

## **RESEARCH TOPIC: ROLE OF FINANCIAL INSTITUTIONS IN ECONOMIC DEVELOPMENT THROUGH ADDING VALUE IN BOTSWANA**

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*Abstract* - Financial Institutions (FIs) have always been recognized to play a significant role in economic development by mobilizing and allocating savings for production, providing structures for monetary management and serving as the basis of liquidity management (World Economic Forum, 2012; Kehinde and Adejuwon 2011). These FIs helped reinforce the thinking behind the colonization of Africa. The traditional view has always been that raw material is obtained from the developing countries for processing in the developed countries. However, the increased demand for more jobs and pressure to provide quality life for their nationals, finds the developing countries trying to expand their industrial bases as well. Consequently most developing countries are now seeking an accelerated effort to add value to their raw materials. However, the onset of the Global Financial Crisis (GFC) has not made it any easier. The developed world views the developing countries as if they are denying them their exclusive preserve and source of sustenance. This paper looks at the role of FIs in economic development in the modern world and efforts that they could engineer in order to bring about a win-win situation for both the developed and the developing countries. The study is carried out in the context of the Botswana environment in the aftermath of the GFC. It discusses on the one hand the importance and nature of FIs in the light of the need to add value to raw materials exported from Botswana to the developed world and, on the other hand offers strategies that could help the developed world to benefit from the value addition processes of the developing world. The study was based on a strong literature review and personal interviews conducted in Gaborone, Botswana. The proposed future contributions of the FIs towards economic value addition are also laid out. It is assumed that countries with similar economies and FIs would benefit from this research.

**Key words:** economic development, value-addition, financial institutions, raw materials, developed world

**JEL Codes:** F11, F23 and 050

### **1. Introduction**

Traditionally international trade has been based on the theory of “absolute advantage” as enunciated by Adam Smith in his “Wealth of Nations” of 1776. David Ricardo improved on this theory by proposing for the theory of “comparative advantage”. Other theorists like Bertil Ohlin, Heckscher and Michael Porter and his famous “Porter’s Diamond” are indeed an improvement of the theory of comparative advantage.

A common premise in all these theories is that for trade to take place, one country specializes in the production of one good/service to the mutual benefit of the trading partners. Thus in practice this meant that the developed nations endowed with modern technology would need to source for raw material for the manufacture of products from the non-developed countries (that experience a deficit in manufacturing expertise).

The developed nations are composed of the European countries like UK, Germany, Portugal, Spain, France and the United States of America. The developing countries have always traditionally been most African countries, South Asian and South American countries. Thus this laid out the trade-pattern of the world.

There are two major flaws of this trade principle. One of the basic flaws of this theory is that it conveniently negates the notion that the country providing the raw materials may in the long run deplete its natural resources.

When this happens the raw material provider may lose capacity to acquire the manufactured products to the detriment of its citizenship. This is not sustainable development (Delphi Report, 1997). Economic development of the raw material provider is limited to the ability to procure resources by the manufacturing nation. Other socio-economic, technological and political demerits of the erstwhile thinking are being discarded by leaders in the developing countries. A seismic shift is being witnessed.

Political leaders and policy proponents in Botswana have also seen the flaws of the traditional trade pattern. In particular, they are calling for the addition of value to raw materials before exporting them as opposed to wholesale export of raw materials. This initiative has not only proved to be more sustainable by offering downstream economic benefits but has particularly, culminated in the creation of employment opportunities for the citizenry.

As a concerted effort is made to further buttress the concept of value addition and sustainability, attention has also naturally turned to the financial institutions and their role to address this challenge. Financial institutions appear to be the panacea to the current quagmire faced by the developing countries in their quest for support and assistance in their value addition sustainability efforts.

Financial Institutions (FIs) have always been recognized to play a significant role in economic development by mobilizing and allocating savings for production, providing structures for monetary management and serving as the basis of liquidity management (World Economic Forum, 2012; Kehinde and Adejuwon 2011). These FIs helped

reinforce the thinking behind the colonization of Africa. The traditional view has always been that raw material is obtained from the developing countries for processing in the developed countries.

Thus as the early white settlers moved from the Cape of Good Hope in 1890 on their way to Ghanzi in Botswana, they moved together with their financial institutions. Thus the financial services that they were initially accustomed to continued to be availed to them.

The traditional role of the financial institutions was to facilitate growth and development of the empires that were being created. Empire building also invariably meant securing more sources of raw materials for the colonizers.

In light of the change in thinking is there a role that the financial institutions can play in order to facilitate value addition and the development of sustainable strategies for the developing nations like Botswana?

Consequently most countries are now seeking more effort in adding value to their raw materials. However, the onset of the Global Financial Crisis (GFC) has not made it any easier. This paper looks at the role of FIs in economic development in the and discusses the importance and nature of FIs in the light of the need to add value to raw materials exported from Botswana to the developed world. The study was based on a strong literature review and personal interviews conducted in Gaborone, Botswana. The proposed future contributions of the FIs towards economic value addition are also laid out. It is assumed that countries with similar economies and FIs would benefit from this research.

## **2. Literature Review**

### *The financial institutions*

Financial Institutions (FIs) have always been recognized to play a very significant role in economic development. The major contribution in economic development is that they facilitate the mobilization and allocation of savings for production World Economic Forum, 2012; Kehinde and Adejuwon, 2011). Consequently some authors have asserted that the more developed the financial sector, the more developed the economy ( ).

FIs have also been known to provide structures for monetary management and serving as the basis of liquidity management (World Economic Forum, 2012; Kehinde and Adejuwon, 2011).

### *Indian Scenario*

In India the Reserve Bank of India established the Industrial Development Bank of India. This institution was primarily created in order to;

- provide credit to the major FIs so that these institutions could assist in the industrial development of India;
- coordinate the functions of the FIs;
- provide assistance to SMMEs; and
- raise finance from the international money market

### *Malawi Scenario*

Malawi is one of the low income economies and hence economic development has always been a priority (Gondwe, ).

### *Global financial crisis*

However, another unforeseen factor has crept in. This factor is the Global Financial Crisis (GFC). Botswana was not spared from this malaise. The effects of the GFC in Botswana poses a further challenge to the noble idea of ensuring that financial institutions become positive change drivers for value addition processes. The question posed in (2) above needs to be rephrased thus, “In the light of the GFC do FIs still have a role to play in economic development through value addition and adoption of sustainability practices?”

### *Botswana Country Sustainability Profile*

Botswana is one of the few poor, underdeveloped countries that have made the successful transition to become a middle income country (Bank of Botswana Annual Report, 2011). If it were not for the ravaging effects of the Global Financial Crisis (GFC) Botswana would be enjoying a steady and robust growth coupled with substantial budget surpluses (ADB Report, 2013). The GFC has led to sluggish demand for diamond exports that has led to a fall in diamond prices and consequently revenue for the Botswana government.

Budget deficits experienced are being financed through reserves supported by both external and domestic debt funding.

For the banks this has led to a reduction in 'loanable' funds as the default rate was extended to Botswana. Consequently, individuals and business could not gain capital funding. Further, when government revenues shrink in Botswana the banks and the economy also experience a shrink in their revenues.

Economic statistics in Botswana are as follows; Inflation has been hovering between 6 to 7.5% from 2012 to 2013; GDP averaged 1.22% from 1994 to 2013 (Bank of Botswana, 2013); and unemployment averaged 42.98 during the period 1991 to 2001.

Botswana is also frequently cited as one of the few African countries with the most stable political environments characterized by having; a democratic government, an independent and impartial judiciary system and Electoral Commission, and a free media (ADB Report, 2013). Botswana also boasts of having good relations with its neighbors.

The Botswana National Development Plan Number 10 was designed to convert Vision 16 Objectives into concrete policies and actions. Its main theme is to accelerate attainment of Vision 16 through;

- Increasing diversification of the economy
- Attaining an improved human resource development
- Infrastructure development
- Utilities improvement
- Agricultural development
- Environmental maintenance and sustenance
- Improved governance

#### *Botswana Mineral Resource Potential*

Compared to the rest of the world, Botswana has some of the richest operational diamond mines. The biggest is Jwaneng Mine followed by Orapa all operated by Debswana. Total mine production was 22.8million carats.

Production figures for mineral ore mined in 2009 are as shown in the table below.

□ Cobalt	335metric tons
□ Copper	29000metric tons
□ Gold	2000kgs
□ Platinum	3000kgs
□ Salt	210metric tons
□ Soda Ash	250Thousand metric tons

There is also a huge potential of coal mining of 36 to 90 Mt in Botswana due to the discovery of coal deposits at such places as Morupule, Mmamabula, Sese and Mmamantswe.

Botswana also has vast potential for farming. It is also considered to be one of the few African countries with a huge herd of cattle. Currently Botswana was exporting 700 cattle to Zimbabwe and \$100m per year to Europe (Daily News Saturday, 9 March 2013). The country also exports live sheep and goats. In 2011 live sheep exports amounted to \$2269 and live goats exports were valued at \$23 943.

The country also has great potential in the following areas crocodile farming, fish farming, game ranching, guinea Fowl farming, and Hoodia cultivation (Government of Botswana, 2013).

#### *Economic development and value addition efforts in Botswana*

As alluded to above the Botswana economy has been growing at an average 1.22% from 1994 to 2013 (Bank of Botswana, 2013). Value addition of diamonds only enabled the creation of 3200 jobs out of a total population of 2m people. However, India has managed to create 800 000 jobs from its beneficiation process. If India could achieve so much, then Botswana with a population of 2m people should be looking at the Indian beneficiation processes with much envy.



and on a quota basis according to the various categories of FIs found in Botswana. The staff had to be people that deal in senior positions and holding at least five years banking experience. The distribution of the respondents is as follows;

The research study method involved conducting personal interviews based on open-ended guideline questions that sought to enable respondents to open up and say out their feelings. Further this research method does not only allow for interaction with the respondents but it also allows for further probing (Saunders et al, 2011). Notes were made in the process and intermittent analysis was made to determine common themes as the research exercise continued.

The guideline questions posed are as follows;

- (a) What role do financial institutions serve in the value addition process in Botswana?
- (b) How should FIs best serve Botswana in encouraging value addition?
- (c) What do you envisage to be the best future role of FIs in order to effectively help in the value addition process?
- (d) If you were the decision maker in your organization how would you best support raw material beneficiation?

The questions posed in the study sought to determine the role of FIs in economic development through adding value in Botswana.

Notes were made during the interview processes and summaries of such interviews were made. The responses were arranged according to the research questions and then condensed in order to identify common themes.

#### **4. Discussion of Findings**

The research findings are discussed below according to responses from the research questions posed. The findings are discussed below;

The response to the question, “*What role do financial institutions serve in the value addition process in Botswana?*” was answered in clear manner. Almost all respondents agreed that FIs are not charity institutions but they are meant to serve the interests of the people who had made



investments in these institutions. They always sought to give a fair return to the investor. This tended to motivate growth of the FIs.

With regard to the question, “*How should FIs best serve Botswana in encouraging value addition?*” many believed that FIs could develop a better entrepreneurial approach. This could be done through actively engaging with would-be industrialists to create a win-win situation.

The question, “*What do you envisage to be the best future role of FIs in order to effectively help in the value addition process?*” elicited a range of responses from the respondents. Some of the roles envisaged are as follows; banks need to develop special niches that they serve like Diamond Bank, Coal Bank and other such raw materials to best serve the specialist areas; a more concerted effort to support the creation growth and development of SMMEs through provision of more linkages with foreign international firms because they are always represented by the banking network in other countries; providing customized support to potential and upcoming entrepreneurs; FIs were envisaged to become more innovative and come up with products (both on the supply and demand side) that best serve the Botswana environment; increased trade support, insurance and related financial services like lease finance.

The question, “*If you were the decision maker in your organization how would you best support raw material beneficiation?*” also generated a very clear message. The responses suggested that more involvement of potential and existing entrepreneurs could be developed.

## **5. Summary, Conclusions and Recommendations**

### *Summary*

There is a range of services that can be promoted by financial institutions without compromising on their need to provide the expected return of their investors (both shareholders and depositors). Financial institutions can be innovative and entrepreneurial in nature and by providing services at a fee in order to enhance their equity. These services can be summarized as shown below;

- Grant project loans
- Coordinate functions of FIs
- Provide indirect assistance to SMMEs
- Raise finance from international markets
- Provide start-up advice and consultancy to potential industrialists
- Provide advice and consultancy services to current industrialists

- Arrange technical support to industrialists
- Facilitate the formation of partnerships, joint ventures and other suitable growth strategies for industrialists in the developing world
- Contribute by way of encouraging and taking up equity in some suitable industrial ventures

### *Conclusions*

It is possible to create a partnership between industrialists in the north and those in the south and bring out a win-win situation with the support of the financial institutions without the financial institutions compromising on both service provision efforts as well as losing out on their expected returns.

According to Robinson and Von Below (1990) mineral beneficiation industry and beneficiation of other raw materials will help promote establishment of adequate skills in the work force as the country seeks to permeate into the export market. Consequently this will give the country a competitive edge on the export market. Raw material endowment alone does not.

This study shows that financial institutions in Botswana are making a commendable effort in enhancing economic development in the era of the GFC in Botswana. Further they are supporting the creation and implementation of sustainable business practices for the benefit of the Botswana citizenry. The country is experiencing a seismic shift in its trading pattern. Several policy stances, institutional changes and the innovative and supportive initiatives of the financial institutions are beginning to bring positive results to the country's benefit. The future role of the financial institutions cannot be ignored as more value addition efforts and other sustainable processes continue to add impetus to the sustainable economic growth and development of Botswana. Value addition and business sustainability are two sides of the same horse. It is assumed that countries with similar economies and FIs would benefit from this research.

### *Recommendations*

There is need for a seismic shift in the world pattern of trade. The developed nations need now to focus more on service provision and assume the role of "world brains" and "think factories" and the developing world needs to become

“raw material beneficiation factories”. A myriad of benefits will emanate from this relationship as briefly summarized below.

- Cost of production will be reduced because products will be manufactured at the point of sourcing.
- Economies of scale will be achieved at both raw material conversion and at idea generation/improvement phase.
- Enhanced research and innovation efforts will be made feasible.
- The process will lead to a win-win situation for both countries endowed with raw materials and those with the capacity to embark on services provision as well as innovation and research and development.
- Economies of scale in entrepreneurship will be reaped as the developed nations develop a niche in their developmental efforts.

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