well familiar with and encounter in your daily work. But it is usually these every day issues that make or break an institution and hence the importance of looking at them seriously.

Economic Overview

But before I discuss issues related to sustainability, I would like to present an economic overview of Solomon Islands. I believe this would provide a general picture of the economy within which DBSI is operating and thus help us to appreciate the constraints and opportunities facing the Bank. The performance up to the end of 1998 reflects an economy with problems but has been remarkably resilient and in fact is showing positive signs in some sectors.

The external sector has remained strong despite the slowdown in exports as a result of the downturn in prices for some major exports and the Asian crisis. This strong performance has been generated by a slowdown in import payments and large inflows of official capital in the form of grants and soft term loans. This has allowed the external reserves to remain high at around \$245 million or over two months of import cover.

The exchange rate has experienced relative stability against the major currencies and in some cases the Solomon Islands dollar has appreciated against currencies like the Australian dollar and Japanese Yen.

External arrears have been reduced and government is current with most of its debts. Efforts are continuing to deal with the government domestic debt. Government finances though still weak has posted a small surplus last year.

Developments in money and credit have also been positive. Credit to the private sector grew by 22% in 1998, while money supply grew by a modest 6% last year. Liquidity in the financial system has remained high and is expected to increase in 1999 as the external sector remain strong and new flows of official capital are received.

Interest rates have been stable and bank margins have narrowed slightly during the year.

Output is estimated to be down in 1998 and inflation still recording double digit levels but there is optimism that production should recover and inflation may fall to pre-devaluation levels.

The government's reform program is going on and the government will continue to discuss with development partners new development programs to assist in the reform process.

The general picture of the economy is one of a sick person slowly recovering from a long illness. He is still weak and wobbly but is now walking instead of lying in bed. Of course he will still have to take his medication or go back to the doctor for some more checks but after a while he should fully recover.

This is the current situation in the Solomon Islands economy, a weak position from which to enter the next century. But there are also opportunities for DBSI. For example, how can DBSI take advantage of the expected increase in liquidity in the system to increase its sources of funds. Or have we prepared ourselves to function under a strong and healthy economy?. These are issues the Bank has to take into account if it has to successfully launch itself into the next millennium.

Sustainability

Now I want to come back to the issue of sustainability in development financing.

Sustainable Development, Financial Sustainability etc; are recently introduced catch phrases now used every day by a lot of people. But the concept has been around for a long time and epitomed by the tenet that *nature sustains itself and life goes on.*

In the area of development financing, sustainability becomes more complicated. This is because developmental objectives such as equitable distribution of wealth, resources etc and wider community participation in the development process (pillars of development financing) often come in conflict with profitability objectives and concerns such as higher profit margins and returns on shareholders capital. Both sets of objectives are important and carefully balancing these opposing goals is vital if we have to remain sustainable. The more successful we are in this balancing act, the brighter the future prospect of the institution becomes.

In the process of performing this balancing act, we encounter a host of diverse challenges, issues and problems. How the Bank deals with these challenges will in turn determine whether the institution can be sustained in the future or not. This is all the more critical in an environment of change as is now happening in Solomon Islands.

Sustaining Development Financing

Some of the problems facing DBSI are created by factors beyond the control of the Bank while others are within the DBSI's purview and can be addressed by management and the Board. A discussion of two major sustainability issues facing DBSI may help enlighten us on this point. I think two of the issues impinging on the sustainability of DBSI are as follows:

1. Sources and Terms of Funding

The Bank utilises funds obtained from somewhere to engage in lending. Until recently, the main sources of DBSI funds are from external creditors channelled through government. This is still an important source but is not the only one. Now DBSI is also attracting lendable resources by issuing its own liabilities. Whilst the Bank can utilise external funding, these are accessible only through government mediation. These are mostly on concessionary terms and therefore relatively cheap and preferred sources of funds. However, with a declining trend in traditional development financing worldwide and the difficulties experienced in government finances, there is increasing pressure on DBSI to seek alternative sources of funds. As a result, the Bank has to attract funding from domestic sources through deposit taking and other products.

This in itself, is an expensive exercise. In order to attract deposits, the interest paid on those deposits must be pitched at a rate attractive to owners of those deposits. But at the same time, the higher the interest rate paid, the higher the cost of servicing those deposits. This problem

is compounded by the deposit/loan maturity structure of DBSI whereby there is a mismatch between the long term lending and short term nature of deposits: an apparently unsustainable situation. Hence the question of sustainability again comes into the picture. What interest rate should be offered to attract depositors but at the same time ensure the cost of servicing those deposits do not become a burden to the Bank is an issue management has to be continuously mindful of.

But then as in this case, DBSI's actions are influenced by what happens outside the Bank. Decisions and actions taken by other people and institutions can have a big influence and impose constraints on what we do. For example, what happens to interest rates are determined by the government and Central Bank decisions and there is little DBSI can do. That is why it is important for DBSI to keep abreast with changes to policy settings taking place in Solomon Islands and the outside world so that appropriate responses can be put in place to minimise the negative impact of such changes on our operations.

This means, in order for us to make decisions on measures and strategies that ensures the Bank remain sustainable, we must have access to relevant and timely information on what other people are doing, what changes are taking place etc.

Arrears Position

There are however, other sustainability issues that is within the purview of DBSI which the Bank can control and influence. It is these areas that the Bank can tackle by using its own resources, initiative and expertise. One such example is the debt collection and arrears problem. As we all know, arrears (and worse still a deteriorating arrears position), threatens the viability of any financial institution and must be eliminated. This is critical to ensure the survival of the operations of the institution. But an arrears problem is basically a symptom. It reflects the quality of the loan appraisal process, the calibre of the personnel doing the appraisal and the quality and accessibility of relevant information on which the appraisal was made. These are the building blocks on which a decision to approve a loan proposal is made. If these building blocks are based on unrealistic assumptions, for example, about the market situation or management capabilities, this will be reflected by problems during the implementation phase of the project. The quality of the loan appraisal process is a key factor to the success of any proposal and therefore very critical that it is done professionally and properly. Failure to do so will only result in arrears problems in the future which would further threaten the sustainability of our activities.

These are issues that fall within your responsibilities as managers of this institution and you have a role to play in this area.

Conclusion

In concluding, as I said in my opening remarks what I have covered here are issues very familiar to you. But these are critical issues for ensuring the sustainability of DBSI activities as the Bank enters the next century. These are issues you will discuss in greater detail in the next few days. I hope I have set the stage for those discussions and believe your combined effort will come up with strategies to address the sustainability issues facing DBSI. As someone involved in the Board of DBSI, I am interested to see the outcome of this conference and hope any measures agreed to in this meeting can be put to the Board for information or decision as soon as is practicable.

The simple message I am conveying to you today is that the sustainability of any institution or business activity depends on a lot of factors. Some of these factors are outside our control and we may not be able to do much about them except to try and minimise their negative impact on our activities. We may have to seek support and assistance from our shareholders and other institutions. And we need to have a good understanding and information on what these factors are.

But we can do more by addressing the internal problems and issues within our control to ensure the Bank remain sustainable in the next millennium. For example, strong management controls over expenditure or effective loan appraisal systems. These are areas under our control. And this is where you as managers of this institution come in. You have a vital role to play in this area.

That is the challenge I want to leave with this conference this morning. Ladies and Gentlemen, thank you very much for your time.