Management and Operations of the Industrial Development Corporation (IDC)

Submitted to the

Committee on Parastatal Bodies

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Preamble

This report is in response to the request made by the Committee on Parastatal Bodies of the National Assembly of Zambia to the Zambia Institute for Policy Analysis and Research (ZIPAR). The report provides an analysis on the management and operations of the Industrial Development Corporation (IDC). The report highlights and attempts to answer the following questions as requested by the committee:

i. How effective is the current legal and institution framework for IDC in achieving its mandate?
ii. What interaction is there between ZIPAR and IDC?
iii. How effective is the model adopted by IDC for managing State-Owned Enterprises (SOEs) in Zambia compared to the one used under ZIMCO, INDECO and FINDECO?
iv. How does the model adopted by Government to monitor SOEs with that of other countries within the region?
v. What measures can be put in place by IDC to improve the performance of SOEs?
vi. Does the parallel arrangement where certain SOEs are still under the line ministries provide a level playing field for SOEs' operations in Zambia? and
vii. Recommendations, if any, on how to improve the operations of SOEs and IDC in Zambia.

Introduction

After the closure of the Zambia Industrial and Mining Corporation (ZIMCO) and other key corporations such as INDECO and FINDECO in the 1990s, State-Owned Enterprises (SOEs) also known as parastatals from various sectors of the economy had been operating under the direct supervision of line Ministries. However, it was then observed that while line Ministries were strong in providing policy guidance, they did not necessarily have the requisite commercial and investment expertise and resources needed to ensure the positive performance of the SOEs under their supervision. And as such, it was found that these parastatals were unable to provide government with the return on investment and thus contribute to the national treasury by way of dividends and taxes.

Therefore in December, 2013 Government established the Industrial Development Corporation (IDC). The corporation was mandated to maximize the potential revenues from SOEs and to play a crucial role in maximizing the value of Government shareholding in SOEs. This becomes even more critical considering the potential role which parastatals play in contributing to growth, economic development and employment creation.

1. **How effective is the current legal and institutional framework for IDC in achieving its mandate**

The Industrial Development Corporation was incorporated as a company limited by shares under the Companies Act and is 100% owned by the Minister of Finance pursuant to the Minister of Finance (Incorporation) Act Cap 349 of the Laws of Zambia, for the President on behalf of the Government of the Republic of Zambia. The IDC commenced operations in March 2014.

The IDC Board is chaired by the President of the Republic of Zambia who presides and provides oversight over the affairs of the Board. The Board has also established three sub-committees that provide the required leadership to ensure that the mandate of the Board is effectively discharged. The Board is also assisted by the Executive Management which does the day to day operations of the corporation. The following are the three sub-committees all of which are chaired by a board member in addition to the Executive Management:

a) **Investment and Portfolio Management Committee**

   The Investment and Portfolio Management Committee assists the Board in fulfilling its responsibilities in respect to management of IDC's investments in a manner consistent with the overall set goals as defined in the investment guidelines. This includes capital preservation and growth of IDC's investment portfolio; prudent maximization of risk adjusted returns on investment consistent with Board policies.

b) **Finance and Administration Committee**

   The Finance and Administration Committee is responsible for the IDC's annual budgets and work plans, fiscal management, staffing and human capital development and ensuring a high performance work environment is established within IDC.

c) **Audit and Risk Committee**
The Audit and Risk Committee is responsible for ensuring that IDC's financial reporting to its core stakeholders is adequate and compliant with regulatory standards and requirements and enterprise-wide risk management strategies.

d) **Executive Management**
The Executive Management for IDC is mandated to implement the Board's developmental policies and conduct day to day operations. It is headed by the Chief Executive Officer and assisted by a senior management team.

With the above structures, we feel the current legal and institutional framework is enforceable and implementable; however we make the following reservations:

i) IDC was incorporated in 2014, as a company limited by shares under the Companies Act to hold and is 100% owned by the Minister of Finance pursuant to Act Cap 349 of the Laws of Zambia. Therefore, we draw some ambiguity in having the President as the Chair of the Board when it should fall under the guidance of the Minister of Finance.
ii) The appointment of directors by the President who is Chair of the IDC board politicizes the directorships. By virtue of their appointment, directors are deemed to act in the interest of their appointers rather than the corporation they are meant to serve thus constrained by the agency problems that arise from their political appointment. Although directors are appointed by the President on behalf of the state, the state is not the principal because it derives its mandate from the voters. As a result, both the President and the directors are agents of the voters. Therefore, this makes it very difficult for directors to act in the best interest of parastatals because the state sometimes requires them to pursue political interests in order to meet the expectations of a strategic element of the electorate.

The main challenge facing IDC is attracting and recruiting the right personnel. Currently the institution faces a shortage of skilled manpower to effectively run and manage the corporation and hence fulfil its intended objectives.

2. ZIPAR's relationship with IDC

ZIPAR had a memorandum of understanding with IDC which was signed in November 2014 for a duration of two years. The overall objective was for ZIPAR to contribute to the provision of empirical evidence and data based on sound analysis and research. Further, ZIPAR was to assist, support and strengthen industrialization interventions of IDC in focus sectors including agriculture and related processing activities, mining, manufacturing, tourism, financial services, energy and infrastructure, through formulation and implementation of appropriate strategies to deepen industrial capacity in Zambia and accelerate job creation.

Under this agreement, ZIPAR was also meant to undertake research studies, on request and on behalf of IDC and monitor and analyze the impact of IDC programs and investments in relation to wealth and job creation for the Zambia citizenry. In undertaking this task, ZIPAR was also supposed to monitor the impact of specific State-Owned Enterprises and recommend appropriate interventions.

However, the MOU was never operationalized during its tenure and since its expiry, there has been no attempt from IDC to reactivate and operationalize it. However, IDC has once requested for information from ZIPAR to aid them in their own analysis.

3. The effectiveness of the Model adopted by IDC for managing SOEs compared to the one used under ZIMCO, INDECO and FINDECO

Under the ZIMCO, INDECO and FINDECO, SOEs were seen as social remnants of the old socialist experience and a mere outward projection of state power in distributing economic and sovereign wealth to the general public. However, under IDC, SOEs are projected to represent a multifaceted nexus point for both public and private enterprise whose main aim will be to provide oversight by serving as an active investment holding company for SOEs to achieve sustainability and profitability. Under the new model, IDC is expected to play a catalytic role in deepening and supporting Zambia's industrialization capacity to support employment creation across the main priority sectors of Manufacturing, Infrastructure, Agriculture and Tourism. Further, it is also envisaged that IDC will play a critical role through the evaluation, pricing mechanisms by serving as co-investors alongside private sector investors as opposed to the previous ZIMCO, INDECO and FINDECO model where SOEs were solely seen as drivers of socialism.

Therefore the new model adopted by IDC will ensure and focus on the positive performance of the SOEs while allowing the Ministries to focus on their core strength which is to provide policy guidance. This model, if properly managed would be effective and help SOEs in ensuring that they contribute positively and also provide Government with a return on its investments. Under the new model IDC will therefore seek to work to maximize the value of Government shareholding by ensuring that SOEs become profitable and engage in bankable projects structured to self-finance with sovereign guarantees serving as a last resort.

However, there is also a lot of confusion about the IDC's broader mandate and precisely how it's supposed to intervene in the industry or what businesses its meant to fund. If its mandate is to play a catalytic role in deepening and supporting Zambia's industrialization capacity in promoting job creation and domestic wealth formation across key economic sectors, it does raise some question: Does the corporation's mandate stretch beyond acting as an investment promotion centre as we have seen in solar projects and where does this leave the Zambia Development Agency? Or are we able to conclude that they are able to carry out the same mandate? Furthermore, the mandate is also unclear about the criterion on what investments the corporation can venture in as was the case when it acquired 90% stake in Zampalm. And is there an exit strategy for the investments which IDC is involved?

4. Comparison of the Model adopted by Government to monitor SOEs with regional countries

The management of SOEs in the region offers little encouragement as most of them continue to rely on government for support through higher spending and job creation. However, Botswana and South Africa despite having some SOEs which are struggling have developed models which have performed reasonably well in an accountable and transparent manner.

Botswana

In Botswana, public enterprises fall under a decentralized public ownership model where they are under the responsibility of different sector ministries and the day-to-day control is devolved to the Boards of Directors and Executive management. The Government thus has an ownership policy which spells out expectations from its shareholding portfolio in public enterprises. The policy serves to confirm or articulate Government's high level and long term objectives and assign stakeholders roles to play in achieving those objectives. The policy also assists in ensuring that public enterprises work towards achievement of the common developmental goals set by Government without regard to which ministries they fall under. The policy is also used as an instrument which facilitates implementation of a more enhanced performance measurement framework and a robust monitoring and evaluation system.

South Africa

In South Africa, the Department of Public Enterprise (DPE) is the shareholder representative for Government and provides oversight responsibility for State Owned Enterprises. The DPE is thus mandated to drive investments, industrialization, job creation, productivity and the transformation of the Government's portfolio in SOEs. The Department oversees the management and operations of state-owned enterprises which the country uses as strategic instruments of industrial policy and core players in the growth path. The department also aims to provide the strategic direction to all SOEs so that their businesses are aligned with the country's growth and development agenda. This is achieved by ensuring that their planning and performance and investment activities are in line with Government medium term strategic framework and the Minister's service delivery agreement.

In addition, South Africa operates a parallel model under the Industrial Development Corporation (IDC). The corporation was established by an Act of Parliament (Industrial Development Corporation Act, No. 22 of 1940) and is fully owned by the South African Government. The core objective for IDC is to develop domestic industrial capacity, especially in manufactured goods, to mitigate the disruption of trade with regional and global partners. The corporation also is mandated to secure investments from all parts of the world and is a champion in developing and establishing major industrial enterprises. It draws its funding through income from loans and investments as well as from borrowings from commercial banks, developmental finance institutions and other lenders. The corporation's mandate also extends to developing the country's industrial capacity as well as playing a major role in facilitating job creation through industrialization.

However, most notable from the two regional comparisons is that both models appear to be the same models we had regarding the management of SOEs before the incorporation of IDC and despite their challenges, Botswana and South African SOEs have performed reasonably well.

5. Proposed measures to improve the performance of SOEs in Zambia

The poor and ineffective management of SOEs can be attributed partly to the appointment criteria especially at board level which is based on political influence rather than relevant technical expertise. This has detrimental effects on the managerial capacity of the board and on the morale of competent staff. Another issue which has contributed to unsatisfactory performance is the role of Government as the shareholder which remains unclear as to how effective and efficient SOEs can be managed with Government support.

The following are measures that could help improve the performance of SOEs in the country:

i) **Closing the performance gap with the private sector**

There is need for SOEs to close the performance gap with their private sector competitors. SOEs need to improve on their service delivery and technical capabilities.

ii) **Setting out clear objectives**

Most SOEs fail because they operate behind a veil, revealing little information beyond their general mandate. One reason for this could be that their objectives are unclear or conflicting but the lack of transparency can be traced to political expediency, a desire to avoid comparison with competitors from the private sector. SOEs need to be encouraged and mandated to openly proclaim their objectives and clarify the trade-offs between their financial and social goals especially in situations where they negotiate a transparent mandate with the government and other stakeholders.

iii) **Performance measurement framework**

A lack of autonomy at board of directors' level impacts negatively on the board's effectiveness as an independent board is key to having appropriate corporate governance. Therefore, in order to strengthen to improve the effectiveness of the of IDC board, an appropriate performance measurement framework needs to be established. IDC therefore, needs to set out a clear policy direction to SOEs, aligned with the developmental objectives contained in the 7th National Development Plan. These objectives need to be accompanied with an implementation plan which is robust and effective.

Related to the issue of performance, Government through IDC needs to provide guidance to SOEs regarding factors such as the expected rate of return, dividends and reporting. This could set the basis for the formal exercise of Government's oversight role as a shareholder.

iv) **Introduction of Performance Contracts**

There is need for IDC to introduce and enter into performance contracts with parastatal directors where they agree to set targets within a particular timeframe upon which they will be rewarded when those targets are met or replaced when targets are not met.

6. The effectiveness of the parallel arrangement where certain SOEs are still under line ministries

Under the old model, SOEs in various sectors through umbrella bodies of ZIMCO, INDECO and FINDECO had operated under the direct supervision of line ministries. And because of competing demands placed on Government as a shareholder and dependence on direct and indirect subventions for survival, there was a limitation on new capital injections for investments. The model was thus seen to have negatively impacted on the performance and operations of SOEs in terms of modernization, growth, governance and accountability.

The new model gives IDC a direct mandate to oversee performance and accountability of the SOEs on behalf of Government. Under this model, most SOEs fall under IDC while there is still a few which continues to fall under their line ministries such as ZESCO which is still under the Ministry of Energy.

However, what is not clear about the parallel arrangement is the difference it makes since the appointing authority for both, the SOEs which fall under their line Ministries or and those which fall under IDC, all lie with the Office of the President. Further, some SOEs are subject to overlapping regulations. In the case of those SOEs which are not under the umbrella of IDC, all directors and the Managing Directors are appointees of the Energy Minister. This makes SOEs subject to direct regulation by parliament which scrutinises them. On this basis we can argue and say that there is some level of accountability and transparency by those SOEs which remain under the guidance of their line ministries.

7. Recommendations

The following are additional recommendations:

i) **Board Chairperson**

Since the corporation is 100% owned by the Minister of Finance, we do recommend that the chairmanship of the Board be moved from state house to fall under the Ministry of Finance as the current framework creates unclear reporting structures.

ii) **Political interference – Governance**

In order to reinforce accountability and ensure that political influence is minimised, there is need to empower an independent body such as parliament to vet the appointments of directors on parastatal boards. This would also ensure that these corporations are run, not in the interest of their appointees but rather in the interest of the corporation. Further, such a process would also ensure and facilitate the appointment of qualified persons and thus enhance the performance of the board by raising the standard of care expected from directors.

iii) **Staffing levels**

Since the corporation is grossly understaffed, there is need to tap into the private sector for individuals with the right skills set so that the corporation can fulfil its intended objectives. Acquiring talented workers at all levels of the corporation remains a problem. The corporation has since inception continued to operate below the required staff levels.

iv) **Universal provision of services**

For some SOEs, though set up with the commercial mandates, they are indirectly tasked with certain social obligations which impact on commercial functions. Therefore, IDC needs to put in place a clear strategy on the financing of non-commercial services and clearly articulate expectations about the effects of providing social services on the overall performance of the enterprise.

v) **Need to clarify IDC mandate**

There is need for IDC to clarify its general mandate as the current operations go beyond its outlined mandate. Further, the corporation should also outline the criteria under which it makes its investment decision and also state what the exit strategy is for such undertakings.