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financiamiento del desarrollo

Development banking in the Eastern Caribbean: the case of Saint Lucia and Grenada

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Santiago, Chile, May 2007

This document was prepared by Wayne Sandiford, School of Arts and Sciences, Saint George's University, Grenada, consultant of the Development Studies Unit of the Economic Development Division, at the Economic Commission for Latin America and the Caribbean (ECLAC), within the activities of the project "Strengthening the Role of Regional and National Financial Institutions for Sustainable Social Development" (GER/03/002)", executed by ECLAC jointly with *Deutsche Gesellschaft für Technische Zusammenarbeit* (GTZ). The author would like to thank Daniel Titelman for his valuable comments on a previous version.

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United Nations Publication
ISSN printed version 1564-4197 ISSN online version 1680-8819

ISBN: 978-92-1-121647-9
LC/L.2741-P
Sales No.: E.07.II.G.77
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Printed in United Nations, Santiago, Chile

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Abstract

This document examines the Saint Lucia Development Bank and the Grenada Development Bank. In an attempt to place the examination of the Development Banks in some context, the examination begins with a discussion of the origins of development banking in general. It then proceeds to look specifically at the emergence of development banking in Saint Lucia and Grenada. It also discusses the statutory basis of the Development Banks, their mandate, ownership, sources of funds, the structure of the their governance and the nature of government control. The document also analyses the instruments and associated policies of the Development Banks, and assesses the performance of the Development Banks. It finally provides suggestions as to possible new directions for the Development Banks.While the study is restricted to the Saint Lucia Development Bank and the Grenada Development Bank the suggested new direction could have some applicability to the rest of the Eastern Caribbean. There are valuable lessons to be learned from other development banking experiences which indicate that development Banks must seek to complement financial markets, rather than to replace them, stimulating private banks to lend alongside public ones; they must lend basically to the private sector, and within the private sector, to firms without adequate access to private markets; they must insist on the long-term profitability of their client firms and must monitor their investment closely and must monitor their investment closely. In the final analysis development banks to succeed they must use commercial standards in their lending procedures. In other words, they must act more as market-oriented financial enterprises than as government agencies. The basic problem with SMEs in developing countries is lack of access to long term finance at market-related interest rates. They do not require subsidy.

Introduction

Development Banks are part of the financial landscape of the Eastern Caribbean. In one form or another they have been in existence since the late 1960s and have played a not too insignificant role in the financing of small and medium size enterprises in the economies.[1] Development Banks emerged in the Eastern Caribbean as a post-colonial financial institution with an emphasis on agricultural development. Indeed, related pre-development bank financial institutions were referred to as Agricultural Development Banks. In the case of Grenada there was initially the Grenada Agricultural Bank, which evolved into the Grenada Agricultural and Industrial Development Corporation which finally gave way to the Grenada Development Bank. Similarly, the Saint Lucia Development Bank was preceded by the Agricultural and Industrial Bank, the Housing Development Bank and the Further Education Loan Fund.

Despite such a history not much has been done by way of an analysis of these institutions. This is not to say that no analyses have been done on the Development Banks. However, it would appear that analyses conducted on the Development Banks were primarily for internal institutional use and/or for the use of fund providers of the Development Bank. Most of the analyses done were therefore not always in the public domain. Hopefully, this study would make its way to a wider audience than those before.

[1] See appendix I for a schematic of financial institutions in the Eastern Caribbean.

This study will examine the Saint Lucia Development Bank and the Grenada Development Bank. In an attempt to place the examination of the Development Banks in some context, the examination will begin with a discussion of the origins of development banking in general. It will then proceed to look specifically at the emergence of development banking in Saint Lucia and Grenada. Discussions of some stylize facts related to the Saint Lucia Development Bank and the Grenada Development Bank will be undertaken. Here, the statutory basis of the Development Banks, their mandate, ownership, and sources of funds, among others will be discussed. The study will then move on to discuss the structure of the Banks which will be followed by an examination of their governance and the nature of government control.

Three other crucial issues will be addressed. The instruments and associated policies of the Development Banks will be looked at. This will be followed by an analysis of the performance of the Development Banks. The study will then close with some suggestions as to possible new directions for the Development Banks.

While the study is restricted to the Saint Lucia Development Bank and the Grenada Development Bank the suggested new direction could have some applicability to the rest of the Eastern Caribbean. Indeed, some suggested new directions may require approaches which may have to transcend the individual countries. This is more so in a context where the Eastern Caribbean share, in some sense, a common financial space; and there is the stated policy objective of deepening the integration process in the Eastern Caribbean.

The conduct of the study encountered some limitation with respect to data. Data for Identical periodic dates were not available for both Development Banks; with a shorter period for the Grenada Development Bank relative to the Saint Lucia Development Bank. Accounting data from the annual accounts of the Development Banks were not always identical and over the different periods accounting formats and standards were evidently changed. Thus, some amount of data mining had to be done. In addition, in 2001 the Saint Lucia Development Bank merged with the then National Commercial Bank of Saint Lucia to form the National Bank of Saint Lucia. The Saint Lucia development Bank as was known before the merger became a division, the division of development banking, of the National Bank of Saint Lucia. There would therefore be some shortcomings in the analysis presented.

The origins of development banking

Development Banks in the Eastern Caribbean are primarily state-sponsored financial institutions established to promote the economic development of a country; i.e., they are state-sponsored development finance institution.

The idea and practice of development banking has a long history; one that is probably centuries old. Its early beginning was in Europe and probably the oldest government-sponsored financial institution for industrial development was the Societe General Pour Favoriser I'Industrie National which was created in the Netherlands in 1822. However, the French was prolific and made more advances in the promotion of these state-sponsored financial institutions. In this regard, the establishment between 1848-1852 of state-sponsored financial institutions such as the Credit Foncier, the Comptoir d'Escompte and the Credit Mobilier were particularly important. Indeed, the participation of Credit Mobilier in the Continental Europe railway investment typified how these institutions contributed to both industrial and financial development. Credit Mobilier was able to acquire considerable proficiency in long-term financing as a result of its involvement in the railway investment. This expertise was then disseminated throughout various Continental European Banks in which Credit Mobilier held an interest.

The rapid industrialization of continental Europe in the nineteenth century went hand in hand with the emergence of large financial institution; not excluding government-sponsored financial institutions. Given the inadequate provision of long-term finance by private finance houses, national governments felt almost compelled to sponsor financial institutions for the explicit purpose of long-term capital financing for industrial development. The existing commercial banks were unable and/or unwilling to provide industry with long-term finance for two reasons. In the first instance, they were not prepared to accept the unavoidable risk which went with the financing of new enterprises venturing into relatively unknown areas, or less known areas. Secondly, they lacked the expertise necessary to deal with the higher risk long-term investment. Financial institutions that were primed to bear the risk associated with long-term investment and which were prepared to develop the required skills for managing such investment therefore had to be established to aid industrial development.

The need for the reconstruction of Europe following the end of World War I gave renewed momentum to the establishment, development and growing importance of government-sponsored financial institutions. Responding to inflows of capital, European countries had to establish institutions to channel the funds for reconstruction and development. As the pace of reconstruction accelerated, those institutions were given the role of providing long-term finance to relatively new industrial sectors such as iron, steel, and shipbuilding. In this regard, the cost of developing expertise in the field and the risk associated with financing these new sectors were assumed by national governments with an increasing degree of sophistication. Government supported these financial institutions through the provision of share capital, loans at below market rate of interest, guaranteeing the bond issue of the institutions, or a combination of all of the above.[2] These state-sponsored financial institutions therefore played a pivotal role in financing the industrialisation process in Europe.

It is with not too dissimilar views and rationale that Development Banks were established in the Eastern Caribbean. The desire for economic development following direct colonial rule in the Eastern Caribbean acted as a catalyst for the establishment of what ultimately became Development Banks. Initially, the Caribbean Development Bank (CDB) and the European Investment Bank (EIB), the principal suppliers of funds to the Development Banks, used the Development Banks simply as “agency offices”. The Development Bank thus acted as initial screener of potential users (borrower) of funds from these institutions. With the granting of loans to the borrowers, the Development Banks disbursed the funds and scrutinize the implementation of the projects funded on behalf of the lending institutions.[3] With the passage of time the lending institutions changed their practice and provided the Development Banks with lines of credit to on-lend in their respective jurisdiction. In some sense, this signaled the functional beginnings of development banking in the Eastern Caribbean.

[2] See William Diamond (1957). Development Banks. The Economic Development Institute, IBRD, Johns Hopkins University Press, Baltimore, USA.

[3] See Garth P Nicholls, “Development Banking Issues in the ECCB Area”, Pg, 3.

Origins of development banks in Saint Lucia and Grenada

Saint Lucia

The Saint Lucia Development Bank was established by an Act of Parliament in February 1981 with the formal opening taking place in September 1982 and with the Government of Saint Lucia being the sole shareholder. The government of Saint Lucia, in accordance with an agreement with the Caribbean Development Bank committed itself to contributing $1.25m to the share capital of the Bank on an annual basis for four years. Upon its establishment the assets and liabilities of the Agricultural and Industrial Bank (AIB), the Housing Development Bank (HDB) and the Further Education Loan were assumed by the Saint Lucia Development Bank as those institutions were effectively abolished.[4] In addition, the lending activities and portfolios of industrial credit (small industries credit) and educational credit (student loans) of the Saint Lucia National Development Corporation were assigned to the Saint Lucia Development Bank.

[4] See the Saint Lucia Development Bank Act 1981, Part VI (38). Under this provision of the Act all lands and other property of any kind vested in the two institutions were transferred to and vested in the Saint Lucia Development Bank. In addition, all the rights, privileges, and advantages and all the liabilities and other obligations of the two institutions were transferred to and vested in the Saint Lucia Development Bank. Parts VI (38) (7) and (39) (1) repealed the legislation relating to the two institutions and the Further Education Loan Fund. However, statutory instruments made under the repealed Acts were deemed to be in force until repealed by statutory instruments made under the Saint Lucia Development Bank Act 1981.

At its birth, the Saint Lucia Development Bank had five lines of duality which complicated the early phase of its operations and functioning. It had two different offices, two groups of staff, two sets of accounts, two, somewhat different, systems of operations and two badly contaminated portfolios. The combined staff of the AIB and the HDB amounted to thirty-two. To ensure some degree of continuity the staff of the two institutions was requested to continue holding office until the staffing situation of the newly formed Saint Lucia Development Bank was rationalized. Some were ultimately released while some continued in the employ of the Bank.

At the beginning of its operations the assets and liabilities of the Saint Lucia Development Bank were as follows:

TABLE 1
SLDB: ASSETS & LIABILITIES EC$M
FEBRUARY 25, 1981

Cash	$132 057
Bank Deposits	$ -
Current Assets	$693 211
Current Liabilities	$3 107 597
Current Ratio	$0.22 : 1

And, its loan portfolio at the same time was as follows:

TABLE 2
SLDB: LOAN PORTFOLIO EC$M
FEBRUARY 25, 1981

	No. of Loans	Value
Agriculture	1 529	$3 899 000
Housing	1 112	$6 578 000
Small Industries Credit	10	$598 000
Education	202	$750 000
	2 853	$11 815 000

The Saint Lucia Development Bank began operations under very tight liquidity conditions with a paltry twenty-two cents at its disposal for every callable dollar of liability. It would appear that such a condition was generated by the predecessor institutions' habit of borrowing short (i.e., accepting short-term one year fixed deposits from insurance companies and commercial banks) and lending long; a practice which runs against the grain of a fundamental banking principle. Besides, the predecessor institutions maintained their funds in non-interest bearing accounts; a practice hardly reconcilable with sound financial management.

Management of the newly created Saint Lucia Development Bank therefore had to take remedial measures to arrest the potentially crippling situation. In so doing, new loan approvals were put on hold, the time lapse between disbursements on existing projects were lengthened, an arrears recovery programme was implemented, tighter control on expenditure was established, and a liquidity float was created. The Bank went further and improved its cash management with the opening of interest-bearing call and fixed deposit accounts. In not too long a time the Bank showed signs of better financial health and proceeded, in a real way, with the genuine business of development banking.[5]

[5] See Saint Lucia Development Bank, Annual Report 1981–1982, Pgs. 1–4.

Grenada

The Grenada Development Bank was established by the Grenada development Bank Act 1976. Before the establishment of the Grenada Development Bank there existed the Grenada Agricultural and Industrial Development Corporation (GAIDC), which in turn was preceded by the Grenada Agricultural Bank. As in the case with the Saint Lucia Development Bank, the assets and liabilities of the prior institutions were vested in the Grenada Development Bank.

Similar to the Saint Lucia Development Bank, the basic operations of the Grenada Agricultural Bank and the Grenada Agricultural and Industrial Corporation were turned over to the Grenada Development Bank. Personnel from the former institutions were shifted to the Grenada Development Bank under the same terms and conditions of employment. The assets and obligations of the former institutions were also vested in the Grenada Development Bank in much the same way as was done in the case of the Saint Lucia Development Bank.

Stylised facts

Statutory basis

Both the Saint Lucia Development Bank and the Grenada Development Bank were established by statute, placing them on a different legal footing than that of the normal company which must be established under the relevant Company Act. As creatures of statute they both fall under some influence of the state. Indeed, they were both established to execute some broad developmental objectives as defined by the governments.

Their statutory foundation in no small way would have been a contributing factor to some of the institutional culture and practices; both of which were akin to the larger public service. In its management report for the year 1983–1984, the management of the Saint Lucia Development Bank observed that the Bank is operating "in an environment still riddled with colonial traits of ascription and particularism and still in the throes of accommodation with the inherited Westminster and Whitehall model of government and bureaucracy". It went further and indicated that "the Bank must seek to establish operating and "cultural" norms out of which should emerge in the long-run a tried and tested philosophy of development banking administration in a micro-state".[6]

[6] See Saint Lucia Development Bank Annual Report 1983–1984. Pg. 33.

Mandate

The Saint Lucia Development Bank was handed a particularly broad mandate. According to the Saint Lucia Development Bank Act 1981, Part II(14)(1)(a), the function of the Bank is "to mobilize and provide finance for and promote and facilitate the expansion and strengthening the economic development of Saint Lucia …" The Act then specifies a number of functions which the Bank could perform. These include, among others, standard banking functions, i.e., the acceptance of deposits from any source (both within and without Saint Lucia), the making of payments authorized by depositors and the granting of loans and advances. The Saint Lucia Development Bank is also empowered to participate in share capital of enterprises and "to give any guarantee or indemnity to and enter into any arrangements with the Government, any public or statutory authority or any body corporate or other person whether within or without Saint Lucia[7]

In the case of Grenada, there is no general chapeau with respect to what the Grenada Development Bank could do. However, in Part II section 4, the Grenada Development Bank Act spells out the functions of the Bank. According to the provisions contained there the Grenada Development Bank is authorized to, among others: (a) provide financial assistance to enterprises in the form of loans and equity participation; (b) foster the development of money and capital markets in Grenada; (c) grant loans for industrial, agricultural, housing, and educational purposes and (d) the mobilization and co-ordination of available resources. Unlike the Saint Lucia Development Bank, the functional scope of activities of the Grenada Development Bank is confined to the state of Grenada.

On the face of the provision, the functions assigned to the Grenada Development Bank are much more circumscribed than those assigned to the Saint Lucia Development Bank. However, some of the provisions are worded in such a manner that their interpretation could be easily strained to expand the scope of operations of the Bank. In addition, the scope for assisting in the development of money and capital markets granted to the Grenada Development Bank puts it in a position uniquely different from the Saint Lucia Development Bank with regards to possible new directions for the Bank.

Ownership

As institutions created by statute to aid in the prosecution of governments' development agenda, the Saint Lucia Development Bank and the Grenada Development Bank are owned by the respective governments. In the case of the former, the government of Saint Lucia took an equity position and from time to time provided funding, either as direct assistance or as part of a loan obligation contracted by the Development Bank. In the case of the latter the government of Grenada has not taken an equity position but provides similar types of financial support as the government of Saint Lucia.

There is no element of private ownership in the Development Bank and the strength of government ownership (and control) is reflected in the control exercised by the designated Minister of Government responsible for oversight of the Development Bank in each country. The extent of private involvement is in the governments' appointment of personnel from the private sector to serve on the Board of Directors.

[7] Part II Section 14 (1a-1r) spells out a range of activities the Saint Lucia Development Bank could be involved in. For example: provide loans and advances to enterprises, individuals, government and parastatal bodies (within and without Saint Lucia), grant, loans for educational purposes, finance the construction, repair or improvement of dwelling houses, and engage in any banking business, make loans and advances or any form of credit to any persons, corporations, company, society or body whatsoever within or without Saint Lucia.

Sectoral lending

Both Development Banks concentrate their lending in two sectors. In the case of the Saint Lucia Development Bank the bulk of the outstanding loans during the period 1983 to 1992 were such that the dominant sector was housing, accounting for, on average, approximately 51.1 percent of the total loans outstanding. The sectors which followed in importance over the same period were industry (19.8 percent on average) and agriculture (15.2 percent on average).

From 1983 to 2001 the dominant sector was the housing sector, accounting for, on average, 47.1 percent of total outstanding loans over the period. The second sector of importance was that of education which accounted for an average of 20.5 percent of the total loans outstanding. Education was followed by tourism in which there was an average of 17.6 percent of the total loans outstanding.[8] See table 3 below and table 26 of Appendix I.

TABLE 3
SLDB: SECTORAL DISTRIBUTION OF LOANS OUTSTANDING EC$M 1983-2001

Year	Agriculture	Tourism	Industry	Housing	Education	Approximate Total
1983	3.40	NA	1.11	6.88	1.53	13.34
1984	3.34	NA	1.90	8.46	1.84	16.05
1985	3.78	NA	2.62	9.89	2.13	21.71
1986	4.06	NA	3.94	11.86	2.21	26.21
1987	3.74	NA	5.90	13.20	2.07	25.47
1988	3.94	NA	7.85	14.95	2.28	29.43
1989	4.12	NA	8.64	16.12	2.32	31.37
1990	4.31	NA	9.73	18.04	2.98	35.19
1991	4.29	NA	10.13	22.23	4.18	41.14
1992	4.50	NA	11.09	29.25	6.15	51.52
1993	7.12	NA	13.52	36.28	8.14	65.76
1994	8.41	8.16	6.91	42.26	10.88	77.34
1995	8.89	12.91	6.59	47.45	15.39	91.77
1996	7.61	17.94	6.97	47.24	20.66	102.00
1997	7.52	20.06	8.43	52.83	24.45	116.35
1998	8.24	21.22	8.44	56.95	29.26	128.12
1999	9.38	22.68	9.62	61.86	35.37	142.38
2000	10.88	25.04	10.39	67.10	40.44	157.46
2001	11.26	30.09	12.35	68.75	45.88	171.54
Average	6.25		7.69	33.24	13.59	70.74

8 In the case of Grenada data on the sectoral distribution of outstanding loans were not available. However, data on loan approval, and more importantly, loan disbursement were available. These would therefore be used to illustrate the relative importance of sectors with regards to the lending of the Grenada Development Bank.

The relegation of agriculture and the relative rise of education may have been indicative of the shift in developmental focus away from agriculture to an increased emphasis on human capital formation and development. The other productive sectors, i.e., industry and tourism remain of lesser importance in the loan portfolio of the Saint Lucia Development Bank.

Cumulative data on the sectoral disaggregation of outstanding loans in the portfolio of the Grenada Development Banks were not available. However, on the basis of loan approved and loans disbursed a not too dissimilar pattern can be deciphered. Over the period 1994 to 2005 disbursements were primarily for educational purposes followed by housing. The same pattern is exhibited as it relates to loan approval.

Over the period the average annual disbursement going to education was EC$M1.28, while for housing it was ECM$0.88. This should be viewed in relation to the annual average disbursement of EC$M2.61 over the same period. Thus, on average, education accounted for approximately 48.4 percent of the disbursed funds over the period, while housing accounted for 31.5 percent.

Again, the major productive sectors were not particularly favoured, as reflected in the relatively low approval and disbursement of funds to those sectors. Over the period the annual average disbursement going to agriculture and fisheries amounted to EC$M0.24, while the amount disbursed to industry and tourism was EC$0.22M. On average, over the period the share of funds going to agriculture and fisheries relative to the total amount disbursed was 10.41 percent, while the share going to industry and tourism was a mere 9.68 percent. The data seem to suggest that the productive sectors of the economy in Grenada were not well fed with financing from the Grenada Development Bank. See Tables 4 and 5 below.

TABLE 4

GRENADA DEVELOPMENT BANK SECTORAL LOAN APPROVAL 1994-2005

(EC$ MILLION)

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Agriculture & Fisheries	0.34	0.21	0.03	0.08	0.49	0.26	0.78	0.26	0.16	0.11	0.20	0.21
Housing	0.50	0.48	0.05	0.55	2.01	1.89	1.60	0.58	0.58	0.47	0.47	1.41
Education	0.78	0.53	0.26	0.73	1.84	1.83	2.10	2.81	0.90	2.23	2.23	2.15
Industry & Tourism	1.11	0.31	0.10	0.15	0.29	0.37	0.17	0.26	0.19	0.04	0.40	0.14
Total Loan Approvals	2.73	1.53	0.44	1.51	4.63	4.35	4.65	3.91	1.83	2.85	3.30	3.91

TABLE 5

GRENADA DEVELOPMENT BANK SECTORAL LOAN DISBURSEMENT 1994-2005

(EC$ MILLION)

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Agriculture & Fisheries	0.44	0.20	0.04	0.08	0.12	0.29	0.73	0.40	0.20	0.15	0.07	0.11
Housing	0.47	0.44	0.05	0.55	1.57	1.35	1.67	1.46	0.82	0.39	0.35	1.41
Education	0.60	0.38	0.26	0.73	0.90	1.03	1.57	1.93	1.50	1.81	1.84	2.75
Industry & Tourism	0.00	0.51	0.10	0.15	0.27	0.29	0.18	0.21	0.19	0.03	0.09	0.58
Total Loan Disbursements	1.51	1.53	0.45	1.51	2.86	2.96	4.15	4.00	2.71	2.38	2.35	4.85
Total Disbursement to Total Approval	55.42	100.26	102.27	100.00	61.77	68.05	89.25	102.30	148.09	83.51	71.21	124.04

Sources of funds

Historically, both Development Banks obtained most of their resources from the Caribbean Development Bank (CDB) and the European Investment Bank (EIB). In the case of the Saint Lucia Development Bank, (which has subsequently merged with National Commercial Bank of Saint Lucia to form the National Bank of Saint Lucia) funds are no longer sourced from the CDB primarily out of cost considerations. The bulk of the funds are now obtained from own source through deposits from the public.

In the case of the Grenada Development Bank, since 1997 the CDB suspended the disbursement of funds because of poor performance of the Bank. An additional source of funding for the Grenada Development Bank is the National Insurance Scheme in Grenada. Unlike the Saint Lucia Development Bank, the Grenada Development Bank is not statutorily permitted to accept funds from the general public in the form of deposits. The table below indicates the funds contracted and drawn-down by the Grenada Development Bank over the period 1990 to 1996.

TABLE 6
GRENADA DEVELOPMENT BANK: FUNDS CONTRACTED & DRAWDOWN 1990 -1996

	Contracted	Drawdown
EIB	ECU 3.9 M	EC$13.2M
NIS	EC$ 6.94M	EC$ 6.9M
CDB		EC$20.2M

Occasionally, and depending on loan agreements, the Development Banks may receive an injection of funds from the respective government. But historically, this source of funding has proven to be not as reliable as the Development Banks would have liked them to be. The unreliable character of funds from the governments is primarily a result of fiscal constraints. In many cases funds sourced from government are received by the Development Banks with a long time lag making it difficult to execute their operational plans in an effective manner. The late receipt of funds from the government is sometimes accompanied by a change in the initial risk conditions and the extent to which the Development Banks adjust for this changed risk conditions are unclear.

Importance of development banking in the financial sector

Financial intermediation in Saint Lucia and Grenada is dominated by commercial banks. The vast majority of financial assets and financial liabilities are held by commercial banks. In addition, the total volume and value of loans disbursed and outstanding as well as the sectoral distribution of loans originating from the commercial banks outweigh those originating from the Development Banks. Commercial banks are followed by the non-bank financial institutions of insurance companies and credit unions.

In the case of Saint Lucia, available data indicate that over the period 1992 to 2001 the average assets held by the Saint Lucia Development Bank amounted to EC$M127.74 while those held by the commercial banks in Saint Lucia totaled EC$B1.65. The Development Bank's holding of assets constituted a mere 0.008 percent of the total assets held by the commercial banks. If the assets of other financial institutions were to be included the relative insignificance of the Saint Lucia Development Bank would be more glaring.

Despite the significantly lower level of assets held by the Saint Lucia Development Bank relative to those held by the commercial banks, the average growth in assets of the Development Banks over the same period was twice as high as that of the commercial banks. The average growth of the Saint Lucia Development Bank's assets over the period was 15.83 percent, compared with an average growth of 7.96 percent achieved by the commercial banks. Of course, since the absolute level of assets of the Development Bank is so small this impressive growth record does not add any significance to the Development Bank as a player in the financial system in Saint Lucia. See Table 7 below.

TABLE 7
ASSETS: SLDB & SAINT LUCIA'S COMMERCIAL BANKS. 1993-2001

	SLDB Assets EC$M	Growth in SLDB Assets	Commercial Banks' Assets EC$M	Growth in Commercial Banks' Assets	SLDB Assets Relative to Commercial Banks Assets
1992	57.50		1 094 218.00		0.005
1993	49.40	-14.09	1 176 579.00	7.53	0.004
1994	84.10	70.24	1 212 928.00	3.09	0.007
1995	97.40	15.81	1 333 079.00	9.91	0.007
1996	119.30	22.48	1 461 799.00	9.66	0.008
1997	129.20	8.30	1 576 688.00	7.86	0.008
1998	140.60	8.82	1 771 264.00	12.34	0.008
1999	165.60	17.78	1 971 024.00	11.28	0.008
2000	173.20	4.59	2 057 817.00	4.40	0.008
2001	190.90	10.22	2 328 096.00	13.13	0.008
Average	127.74	15.83	1 654 363.78	7.96	0.008

In Grenada the situation is not dissimilar; indeed it is worst. The average assets held by the Grenada Development Bank over the period 1994 to 2005 was EC$M33.1, while commercial banks' assets holding over the same period averaged EC$B1.39. Over the same period, the growth in assets of the Grenada Development Bank was negative 2.61 percent while that of the commercial banks was 11.37 percent. The assets of the Grenada Development Bank relative to those of the commercial banks were a paltry 0.002 percent. See Table 8 below.

TABLE 8
ASSETS: GDB & GRENADA'S COMMERCIAL BANKS. 1994-2005

	GDB Assets EC$M	Growth in GDB Assets	Commercial Banks' Assets EC$M	Growth in Commercial Banks' Assets	GDB Assets Relative to Commercial Banks Assets
1994	36.22		712 782.00		0.005
1995	35.02	-3.31	776 124.00	8.89	0.005
1996	37.65	7.51	866 643.00	11.66	0.004
1997	37.65	0.00	971 070.00	12.05	0.004
1998	30.26	-19.63	1 085 930.00	11.83	0.003
1999	28.84	-4.69	1 236 707.00	13.88	0.002
2000	28.76	-0.28	1 387 101.00	12.16	0.002
2001	25.77	-10.40	1 566 542.00	12.94	0.002
2002	25.01	-2.95	1 725 590.00	10.15	0.001
2003	25.41	1.60	1 841 205.00	6.70	0.001
2004	26.55	4.49	2 309 645.00	25.44	0.001
2005	26.96	1.54	2 237 879.00	-3.11	0.001
Average	33.10	-2.61	1 393 101.50	11.37	0.002

Loans disbursed in the economies as a whole are primarily from the commercial banks. When outstanding loans of the Development Banks are compared with outstanding loans of the commercial banks the magnitude of the formers' relative insignificance in the financial system becomes clearer. In the case of Saint Lucia, the outstanding loans of the Saint Lucia Development Bank remained flat at 0.02 percent of the total outstanding loans held by the commercial banks over the period 1993 to 2001.[9] It should be noted that the total loans of the commercial banks include sectors in which there is little or no Development Banks lending activity. More on the sectoral distribution of loans of the Development Banks were provided before under sectoral lending. See tables 3, 4 and 5 above.

The commercial banks are indeed unlike the Development Banks. As such, the commercial banks offer a range of services that are not offered by the Development Banks. And, where the statute allows the Development Banks to engage in some of the activities undertaken by the commercial banks, the Development Banks are either not engaged in the provision of those services or are doing so at a noticeable low level.

While the importance of the Development Banks in the financial system is relative low in terms of standard indicators (for example, assets, and range of products) they may hold the distinct tribute of providing financing to enterprises and households that would have otherwise been rationed out of credit by the commercial banking system. Qualitatively, the Development Banks would have been serving a purpose that the commercial banks were not necessarily willing to provide. Indeed, the very statue establishing the Development Banks sets them apart from the commercial banks and the Development Banks may need to be judged in a manner that is not entirely identical to how commercial banks are normally judged.

The direct quantitative participation of Development Banks in the process of industrialization is always a subject of debate. But their qualitative contribution has been commonly recognized and according to Diamond, "probably the aggregate resources provided by the development banks have been small, but the fact that there were made available at particular times for strategically important enterprises and industries gave them significance far greater than the amounts involved suggested".[10]

This general observation of Diamond may not be directly applicable to the Saint Lucia Development Bank and the Grenada Development Bank in the traditional sense in which "enterprises and industries" are conceptualized. Indeed, most of the loans approved and disbursed by the two institutions went to education and education. Nonetheless, it would appear that by whatever standards they are judged, the Development Banks in the Eastern Caribbean have been relatively insignificant compared with other financial institutions, in particular commercial banks. At the same time the Development Banks, by their relative small size, would appear to be ineffective in attenuating the consequences of economic development. There is no evidence to suggest that they would have played any role in smoothening out the effects of economic cycles in both Grenada and Saint Lucia.

[9] The use of loans outstanding should be taken with a degree of caution. While it may indicate the magnitude of lending, the value of accumulated outstanding loans may be influenced by the untimely and/or non-repayment of loans. Even if the year to year difference between loans outstanding is taken this may still not be totally satisfactory as that difference would be influenced by the same factors. The ideal statistic would therefore be actual loans disbursed. However, such data were not available foe commercial banks.

[10] William Diamond (1957). Development Banks. The Economic Development Institute, IBRD, Johns Hopkins University Press, Baltimore, Pg. 38-39.

Structure of the organisations

Grenada

Despite being called by different names over time and with varying sub-units, three divisions typify the structure of the Grenada Development Bank. There is the Personnel and Administration Division which deals with, as the term suggests, personnel and administrative matters. This Division is primarily responsible for the management of the human resources of the Bank, including all staff matters and the provision of administrative support. The latter includes office operations and procedures, and record keeping for the effective management of the Bank.

The Finance and Information Technology Division, the second Division, has the responsibility for managing the finances, information flows and the technology in use at the Bank. This Division handles all financial transactions of the Bank including those related to the providers of funds and those related to the clients of the Bank. All disbursements to clients, repayments on loans and the management of clients' accounts are the responsibilities of this Division. Similarly, the Bank's financial relationship with institutions providing it with financing falls under the portfolio of this Division. It is also responsible for capturing information and the generation of internal accounts for the review of management and the Board of Directors. It is instructive to note that the Grenada Development Bank was without an internal auditor for a number of years.

Finally, there is the Credit and Business Development Division which has responsibility for the core business of the Bank, i.e., lending. This Division seeks out new businesses with a view to expanding and diversifying the portfolio of the Bank. It is with this Division that potential clients come into first contact with the Bank. The Division provides a first screen for applicants wishing to access the resources of the Grenada Development Bank. Personnel in the Division, in particular Project Officers, conduct an initial appraisal of all projects seeking the financial support of the Bank. On the basis of its findings the Division forward its recommendations to the appropriate entity depending on the size of the funding requested by a project.

Apart from those three divisions a Small Enterprise Development Unit (SEDU) was established as an arm of the Grenada Development Bank in 1988. Its aim is to provide management, technical and ancillary support to existing and potential micro and small businesses"[11] SEDU of the Grenada Development Bank, in attempting to fulfill its functions, has been engaged in a number of training activities related to business operations; e.g., custom brokerage, customer service, financial management, small business management and project appraisal, among others. The SEDU was however removed from under the umbrella of the Grenada Development Bank and placed under the authority of the Grenada Industrial Development Corporation from August of 2006.

The organizational structure of the Saint Lucia Development Bank was very similar with respect to divisional lines although the divisional names may have been different. The functions performed were however identical. Since the merger of the Saint Lucia Development Bank with the National Commercial Bank of Saint Lucia, the structure of the then Saint Lucia Development Bank was apparently abandoned. The operations performed by the Saint Lucia Development Bank are now performed by the development banking division of the National Bank of Saint Lucia.

Besides, and similar to the SEDU of the Grenada Development Bank, a Small Business Assistance Programme (SBAP) was established within the Saint Lucia Development Bank, in December of 1988, with financial assistance from the then National Commercial Bank of Saint Lucia. The objective of the SBAP was the advance the development of micro-businesses in Saint Lucia. The funds thus provided by the National Commercial Bank of Saint Lucia were to provide loans of a concessional nature, grants, and technical assistance to eligible applicants. However, the criteria for determining eligible applicants were not entirely clear.

The divisional set-up of the Development Banks was simply of a traditional institution where finance was the core business. It would appear that the configuration may have contributed to some of the difficulties experienced by the Banks, especially the Grenada Development Bank. More would be said on this in the discussion of new directions for the Development Banks.

[11] Small Enterprise Business Development Unit: 2005 Activities. Pg. 2.

Governance and the nature of government control

Structurally, there are three tiers to the governance of the Development Banks. At the highest level there is the Minister of Government responsible for the Development Banks (invariably the Minister of Finance). At the institutional level proper there are the Board of Directors and the management, i.e., management in the sense of day-to-day operations.

The powers of the Minister are wide ranging. In both cases of Saint Lucia and Grenada the statute makes provision for the Minister to give general policy directions to the Development Bank. According to the Saint Lucia Development Bank Act 1981, Part II(10)(1), "in the exercise of its powers and discharge of its functions the Corporation shall conform with any general directions on matters of policy given to it by the Minister". Similarly, under Part II(11)(1) of the Grenada Development Banks Act 1976, "the Minister may, after consultation with the chairman, give the Board such directions of a general character as to the policy to be followed by the Bank in the exercise and performance of its function as appears to the Minister to be necessary in the public interest". In both cases, therefore, the Minister has the authority to give policy directions to the Bank.

The practical potential problem raised by this power of the Minister could be in the degree to which the direction given is sufficiently general so as not to encroach on the functioning of the Board and Management of the Banks. What in some cases may be considered a general direction by the Minister may not necessarily be so considered by the Board and/or Management. Where this difference of opinion arises there is almost sure to be governance conflict. Indeed, in the case of Grenada, the Act goes a step further and provides, under Part II(11)(3), that the power of the Minister to give directions to the Board shall include power to give direction whether of a general or *specific* character as to the exercise by the Bank of its borrowing function". (Emphasis added).

This aspect of governance and the systemic possibility for governance conflict can be more real as the Minister has the power of appointment in respect of some of the Board members and the senior management on the Bank. In the case of Grenada, approval of the Minister is required for the appointment and employment by the Board of "a secretary, and any such officers, employees and agents as may be necessary for the proper performance of its function". Furthermore, the Minister may at any time revoke the appointment of a director if he considers it expedient to do so …".[12] Similar provisions exist in the case of the Saint Lucia Development Bank.[13] And, the Minister has the power to determine the level of remuneration, if any, of the chairman and other directors of the Board".[14] The same applies in the case of Saint Lucia.

The power of the Minister is further extended in a very crucial manner in the case of both Development Banks. This further extension of power relates to the ability of the Minister to make further regulations affecting the core operations of the Banks. The Minister's power is extended to make regulations concerning, among others, additional purposes for which loans can be made, the maximum amount for which various categories of loans may be granted, the persons or bodies to whom loans may be made, methods of disbursement or the securing of loans, the period of repayment and matters generally for carrying out the objectives and purposes of the Act establishing the Banks.[15] Many of these are what can be considered pure managerial functions of the Board and/or management proper.

Generally, the Board of Directors is responsible for "the policy and general administration of the affairs of the Bank".[16] It should be recalled that the Minister has the power to provide the Bank with policy directions. There could therefore be fertile ground for governance conflict. In the case of the Grenada Development Bank, the Board of Directors are statutorily obliged/under a duty "to ensure that every application dealt with on behalf of the Bank is considered principally on its financial and economic merit", and it is "to take all such measures as may be necessary to ensure that financial assistance granted by the Bank to a development enterprise is utilized for the purpose for which it is given".[17]

For both Development Banks, provisions are made for the proper keeping of records and the generation of audited accounts on an annual basis. The standard of accounting should, according to statute, conform to the best commercial standards. But, further to that, the Minister has the discretionary power under the statute establishing both Development Banks to cause the Government Auditor to examine and report on the accounts of the Development Banks. Related to the issue of accounts, both Development Banks are statutorily obliged to provide the Minister by an annual report and audited accounts on the operations of the Bank. The Minister is then in turn obliged to have those laid before Parliament.

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[12] The Grenada Development Bank Act 1976, First Schedule Article 6.
[13] Saint Lucia Development Bank Act 1981, Part II (3)(8).
[14] Grenada Development Bank Act 1976, First Schedule, Article 11.
[15] See The Saint Lucia Development Bank Act 1981, Part V,(30)(1), and the Grenada Development Bank Act 1976, Part II(29).
[16] This is with respect to what is statutorily provided for in the Grenada Development Bank Act 1976. See the First Schedule to the Act.
[17] Grenada Development Bank Act 1976, Part II (4) (2) (a) & (b) respectively.

Annual report and accounts shall be tabled in Parliament; and shall be published in such a manner as the minister may direct and shall be made available to the public by the Development Bank. See the Grenada Development Bank Act 1976, Part II (18) (2) (3). While this is statutorily the case it may not be entirely incorrect to say that the annual reports of the Development Banks do not reach the public; and where and when they do, they need not be in a timely and accessible manner in which the public can use. Indeed, the general public is not fully aware of the operations of the Development Banks. Nonetheless, the publication of the annual reports and the audited accounts can be viewed as a measure of transparency in the governance of the Development Banks.

There is also statutory provision prohibiting the Grenada Development Bank from investing or conducting any business transactions in which a Board member has an interest unless it is unanimously approved by the directors of the Bank.[18] Further, when a proposal comes before the Bank a director with any direct or indirect interest in such proposal is under an obligation to disclose his/her interest and is statutorily barred for participating in the deliberations connected with the proposal.[19]

On the face of the Saint Lucia statute it is not entirely clear whether similar provisions exist to avoid what could be conflict of interest at the level of the Board of Directors. There is also no discernible delineation, whether of a general or specific nature, of the role and functions of the Board. If the role and functions of the Board are not indicated then there could be a basis for conflict in the governance of the Bank. Conflict, in the absence of such indicators, could be between the Board and the Minister as well as between the Board and the management of the Bank. Indeed, such conflicts, which may in part be as a result of the absence of such demarcation, are not unheard of; expressing themselves ultimately in the form of “quiet resignations” in the nature of “a public secret”.

Despite the statutory provisions giving the Minister vast powers over the operational direction of the Development Banks, government control appears to no more than the control exercised by shareholders of any company. It appears not to be the case that there is direct and overt direction given to the Board and/or management by the political directorate. There is certainly no documented instance of this that was revealed. However, there is always the possibility that the political directorate would seek to influence decisions of the Development Banks through the exercise of influence over members of the Board of Directors and senior management given the statutory power the Minister has over their tenure. This is more so as the governments provide funds and guarantees to the Development Banks.

Where this is the case, officials of the Development Banks see this as no different from a CEO of a parent company seeking to influence the decision of a local manager. Further, Development Banks officials suggest that it has not been the case where a decision on loan application was made under duress of the political directorate. Rather, in the face of any kind of political influence, the operational procedures of the Development Banks with respect to loan awards are not by-passed to the detriment of sound business practices.

While this may be the case there is the obvious possible control which can be exercised by Government through its control over the appointment of members of the Board of Directors as well as its role in the appointment of senior managers of the Development Banks. It is not an uncommon view that serving on the Board of parastatal institutions in the Eastern Caribbean are for many a source of revenue enhancement dispensed by the political directorate. Knowing that that source of income can be taken away by the political directorate is no great comfort in the exercise of totally independent judgment in the face of attempted political interference. In the final analysis, it should be observed that as the sole “owner” of the Development Banks, it would be unlikely that there would be no influence exerted by the political directorate. This is even more so in a context where the Development Banks were established to assist in the prosecution of the developmental agenda of the governments.

[18] Ibid, Part II (4) (3). The interest of a director could be in the nature of partnership, director or shareholder, or any other direct or indirect interest.

[19] Ibid, Part II (4).

Instruments and associated policy

Instruments

The underdeveloped nature of the Development Banks in the Eastern Caribbean is such that the dominant, if not only, financial instrument used is loans. This is despite the fact that statutorily there is the possibility of using other instruments. One possible explanation could be in the purposes for which the Development Banks were established. But, whatever the reason, it is clear that such a situation should not be allowed to continue if the profitability, and consequently the effectiveness, of the Development Banks is to be assured.

As a loan is the principal financial instrument used by the Development Banks elaborate provisions are made to secure the loans they would have granted. This is understandable, as with no other instruments at their disposal, the Development Banks have to properly secure this asset more so than ever. The various associated policies for loans under the different lending heads of the Development Banks will be examined. The focus will be on the Saint Lucia development Bank but those related to the Grenada Development Bank are not fundamentally different to warrant separate treatment given the scope and space of the study.

For the Saint Lucia Development Dank development credit is considered to be financing to create or expand productive and social capacity or asset which can lead to tradable output, employment, foreign exchange earnings and essential social services. It does so through the provision of medium and long term financing to

facilitate production and trade for small unincorporated businesses; although short-term financing are also given consideration. This includes loans for productive purposes to self-employed persons. The sectoral coverage of the Bank's activity includes agriculture and fisheries, agro-processing, industry, tourism and ancillary services, distribution and commerce.

Sectoral associated policies

Agriculture and fisheries

The objective is to contribute to the growth and sustainability of agriculture and fisheries in Saint Lucia through finance and technical support to farmers and fishermen. In the case of agriculture, this support is granted to agricultural enterprise, defined as enterprises engaged in crop and livestock production, while fishing enterprises are defined as those engaged in fishing culture. The support for agriculture is also extended to the following:

- The purchase and/or manufacturing of farm machinery and equipment, and agricultural chemicals.
- The construction, renovation or repair of farm building.
- Soil conservation measures (terracing, contour drainage and afforestation).
- Irrigation and drainage.
- The construction and repair of on-farm roads.
- Storage, packaging, and marketing of agricultural produce.
- Land purchase as part of an agricultural enterprise.

In the case fishing, support is extended to activities involving:

- The packaging and canning of fish and fish products.
- The purchase of boats, marine engines and equipment for fishing.
- Repairs of boat, marine engines and fishing equipment.
- Storage for fish marketing.
- Aquaculture.

Industry/Tourism

For this sector an industrial enterprise is defined as one engaged in manufacturing, assembling, installing, overhauling, reconditioning, altering, repairing, cleaning, packaging, canning, transporting and warehousing of goods. And, tourism enterprises are considered to be those engaged in the purchasing, development and supply of hotel rooms and all other accommodation and facilities intended to meet the demand of visitors to Saint Lucia.

General terms and conditions

- Minimum Equity Contribution
  - Hotels: fifty percent of the total cost but the value of the land may account for a maximum of twenty percent of the required equity.
  - Villas and Condominiums: fifty percent of the land and building cost.

- Other tourism projects: thirty percent of the total project cost but the value of land may account for a maximum of twenty percent of the required capital.
- Industry: thirty percent of the project cost but the value of land may account for a maximum of twenty percent of the required equity.
- Services: thirty percent of the total cost of the project but land may account for a maximum of twenty percent of the required equity.
- Land development: fifty percent of the total project cost but land may account for twenty percent of the required equity.
- Distributive trade: thirty percent of the total project cost.

- Loan Term

The loan term depends of the projected cash flow and project life. The Bank will therefore make an assessment based on those two factors, and other considerations, and determine the loan term on a case by case basis. However, the maximum term is fifteen years. In the specific case of land development projects, eighty percent of the sales proceeds of lots should be used for loan repayment and the maximum loan period is no more than five years.

- Grace Period

Generally, on projects requiring implementation before the generation of revenue, the length of the grace period depends on the period of implementation and the promoters' financial capability. However, the grace period, under normal circumstances, does not go beyond two years. Interest is payable during the grace period but the loan proposal may include the capitalization of the required interest payment during the grace period. Fees and charges may be includes in the loan agreement but the Bank encourages applicants to cover those costs separately and out of their own resources.

- Security

For security purposes the following instruments are used: (a.) hypothecary obligation; (b). mortgage debenture; (c). bill of sale; (d). cash collateral; (e). personal guarantee; (f). cash surrender value of insurance policy; (g). assignment of shares, bonds etc.

When land and building are used the accepted value for security purposes is sixty-six percent of the market value as appraised by the Bank's approved evaluator. If equipment is offered then fifty percent of the invoiced purchase price is used assuming the equipment in question is new. If the equipment is not new then there would be a professional evaluation which would take into account its age, condition, capacity and expected life. Where a bill of sale is used the loan term would not be more than five years or the expected life of the equipment, whichever is shorter.

- Land Development Project

Where the project is of a land development character there must be evidence of title (deed of sale), an approved development plan, including houses and feasibility study with cash flow. The project must also be of a marketable quality as evidenced by location and a pricing level which is within the reach of the targeted income group of the project. A valuation and bill of quantities must be prepared by approved professionals in the fields and the cost must be assumed by the client.

Where a hypothecary obligation has been taken on the property to be developed, the proceeds of lots sold are applied to the liquidation of the loan and the obligation is released over the respective lots. The usual assignment is for eighty percent of the proceeds to be used for loan repayment. There is usually the requirement that the developer has a secondary source of funds for repayment in the event

that the lots are not sold within the anticipated time frame. Such conditions are written into a commitment letter which the client signs.

- Student Loans

The student applicant must be a Saint Lucian national, be over sixteen year and resident in Saint Lucia at least one year prior to applying for the loan. The student applicant must be enrolled in an educational institution which must be accredited by an authorized accreditation body. The student applicant is expected to contribute twenty percent of the cost of the programme of study. The preference of the Bank is for the student applicant to attend a regional institution. However, the student applicant can be granted the loan to attend an educational institution outside of the region if certain conditions are met. Such conditions include the following:

- There is no place in a regional institution.
- The student applicant cannot satisfy the entry requirement to a regional institution.
- The cost of attending the educational institution outside the region is substantially less than the cost of attending a regional educational institution.
- The course of study to be pursued by the student applicant is not offered by a regional educational institution.
- The student applicant may have already done a large part of the course of study in an educational institution outside of the region.

The value of the loan granted for educational purposes varies according to the course of study. The student applicant is expected to contribute twenty percent of the cost of study. The Bank will therefore finance up to eighty percent of the programme. This contribution of the Bank appears to be further constrained by the maximum size of the loan the Bank can grant depending on the course of study.[20] From the schedule, it would appear that the fields and the respective maximum resource allocation need t be adjusted. Specific allocations should be made for technological and vocational training in the fields of computing, information technology and management information systems.

In general the conditions attached to the loans offered by the Development Banks are not substantially less onerous than those attached to loans offered by the commercial banks for similar purposes. However, in the case default, there is the tendency on the part of the development Banks to be less swift and stringent in calling-in the associated collateral. There is the argument that influencing to Development Banks posture is this regard is the political sensitivity of acting in such a manner. Needless to say, the viability of the development Banks will be affected by the extent of the validity of the argument. What appears to be generally true is that the Development Banks do have greater difficulties in realizing collateral attached to some of their loans.

[20] The limits on Bank loans for educational purposes are as follows:
For bachelor degrees, medicine, architecture, and law a maximum of EC$120,000.0.
For professional courses, engineering, surveying, a maximum of EC$100,000.0
For other courses of study a maximum of EC$87,000.0
For master's degrees, in all fields, a maximum of EC$87,000.0
For associate degrees in engineering, quantity surveying and architecture a maximum of EC$60,000.0. Any other such degree will be funded to a maximum of EC$50,000.0.
All certificates or diplomas will be funded to a maximum of EC$40,000.0

Performance of the development banks

Solvency

The first concern with solvency would give us an idea of whether the Development Banks have a long-term future. In attempting to access the solvency of the Development Banks one can look to see if their total assets exceed their total liabilities. This would give a sense of the net worth of the Development Banks. Net worth is an absolute measure of solvency. If the value of the Banks' assets exceeds their liabilities – a positive net worth – then they are solvent. While net worth gives an absolute sense of solvency, it does not indicate how vulnerable the Banks are to changing economic and financial conditions. For example, one of two Banks with the same net worth could be more vulnerable than the other. A relative measure of solvency in the form of assets to liabilities ration would be called for. An analysis of Banks assets and liabilities will therefore begin the discussion of the performance of the Development Banks.

Over the period 1982 to 2001 the assets of the Saint Lucia Development Bank consistently exceeded its liabilities. On average, over the period assets amounted to EC$M74.58 while liabilities averaged EC$M60.51 over the same period giving an average difference of EC$M14.08. The average growth in assets of the Saint Lucia Development Bank was 14.3 percent, while its liabilities grew by 14.4 percent over the period. This meant that the Saint Lucia Development Bank consistently showed a positive net worth over the

period and consequently remained solvent. There was therefore little question as regards its long-term future as a financial institution. However, if the trend in the growth of liabilities relative to assets, especially so if the growth in liabilities outpaces the growth in assets, were to continue then eventually there could be the possibility of insolvency raising its head. Since the merger of the Saint Lucia Development Bank with the National Commercial Bank of Saint Lucia, separate data on the operations of the development banking section of the National Bank of Saint Lucia were not readily available so as to allow for a determination of the trend in assets and liabilities growth since 2001. See table 9 below.

Using assets and liabilities, solvency can also be looked at from the point of view of the assets relative to the liabilities. This ratio shows the extent to which the assets of the Development Banks can cover their liabilities, i.e., how much of the Banks' liabilities are covered by their assets. The assets to liabilities of the Saint Lucia Development Bank were, on average over the period 1982 to 2001, 1.25. This meant that there was a one dollar and twenty-five cents cover for every dollar of liability held by the Saint Lucia Development Bank. Thus, should all creditors have called on the Bank, it would have been able to meet their demands. At no time over the period did the liability cover of the Saint Lucia Development Bank fell below one.

TABLE 9

SAINT LUCIA DEVELOPMENT BANK: ASSETS & LIABILITIES EC$M 1982 - 2001

Year	Assets. EC$M	Liabilities. EC$M	Difference. EC$M	Assets Growth	Liabilities Growth	Assets to Liabilities
1982	15.4	12.3	3.1			1.25
1983	17.9	14.1	3.8	16.23	14.63	1.27
1984	19.9	15.1	4.8	11.17	7.09	1.32
1985	21.7	16.4	5.3	9.05	8.61	1.32
1986	26.2	19.6	6.6	20.74	19.51	1.34
1987	30.2	23.9	6.3	15.27	21.94	1.26
1988	32.9	26.4	6.5	8.94	10.46	1.25
1989	37.8	29.4	8.4	14.89	11.36	1.29
1990	42	33.8	8.2	11.11	14.97	1.24
1991	49.4	40.8	8.6	17.62	20.71	1.21
1992	57.5	47.9	9.6	16.40	17.40	1.20
1993	49.4	40.8	8.6	-14.09	-14.82	1.21
1994	84.1	69.9	14.2	70.24	71.32	1.20
1995	97.4	80.9	16.5	15.81	15.74	1.20
1996	119.3	99.1	20.2	22.48	22.50	1.20
1997	129.2	105.2	24	8.30	6.16	1.23
1998	140.6	112.2	28.4	8.82	6.65	1.25
1999	156.6	126.4	30.2	11.38	12.66	1.24
2000	173.2	141.1	32.1	10.60	11.63	1.23
2001	190.9	154.8	36.1	10.22	9.71	1.23
Average	74.58	60.51	14.08	14.26	14.41	1.25

The situation with the Grenada Development Bank contrasts sharply with that of the Saint Lucia Development Bank. Available data from 1994 to 2004 indicate that the Grenada Development Bank was practically insolvent for most of the period save and except two years. Over the period, the average assets of the Grenada Development Bank totaled EC$M33.1 while its liabilities averaged EC$M33.83, giving an average difference of negative EC$M0.73. There was a gradual, but consistent erosion of the assets of the Grenada Development Bank over the period. Assets moved from EC$M36.22 in 1994 to EC$M26.96 in 2005. Indeed, asset growth over the period was negative (2.73) while liabilities growth displayed the same downward trend (2.97). By the close of the financial year 2005 the Grenada Development Bank had a negative net worth and was practically insolvent. See table 10 below. It should be noted however, that since then, i.e., the end of 2005, the Government of Grenada has injected (in three installments) a total of EC$M8.5 during 2006, thereby helping the Grenada Development Bank to stay afloat.

In terms of its assets relative to its liabilities, the Grenada Development Bank had an average liability cover of 0.99. In seven of the ten year period the Bank was unable to cover its liabilities with its assets. In the other five years it was marginally in a position to cover its liabilities with its assets. See table 10 below. Should there have been a situation where all creditors to the Bank had called-in on the Bank then it would not have been in a position to satisfy them and may very well have had to be wound-up.

TABLE 10
GDB ASSETS & LIABILITIES 1994-2005 EC$M

Year	Assets EC$M	Liabilities EC$M	Difference. Assets-Liabilities EC$M	Assets Growth	Liabilities Growth	Assets to Liabilities
1994	36.22	40.96	-4.74			0.88
1995	35.02	39.66	-4.64	-3.31309	-3.17383	0.88
1996	37.65	34.79	2.86	7.509994	-12.2794	1.08
1997	37.65	32.17	5.48	0	-7.5309	1.17
1998	30.26	30.37	-0.11	-19.6282	-5.59528	1.00
1999	28.84	31.04	-2.2	-4.69266	2.206124	0.93
2000	28.76	30.61	-1.85	-0.27739	-1.38531	0.94
2001	25.77	28.30	-2.53	-10.3964	-7.54655	0.91
2002	25.01	26.72	-1.71	-2.94917	-5.58304	0.94
2003	25.41	26.32	-0.91	1.59936	-1.49701	0.97
2004	26.55	25.20	1.35	4.486423	-4.25532	1.05
2005	26.96	25.95	1.01	1.544256	2.97619	1.04
Average	33.10	33.83	-0.73	-2.37	-3.97	0.99

Another approach to the issue of solvency is to examine the interest cover of the Development Banks. The interest cover is measured by the ratio of profit before interest expenses to interest expense. This measure would be of particular analytic value as the Development Banks' business is primarily of a financial nature where interest payments are of central consideration. What is examined here is whether or not the Development Banks are able to meet their interest obligations, as they fall due, out of profits generated from their operations. In turn, the interest cover measure would give an indication of whether or not the Development Banks can afford the level of gearing they have committed themselves to and consequently, over time, if they can continue to stay in business.

An analysis of the Saint Lucia Development Bank over the period 1982 to 2001 suggests that in the first four years of the period under consideration the Bank was unable to meet its interest payments out of profit before interest. It could have honoured 81.0 percent of its interest

obligations during those four years. Thereafter, the performance of the Bank turned and it began to generate enough profit before interest to cover its interest obligations. This positive performance since 1986 led to an overall average interest cover over the entire period of 1.2 times. See table11 below.

While it was covering its interest payments the trend was not as strong as it probably should have been for the Saint Lucia Development Bank. Given the line of business the Bank is engaged in, a stronger posting should be expected in light of the level of risk associated with lending; i.e., the associated credit risk. There is the view that, given the nature of the business, the interest cover of the Development Banks should be a least three times; i.e., the generated profit before interest should be able to cover interest expenses three times. If that is use as a "prudential" measure then the performance of the Saint Lucia Development Bank would have to be considered as less than prudential. Over the period, after the discharge of its interest obligations, little would have been left to support the Bank's development.

TABLE 11
SLDB: PROFIT BEFORE INTEREST EXPENSE TO INTEREST EXPENSE

Year	Interest Expense. EC$M	Profit Before Interest EC$M	Profit Before Interest Expense to Interest Expense. (Times)
1982	0.68	0.61	0.90
1983	0.69	0.63	0.91
1984	0.75	0.70	0.93
1985	0.91	0.45	0.49
1986	1.01	1.19	1.18
1987	1.31	1.56	1.19
1988	1.51	1.92	1.27
1989	1.45	2.07	1.43
1990	1.42	1.64	1.15
1991	1.76	2.24	1.27
1992	2.11	2.15	1.02
1993	2.77	3.32	1.20
1994	3.40	4.04	1.19
1995	3.77	4.04	1.07
1996	4.40	6.67	1.52
1997	5.20	7.72	1.48
1998	5.48	8.04	1.47
1999	6.05	7.88	1.30
2000	6.66	10.75	1.61
2001	7.72	11.29	1.46
Average	2.95	3.95	1.20

Interest expense is met from cash flow generated during the accounting period. As such, it may be useful to examine the cash interest cover of the Development Banks, in addition to the pure interest cover as was done immediately above. The cash interest cover is measured as a ratio of the operating cash flow to interest expenses. This would provide an indication of how much of the development Banks' operating cash flow is going to the payment of its interest obligations.

Over most of the period the operating cash flow of the Saint Lucia Development Bank was negative. Indeed, it was negative from 1990 to 2001. In the three years immediately before 1990 the Bank was unable to generate enough cash flow to cover its interest expenses, while during the period 1982 to 1986 it generated cash flows that would have allowed it to cover its interest expenses

approximately four times (3.9). Evidently, the Bank's cash flow was not that strong and exhibited a degree of volatility over the entire period; i.e., 1982 to 2001. Over the period as a whole the average cash flow outturn (of negative 0.22) was such that the Saint Lucia Development Bank could not have covered its interest expenses out of cash flows. See table 12 below.

TABLE 12
SLDB: OPERATING CASH FLOW TO INTEREST EXPENSE

Year	Interest Expense. EC$M	Operating Cash Flow. EC$M	Operating Cash Flow to Interest Expense
1982	0.68	1.47	2.16
1983	0.69	1.64	2.38
1984	0.75	4.48	5.97
1985	0.91	3.93	4.32
1986	1.01	4.62	4.57
1987	1.31	0.49	0.37
1988	1.51	0.95	0.63
1989	1.45	0.83	0.57
1990	1.42	-2.96	-2.08
1991	1.76	-6.13	-3.48
1992	2.11	-9.18	-4.35
1993	2.77	-11.92	-4.30
1994	3.40	-7.11	-2.09
1995	3.77	-8.31	-2.20
1996	4.40	9.07	2.06
1997	5.20	-13.66	-2.63
1998	5.48	-6.99	-1.28
1999	6.05	-13.83	-2.29
2000	6.66	-7.26	-1.09
2001	7.72	-12.76	-1.65
Average	2.95	-3.63	-0.22

In the case of the Grenada Development Bank, over the period 1994 to 2005, profit before interest expense to interest expense averaged 0.20. The Bank was therefore in a position to meet only 20.0percent of its interest obligations from profit before interest. In four consecutive years (1996 to 1999) there was a negative profit before interest and as such it was practically unable to meet its interest obligations. It was only in two years, 2004 and 2005, that the Grenada Development Bank turned in a profit before interest that would have allowed it to cover its interest payment. If the suggested prudential guide for interest coverage of three times is invoked then the Grenada Development Bank could easily be classified as insolvent. No doubt, this was not a good performance. See table 13 below.

TABLE 13
GDB: PROFIT BEFORE INTEREST TO INTEREST EXPENSE

Year	Interest Expense. EC$M	Profit Before Interest. EC$M	Profit Before Interest to Interest Expense
1994	1.64	0.99	0.60
1995	1.57	0.24	0.15
1996	1.42	-1.09	-0.77
1997	1.25	-1.22	-0.98
1998	1.26	-0.54	-0.43
1999	1.12	-0.81	-0.72
2000	1.20	0.33	0.28
2001	1.25	-0.06	-0.05
2002	1.16	1.14	0.98
2003	1.02	0.86	0.84
2004	1.11	1.28	1.15
2005	1.18	1.63	1.38
Average	1.27	0.23	0.20

When attention is directed to the operating cash flow/interest expense ratio of the Grenada Development Bank, the dire situation facing the Bank was evidently stronger. Operating cash flow over the period 1994 to 2005 was negative for ten of the twelve years. Therefore, for those ten years the Bank would not have generated enough cash flow to finance its interest expenses. The net result was that the Grenada Development Bank could not have met its interest expenses out of the generated cash flow.

Over the period, the ratio of operating cash flow to interest expenses averaged negative 0.69. And, it has been consistently negative on an annual basis over the period. See table 14 below. Needless to say, such a situation can only continue in the face of increased borrowing to finance the interest expenses and/or the continued accumulation of interest payable. Where there is increased borrowing, it would more than likely be at a higher cost, as the risk of default based on the data would appear to be higher. Of course there is the possibility of the government guarantee of loans contracted by the Grenada Development Bank coming into the picture to bail the bank out of its difficulties. However, the ability of the government to continually bail the Grenada Development Bank out of its difficulties would eventually face the limit imposed by the government's fiscal conditions.

TABLE 14
GDB: OPERATING CASH FLOW TO INTEREST EXPENSE

Year	Interest Expense EC$M	Operating Cash Flow EC$M	Operating Cash Flow to Interest Expense. Ratio
1994	1.64	-0.33	-0.20
1995	1.57	-0.83	-0.53
1996	1.42	-2.66	-1.87
1997	1.25	-0.78	-0.62
1998	1.26	-1.92	-1.52
1999	1.12	0.95	0.85
2000	1.20	-0.65	-0.54
2001	1.25	-3.81	-3.05
2002	1.16	-0.39	-0.34
2003	1.02	-0.17	-0.17
2004	1.11	0.38	0.34
2005	1.18	-0.79	-0.67
Average	1.27	-0.92	-0.69

Profitability

The next issue in assessing the performance of the Development Banks is their profitability. A standard measure of profitability is the return on capital employed. It shows how much profit a business is generating on the capital invested and through that, how efficient the business is in utilizing its assets to generate revenue and therefore profit. The higher the percentage the more efficient is the business. Return on capital was calculated in the annual reports of the Saint Lucia Development Bank but had to be calculated for the Grenada Development Bank.

During the period 1982 to 2005 the average return on capital employed posted by the Saint Lucia Development Bank was 0.093 or 9.3 percent. The lowest return on capital employed recorded during the period was 0.005, i.e., 0.5 percent in 1992 while the highest was 0.250 or 25.0 percent in 2000. When compared with what can be considered the average riskless rate of return of 5.0 percent on government bonds, then the average rate of return on capital employed by the Saint Lucia Development Banks may be considered respectable. On this basis the Saint Lucia Development Bank would have performed profitably over the 1982 to 2001 period. However, the implicit risk premium of 4.0 percent achieved by the Saint Lucia Development Bank can be considered low given the nature of credit risk assumed in the long term lending of the Bank. See table 24 of the appendix.

The profitability of the Grenada Development Bank, as measured by the rate of return on capital employed, was particularly bad over the 1994 to 2005 period. The average rate of return on capital employed over the period was 0.009 or 0.9 percent. The lowest rate of return on capital employed was -0.002 or –0.2 percent in 2001, while the highest return of 0.060 or 6.0 percent was achieved in 2005. This highest return was just marginally above the market riskless rate of return, giving a risk premium of only 1.0 percent. In four successive years (1996–1999), the Bank's rate of return on capital was negative, implying losses on its investment. See table 15 below. This performance of the Grenada Development Bank was clearly indicative of a non profitable business and its future survival as a financial institution could only be assured with, among other measures, a strong injection of funds.

TABLE 15
GDB: RETURN ON CAPITAL EMPLOYED

Year	Profit Before Interest. EC$M	Capital Employed. EC$M	Return on Capital Employed
1994	0.99	42.52	0.023
1995	0.24	41.42	0.006
1996	-1.09	37.65	-0.029
1997	-1.22	31.84	-0.038
1998	-0.54	30.26	-0.018
1999	-0.81	28.84	-0.028
2000	0.33	28.71	0.011
2001	-0.06	25.78	-0.002
2002	1.14	25.01	0.046
2003	0.86	25.41	0.034
2004	1.28	26.55	0.048
2005	1.63	26.97	0.060
Average	0.23	30.91	0.009

Attention can now be turned to the use of interest income and interest expenses to assist in the analysis of the Banks' profitability. First, interest income to capital employed can be examined. This measure gives an indication of the interest income, the revenue from the core of the Banks' business, generated by the capital employed.

In the case of the Saint Lucia Development Bank the interest income to capital employed averaged 0.43, i.e., 43 percent, over the period 1982 to 2001. This is to say, for every EC$M1.0 employed by the Bank the interest income generated amounted to EC$430,000.0. Insofar as interest expenses to interest income are concerned the Saint Lucia Development Bank averaged 0.41. As a result, out of every one dollar of interest income generated by the Bank, forty-one cents went out in the payment of interest expenses. See table 16 below. While this could have been better there was still some elbow room for the Saint Lucia Development Bank to remain profitable.

TABLE 16
SLDB: PROFITABILITY INDICATORS

Year	Interest Income to Capital Employed. Ratio	Interest Expense to Interest Income. Ratio
1982	0.36	0.59
1983	0.33	0.55
1984	0.32	0.49
1985	0.36	0.48
1986	0.36	0.43
1987	0.44	0.47
1988	0.45	0.49
1989	0.43	0.39
1990	0.44	0.39
1991	0.49	0.42
1992	0.54	0.41
1993	0.58	0.43
1994	0.48	0.50
1995	0.50	0.46
1996	0.46	0.47
1997	0.44	0.50
1998	0.41	0.47
1999	0.41	0.49
2000	0.44	0.47
2001	0.42	0.51
Average	0.43	0.47

Unlike the Saint Lucia Development Bank, the Grenada Development Bank, consistent with the other performance indicators examined before, showed clear signs of weak profitability. Over the period 1994 to 2005 the average of interest income to capital employed was 0.07, i.e., 7.0 percent. In other words, for every EC$M1.0 of capital employed by the Bank, it generated only EC$70,000.0 in interest income. The Bank was therefore not even able to generate one percent of interest income on its capital employed. This is hardly a situation which can continue indefinitely.

A similar picture is depicted when the interest expense to interest income is examined. Here, the Grenada Development Bank posted an average of 0.65, indicating that for every dollar of interest income it earned, sixty-five cents went out in the payment of interest expense. This does not give the Bank an opportunity to expand and if other expenses are taken into account it will strongly suggest an unprofitable situation. See table 17 below.

TABLE 17
GDB: PROFITABILITY INDICATORS

Year	Interest Income to Capital Employed. Ratio	Interest Expenses to Interest Income. Ratio
1994	0.07	0.54
1995	0.07	0.56
1996	0.06	0.63
1997	0.06	0.67
1998	0.06	0.72
1999	0.05	0.79
2000	0.05	0.77
2001	0.06	0.83
2002	0.08	0.62
2003	0.07	0.58
2004	0.07	0.57
2005	0.09	0.50
Average	0.07	0.65

Other measures of profitability could be examined, but the picture would remain practically the same for both the Saint Lucia Development Bank and the Grenada Development Bank. Needless it would be, therefore, to examine those indicators in any detail. Suffice it to say, the operating profit of the Saint Lucia Development Bank averaged EC$M1.66 while that of the Grenada Development Bank averaged EC$M-0.54. Only in one year, 1994, did it generate an operating profit; a mere EC$M0.18. Tables 18 and 19 below show the details for the Saint Lucia Development Bank and the Grenada Development Bank respectively.

TABLE 18
SAINT LUCIA DEVELOPMENT BANK PROFITABILITY INDICATORS

Year	Interest Income EC$M	Interest Expense EC$M	Interest Margin EC$M	Other Income EC$M	Operating Costs EC$M	Operating Profit EC$M
1982	1.15	0.68	0.47	0.15	0.69	-0.07
1983	1.26	0.69	0.57	0.31	0.76	0.12
1984	1.54	0.75	0.79	0.42	0.99	0.22
1985	1.91	0.91	1.00	0.38	1.11	0.27
1986	2.34	1.01	1.33	0.79	1.19	0.93
1987	2.78	1.31	1.47	0.80	1.40	0.87
1988	3.09	1.51	1.58	0.51	1.45	0.64
1989	3.68	1.45	2.23	0.55	1.64	1.14
1990	3.62	1.42	2.20	0.52	1.97	0.75
1991	4.20	1.76	2.44	0.69	2.09	1.04
1992	5.16	2.11	3.05	0.45	2.29	1.21
1993	6.45	2.77	3.68	0.69	2.44	1.93
1994	6.85	3.40	3.45	0.56	2.62	1.39
1995	8.18	3.77	4.41	0.69	2.78	2.32
1996	9.30	4.40	4.90	1.30	3.10	3.10
1997	10.50	5.20	5.30	1.10	3.34	3.06
1998	11.66	5.48	6.18	0.89	3.37	3.70
1999	12.28	6.05	6.23	1.04	4.59	2.68
2000	14.18	6.66	7.52	1.10	4.59	4.03
2001	15.18	7.72	7.46	1.29	4.89	3.86
Average	6.27	2.95	3.31	0.71	2.37	1.66

TABLE 19
GDB: PROFITABILITY INDICATORS. EC$M

Year	Interest Income. EC$M	Interest Expense. EC$M	Interest Margin. EC$M	Other Income. EC$M	Operating Cost. EC$M	Operating Profit. EC$M
1994	3.04	1.64	1.40	0.26	1.48	0.18
1995	2.80	1.57	1.23	0.38	1.69	-0.08
1996	2.24	1.42	0.82	0.35	1.71	-0.54
1997	1.86	1.25	0.61	0.36	1.87	-0.90
1998	1.75	1.26	0.49	0.35	1.78	-0.94
1999	1.42	1.12	0.30	0.38	1.45	-0.77
2000	1.56	1.20	0.36	0.25	1.50	-0.89
2001	1.50	1.25	0.25	0.94	1.49	-0.30
2002	1.88	1.16	0.72	0.03	1.49	-0.74
2003	1.76	1.02	0.74	0.05	1.62	-0.83
2004	1.95	1.11	0.84	0.12	1.35	-0.39
2005	2.34	1.18	1.16	0.21	1.63	-0.26
Average	2.01	1.27	0.74	0.31	1.59	-0.54

In the case of the Saint Lucia Development Bank the increase in operating profit over time may be attributed to effective management of budgeted income and expense levels. Over the period there was also a more successful management of existing working capita through deployment in high yield investment. This contrasts starkly with the earlier period of the Banks history when cash was held in non-interest bearing bank deposits. The profitability was also enhanced by the growing interest margin which averaged 3.31 over the period. With improved profitability there was a stronger solvency position of the Bank. Assisting in this regard was effective delinquency control coupled with a more aggressive collection policy leading to cash inflows.

Operating efficiency

On the issue of operating efficiency one can examine the return on capital employed. That was done before in the discussion on profitability. In addition, the relationship between operating cost and operating income gives us a further insight into the operating efficiency of the Development Banks. For this, attention is directed to the two tables below. In the case of the Saint Lucia Development Bank operating cost was averaged 85.8 percent of its operating income. And, in a few years (1982, 2000, 2001) operating cost actually exceeded operating income. See table 20 below.

In the case of the Grenada Development Bank, operating cost averaged 146.5 percent of its operating income. In other words, the Bank was not generating enough income from operations to cover its costs; it was simply inefficient. Some degree of operational efficiency was therefore attained by the Saint Lucia Development Bank whereas the Grenada Development Bank consistently displayed operational inefficiency. See table 21 below.

TABLE 20
SAINT LUCIA DEVELOPMENT BANK PROFITABILITY INDICATORS 1982-2001EC$M

Year	OC EC$M	OI EC$M	OC/OI Percentage	OP(L) EC$M	PBL EC$M	APBL	LO EC$M	APBL/LO Percentage
1982	1.38	1.31	105.34	-0.07			11.76	
1983	1.45	1.51	96.03	0.06	0.11	0.111	13.34	0.8
1984	1.76	1.91	92.15	0.15	0.21	0.31	16.05	1.9
1985	2.02	2.26	89.38	0.24	0.7	0.89	18.36	4.8
1986	2.22	3	74.00	0.78	0.6	1.29	21.83	5.9
1987	2.73	3.58	76.26	0.85	0.6	1.76	25.47	6.9
1988	2.98	4.1	72.68	1.12	0.72	1.99	29.43	6.8
1989	3.11	4.24	73.35	1.13	0.5	2.34	31.37	7.5
1990	3.42	4.14	82.61	0.72	0.5	2.79	35.19	7.9
1991	3.92	4.89	80.16	0.97	0.5	2.52	41.14	6.1
1992	4.59	5.7	80.53	1.11	0.59	2.55	51.52	4.9
1993	5.31	7.14	74.37	1.83	1.09	2.22	65.76	3.4
1994	6.22	7.4	84.05	1.18	0.6	3.84	77.32	5.0
1995	6.73	8.87	75.87	2.14	0.5	3.89	91.77	4.2
1996	7.69	10.52	73.10	2.83	0.55	2.44	102	2.4
1997	8.39	11.61	72.27	3.22	0.6	3.12	116.35	2.7
1998	9.04	12.57	71.92	3.53	0.61	3.12	128.12	2.4
1999	10.9	13.32	81.83	2.42	0.69	3.52	143.38	2.5
2000	16.47	11.54	142.72	-4.93	0.7	4.32	157.47	2.7
2001	15.21	12.87	118.18	-2.34	1.04	5.27	171.54	3.1
Average	5.78	6.62	85.84	0.85	0.57	2.41	67.46	4.10

TABLE 21
GRENADA DEVELOPMENT BANK PROFITABILITY INDICATORS 1994-2005

Year	OC EC$M	OI EC$M	OC/OI Percentage	OP(L) EC$M	APBL EC$M	LO EC$M	APBL/LO Percentage
1994	4.01	3.43	116.9	-0.58	5.46	33.17	16.5
1995	4.62	3.29	140.4	-1.33	6.74	31.34	21.5
1996	5.21	2.45	212.7	-2.76	7.93	27.32	29.0
1997	4.71	2.66	177.1	-2.05	9.03	22.71	39.8
1998	3.91	2.11	185.3	-1.8	9.69	21.42	45.2
1999	3.73	1.8	207.2	-1.93	10.69	19.52	54.8
2000	2.72	1.81	150.3	-0.91	10.49	18.98	55.3
2001	2.92	1.62	180.2	-1.3	10.5	19.95	52.6
2002	3.55	3.53	100.6	-0.02	9.66	18.71	51.6
2003	2.89	2.73	105.9	-0.16	7.84	18.53	42.3
2004	2.58	2.76	93.5	0.18	6.88	18.59	37.0
2005	3.18	3.63	87.6	0.45	4.75	19.96	23.8
Average	3.67	2.65	146.47	-1.02	8.31	22.52	39.12

OC = Operating Cost
OI = Operating Income
OP(L) = Operating Profit (Loss)
PBL = Provision for Bad Loans
APBL = Accumulated Provisions for Bad Loans
LO = Loans Outstanding

What is relatively clear from all of the above is that the Saint Lucia Development Bank operated during the period 1982 to 2001 with a fair degree of solvency while that was not the case with the Grenada Development Bank. The same can be said with respect to the profitability. The former Bank operated with a fair level of profitability while the latter was wholly unprofitable. Operational efficiency, while not of the best, was fairly good in the case of the Saint Lucia Development Bank but was not as good in the case of the Grenada Development Bank. In varying degrees, the issues of solvency, profitability and operational efficiency of the Development Banks pose challenges which the Banks will have to come to terms with if they are to fulfill the mandate assigned to them. An assessment of the performances of the Development Banks thus provides a basis for pointing to possible future directions in which they can consider going. A discussion of some possible new directions will now be undertaken.

Possible new directions for the development banks

Universal banking

In addressing the possible new directions for Development Banks in the Eastern Caribbean it would probably be useful to begin with the financial system as a whole. New directions for the Development Banks cannot be easily divorced from the financial system as some of the prime difficulties of the Development Banks are in part rooted in the financial system. In this regard the problem of asymmetric information may be of some concern.

In the Eastern Caribbean bond and equity markets are still underdeveloped and will be slow in developing. This implies that commercial banks will continue to play an important role in selecting borrowers and monitoring their performance. But commercial banks cannot perfectly determine the probability of credit risk (loan default or non-payment) and as such they cannot simply allocate resources to the highest bidder, i.e., those who offer the highest rate of interest. Commercial banks are therefore forced to choose among potential borrowers who are willing to pay the going rate and are most likely to repay. In essence, this process of resource allocation is a form of credit rationing.

A crucial issue giving rise to this kind of resource allocation through credit rationing has to do with the problem of asymmetric information and the attendant or additional risk factor it generates

for the financial system as a whole. Asymmetric information, through increasing risk, can and does, narrow the scope of lending by the Development Banks as well as commercial banks, and other financial institutions for that matter. Minimising the problems associated with asymmetric information and the attendant risk factor is therefore one issue which any new direction may have to consider. It should be remembered that the prime objective lurking behind the possible new directions for Development Banks (and it can be added the financial system) is the mobilization and allocation of financial resources for economic growth and development. The latter essentially involves the provision of lone-term financing to economic enterprises. And, this is the type of financing which is not generally forthcoming from the principal financial institutions in the system, i.e., commercial banks.

Probably an overarching new direction in which the financial system as a whole could consider going is the more aggressive use of universal banking. This is a version of a financial system, and more specifically, a baking system, which allows commercial banks to take up equity positions in other commercial enterprises.[21] Already the banking legislation in the Eastern Caribbean makes provisions for commercial banks to engage in a limited form of universal banking.

According to the Amended Banking Act 2005, commercial banks are allowed to take up equity position in any single commercial enterprise in an amount not exceeding ten percent of their unimpaired capital and reserves. So, the total exposure of a commercial bank to one enterprise is limited to that amount. However, the total amount of a commercial bank's holding of equity positions in all other enterprises collectively should not exceed sixty percent of its unimpaired capital and reserves.[22] However, most of the commercial banks in the Eastern Caribbean have not used this provision.

Getting commercial banks in the Eastern Caribbean to take equity positions in enterprises may not be an easy endeavor. In the final analysis, even if statutorily permitted to so do, the commercial banks make their decision on the basis of risk in relation to possible return on their investment. One possible way of encouraging commercial banks to take up equity positions in other commercial enterprises is with the use of fiscal policy; specifically company tax policy.

Currently, company tax in Saint Lucia and Grenada is 33.3 percent and 30.0 percent of gross profit respectively. The company tax provisions could be tweaked to allow a tax break for commercial banks which assume equity position in other commercial enterprises. One approach is to tax exempt the amount invested in equities in other economic enterprises from the company tax liability of the commercial banks. Thus, the amount of resources used to assume equity position will be offset as an expense item qualifying for tax deductibility and subtracted from the gross profit when determining the tax liability of a commercial bank.

The major reason for commercial banks staying away from equity financing is the inherent risk involved in that kind of investment in the context of their source of funds. But part of that risk is associated with asymmetric information. Depending of the level of equity holding on the part of the commercial banks they may be able to hold a seat on the board of directors of the economic enterprise in which they took the equity positions and reduce the risk arising from asymmetric information. In addition, the traditional mandate of commercial banks in the Eastern Caribbean is to grant loans. This is in part consistent with the fact that their liabilities are primarily of a short-

[21] In essence there are three types of banks: (1) a commercial banks which accept deposits but are restricted to entering into debt contract with other commercial enterprises, i.e., they are only allowed to grant loans to other commercial enterprises; (2) universal banks which are allowed to accept deposits, enter into debt contract with and take equity positions in, other commercial enterprises; (3) investment banks (or merchant bank) which are allowed to issue debt contract to, and take equity positions in, enterprises, but are not allowed to accept deposits.

[22] Before the Amended Banking Act 2005, commercial banks' holding of equity positions in other enterprises was restricted to the 10.0 percent of their unimpaired capital and reserves. The Amended Act now extends the limit to a total of sixty percent of their unimpaired capital and reserves.

term nature but the risk associated with the granting of loans is somewhat “insured” by the security attached to such loans.

The interest deductible allowance for the acquisition of equity positions in other commercial enterprises can in some sense be seen as the provision of some form of “insurance” for the commercial banks analogous to the security attached to loans granted. The security attached to loans no doubt bears some relationship to the risk as assessed by the commercial banks. The issue that would now left to be addressed in more detail is the extent of the tax break which would be required to “equate” the risk inherent in equity investment to provide a sufficient risk premium for the commercial banks to take up the equity positions in other economic enterprises.

Of course, it is perfectly legitimate to argue that the risk premium is already included in the possible dividends to be had, and the higher rate of return on equity relative to debt. It is also perfectly legitimate to argue that the state should not bear the burden of private capital. However, if in the long-run the equity positions assumed by the commercial banks allow for the growth and development of commercial enterprises then there could be some economic justification for state involvement in this suggested form. So, a case can be made for commercial banks equity involvement in other commercial enterprises through the use of tax incentive; involvements which can possible assist in the provision of long-term financing for other commercial enterprises. More will be said of this form of state intervention as it relates directly to the sourcing of funds by the Development Banks.

The holding of equity position on the part of the Development Banks are allowed in their respective statute; with more scope than the commercial banks insofar that there is no limits placed of the equity position they can hold. In the case of Saint Lucia, The Saint Lucia Development Bank Act 1980 makes provision for the Saint Lucia Development Bank to engage in what are essentially activities of a universal bank. Under Part II, Section 14(1)(a) it is allowed to accept deposits from government, Co-operatives or Friendly Societies, and “from any person or body whether within or without Saint Lucia”. (Part II, Section 14(a)(iii). Under the same provision the Bank is permitted to make loans and advances or any form of credit “to any person, corporation, company, society or body whatsoever within or without Saint Lucia”. (Part II, Section 14(e). The Bank also has the authority to participate in the share capital or management of enterprises. And, in the case of the Grenada Development Bank, provisions are made for the Bank “to assist persons to establish, carry on or expand development enterprises by participating in share capital, granting loans and providing other forms of financial assistance to such persons”. (Grenada Development Bank Act, Part II(4)(1)(a). Both Development Banks can therefore, in addition to granting loans, take up equity positions in other economic enterprises and are therefore in a position to mitigate the negative consequences of asymmetric information with representation on the board of directors.

It is assumed that most of the lending to be undertaken by the Development Banks would be going to small and medium sizes enterprises. (SMEs). This does not necessarily mean that the Development Banks would not be lending to larger enterprises or would not be engaged in the financing of proposals which are larger than the size they are generally accustomed to. In any case, the relative size of enterprises in the Eastern Caribbean is such that they all can be considered as falling in the category of SME, despite classification that may suggest otherwise.

SMEs in general and particularly those in the Eastern Caribbean tend to face credit rationing as a result of adverse selection and moral hazard problems resulting from asymmetric information (Stiglitz and Weiss, 1981).[23] Such credit rationing is normally a consequence of the inability of financial institutions to accurately assess and price risks, and the inability or unwillingness of SMEs to provide adequate collateral or third party guarantees. For SMEs, credit rationing can also result from "financial exclusion", which occurs when potential borrowers wish to borrow amounts that are seemingly too small for financial institutions to lend at a profit. Essentially, the fixed cost of making the loan appears to be too high, relative to the potential return, given the uncertainty about the riskiness of the loan applicant.

Now, there are three basic mechanisms used by banks, whatever form they may take, to monitor their borrowers. First, banks directly obtain information on the borrowers' cash flow when the banks themselves manage the borrowers' deposit accounts. Secondly, there are the more formal restrictive covenants which can be inserted in loan agreements; for example, a covenant which requires a borrower to maintain a pre-determined range of liquidity determined by the bank. Thirdly, banks can be granted the right to scrutinize the operations of the enterprises that access their funds giving them a greater degree of access to information on the enterprises. Universal banks often utilize the third mechanism and maintain close and extensive connections with borrowers. Such connections allow for a stronger element of lender's control over those enterprises, and hence, universal banks are argued to be in a more advantageous position to overcome the problem created by the absence of reliable information, i.e., asymmetric information.

Proponents of the universal banking model argue that the profitability of enterprises monitored by universal banks is more likely to be promising than otherwise. A chief reason for this is the reduction of asymmetric information. Banks presentation on company boards could serve to mitigate the risk element presented by information asymmetries that would otherwise lead to credit-rationing and onerous lending terms in the provision of debt finance. When banks have easier access to information credit-rationing unquestionably becomes more efficient and financial resources are more likely to be allocated in quality projects.

Pozdena (1991) argues that the debt-equity contract may encourage enterprises to undertake less risky investment policy than a pure debt contract. In fact, the higher the face value of the debt the more the enterprise is likely to undertake risky projects with a high expected return in order to repay the loan. Thus, by substituting equity for some of this debt, the required face value of the debt needed by the firm will be lower and the implemented policy will be less risky that the "100% debt" case.

The case of Grenada Development Bank may be instructive here. In 1991 the Grenada Development Bank granted a loan, in the amount of EC$M3.5 and at a 7.5 percent rate of interest, to Liberty Club to finance the construction of a hotel called La Source. At the same time the Bank took up an equity position in the company.[24] The equity was to the tune of EC$1.7M., i.e., 1,688,499 ordinary shares at $10.0 each. The Bank was then in a position to hold a seat on the Board of Directors Liberty Club. While initially there was some problems with the repayment of the loan requiring rescheduling, Liberty Club was able to fully discharge its debt obligations to the Development Bank. The Grenada Development Bank, by virtue of holding a seat on the Board of

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[23] Adverse selection and moral hazard could prevent interest rates from equilibrating the supply and demand for credit. Adverse selection arises when lenders cannot ascertain the truthfulness of the borrower and hence the riskiness of the activity to be financed. In such a case, riskier borrowers/projects would be attracted to higher interest rates. Moral hazard allows borrowers to undertake riskier actions after the funds have been disbursed. A consequence of both situations is that lenders would not raise interest rate to ration funds but may instead deny loans to those who are not well know or whose reputations cannot vouch for their honesty. Such credit rationing may preclude worthwhile activities from being undertaken, reducing investment, output and welfare. (Gonzalez-Vega pg. 13) There is uncertainty as to the probity of the borrower himself. On the other hand borrowers have difficulties transmitting to lenders what they know about their projects, because the lender will always suspect that the borrower is exaggerating the qualities of his project and downgrading its riskiness.

[24] Liberty Club is the owner of the hotel La Source hotel in Grenada.

Directors of Liberty Club was in a position to have first hand information on the operations of La Source and consequently mitigating some of the problems associated with asymmetric information. While this may not be the very best of examples, it certainly is one of better cases which can be used to illustrated the point.

Finally, the supply of external finance in the model of universal banking is likely to increase in line with the suppliers' controlling power over their borrowers' behaviour. Representation of universal banks on the board of directors increase profitability, as this arrangement makes the provision of external finance more attractive. Universal bank could information flows within the economy and as such their contribution should not be only measured in terms of external funds they supply but also of improved information flows as a result of banks' improved capabilities to compare companies within an industry and across industries within the whole economy.

Syndicated lending

A second direction in which Development Banks could consider going is in syndicated lending. There are two possible advantages of syndicate lending. The first is associated with the fact that the borrowing requirement of an enterprise, or a proposed new enterprise, may be beyond the funding (and credit risk tolerance) of the Development Bank. In itself, that need not necessarily be a problem.

However, it may be a problem if it is the case that a particular proposal coming before the Development Bank requires a certain level of funding below which the project would not be viable and the Development Bank is unable to meet the funding requirement of that project. Further, it may even be the case that the project in question may have positive externalities impacting (or harbours the potential to have a positive impact) on other assets of the Development Bank. At the same time the project proposer finds it difficult to rise the necessary funding from the commercial banking sector.

These are some of the instances in which the instrument of syndicate lending could be used by the Development Bank to fund the project. In essence, the funding would be provided by two or more lenders. Although there would be a single loan agreement, each lender under the syndicated lending arrangement would maintain a separate claim on (and would share the credit risk for) the portion of the funds it provided.

Two groups of lenders would therefore be in a typical syndicated loan arrangement. There will be the more senior lender (or lenders as the case may be), which in the case under consideration, would be the Development Bank. The Development Bank would be responsible for putting together the syndicated deal and would assume the role of arranger (or lead manager). In that role, the Development Bank would assume responsibility for structuring the loan facility, including the negotiation of price as well as terms and conditions. The responsibilities of the Development Bank, as lead manager, could also extend to underwriting and marketing the loan to other financial institutions. As lead manager, the Development Bank could also act as agent in the process thereby assuming responsibility for administering the loan after it has been executed, managing the ongoing relationship with the other financial institutions making up the syndicate as well as their relationship with the client (I.e., the borrower). This second group, the other financial institutions, would simply provide funds for the loan.

The pricing of the syndicated loan could be an issue for serious consideration. Generally, syndicated loans are priced at an interest rate spread above a floating reference rate (LIBOR, for example). The spread would mainly depend on the credit risk of the borrower and the size and term of the loan, but it may also vary with general demand and supply conditions in the market. The

spread may be fixed for the term of the loan, or it may be linked to certain corporate events, such as changes in the borrower's gearing or profitability.

In addition to earnings from the spread on the portion of the loan that is drawn, syndicate members also receive various fees depending on their role in the transaction as arranger, underwriter, agent or participant. Those involved in arranging the deal are paid a fee for their role in putting the deal together. The institution underwriting the transaction could earn a fee for guaranteeing the availability of funds, and the agent bank could earn an annual fee for administering the loan after commencement. In some cases junior participants may earn a fee for participating in the syndicate, with the size of the fee usually dependant on the size of their commitment. Also, for that part of the facility that remains undrawn, the participants will typically receive an annual commitment or facility fee to compensate them for the cost of tying up their capital. Even when the facility is drawn, some deals also incorporate a utilization fee, in which case the interest rate spread may be somewhat lower than others.

In addition to interest rate spreads and fees, there are various non-pricing conditions, known as covenant, that are also attached to syndicated loans. These are undertakings given by the borrower in a loan agreement that are designed to limit the lenders' risk. Typical covenants include limits on the amount of financing the borrower can obtain and restrictions on the use of any funds it might realize from asset sales.

Resource mobilisation

One of the major challenges facing Development Banks in the Eastern Caribbean is resource mobilization for on-lending to clients. The traditional sources of funds for the Development Banks are becoming less available. This is so because of the redirection of developmental assistance and the increasing cost of funds. Less concessional funds are available. It is also because of the relative inefficiency in the operations of Development Banks themselves. The development banking division of the National Banks of Saint Lucia (which replaced the Saint Lucia Development Bank) has already discontinued sourcing its funds from the CDB out of cost considerations, while the CDB and the EIB have suspending their lending to the Grenada Development Bank out of concerns over profitability of the Bank.[25] Funds from the CDB now average between six and eight percent thus narrowing the interest spread and consequently the potential profitability of the Development Banks. This raises the issue of resource mobilization for the Development Banks.

More and more Development Banks are required to raise funds on the private market. Development Banks in the Eastern Caribbean, in particular the development banking division of the National Bank of Saint Lucia and the Grenada Development Bank. The need for sourcing funds outside the traditional sources also poses the issue of the adequacy of the statutory framework under which the Development Banks operate. A new direction would suggest a change in the statutory provisions for the operations of the Development Bank.

In the case of the Grenada Development Bank, there is no provision in the statute which would allow the Bank to accept deposit funds from the general public. This is unlike the statutory provision relating to the Saint Lucia Development Bank wherein it can accept deposit from the general public at large. While the Grenada Development Bank has no authorized share capital, it has the power to "order the issue of stock, shares, bonds, debenture stock, debentures and other securities". It also has the power to "…issue debentures, debenture stock, or bonds for the purpose of exercising its borrowing powers". Part II(15)(a) of the Grenada Development Bank Act 1976.

[25] The development banking division of the National Bank of Saint Lucia now uses "own source" of funds because of its cost. The interest rate on deposits taken by the bank is between 2.5 percent and 3.5 percent whereas CDB's lending rate to the division is between 5.0 percent and 7.0 percent.

Similarly, under the Saint Lucia Development Bank Act shares can be issue with a proviso that "the government of Saint Lucia shall hold no less than fifty-one per centum of the shares for the time being issued by the Corporation". Part IV(21)(5) of the Saint Lucia Development Bank Act 1981. And, "any person may in accordance with the regulations made pursuant to section 30 subscribe for and hold shares in the Corporation". Part IV(21)(3) of the Saint Lucia Development Bank Act 1981. The total authorized share capital of the Bank is EC$M5.0 with a par value of EC$5.0 each. However, there is a statutory limit on the liabilities of the Saint Lucia Development Bank. According to the Act, the liabilities of the Bank should not exceed seven times the paid up share capital and free reserves. This effectively places a limit to the tune of approximately EC$M35.0, assuming that the share capital is fully paid up and leaving aside for the moment free reserves as this would be a function of the Bank's profitability which can vary widely. Consideration should therefore be give to raising the share capital of the Saint Lucia Development Bank. In addition, both Development Banks can issue bonds, but none has done so as yet.

Now, the general new direction on the mobilization of resources calls for statutory provisions which will allow the Development Banks to source funds from the widest possible sources, including within the jurisdiction in which they operate and outside of that jurisdiction. Separate and apart from mobilizing funds from the general public through the taking of deposits, the Development Banks can look to institutional investors. It is already the case the National Insurance Scheme in Grenada provides the Grenada Development Banks with lines of credit. It is not entirely clear whether the same is practiced in Saint Lucia. But, The Development Banks must go beyond the National Insurance Scheme in the case of Grenada and the National Insurance Corporation in the case of Saint Lucia. Here is where the issue of tax deductibility can potentially play a crucial role.

With the tax deductibility provision, institutional investors could be wooed to, in the first instance, taking up equity positions in the Development Banks.[26] The equity issuance could be in the form of private placement to the institutional investors. Depending on the extent of their holdings, the equity position could give them a seat on the Board of Directors of the Development Banks and minimize the problems associated with asymmetric information. Of course, the mere granting of the tax deductibility may not be sufficient for the institutional investors to take up equity positions in the Development Banks. What would also be required is a strengthening of the technical capacity, in the very general sense of the term, of the Development Banks. The strengthening of their technical capacity would be crucial in aiding their profitability and consequently raising their profile as potentially less risky institutions in which institutional investors can place their resources. Presumably, the involvement of institutional investors in the Development Banks by way of equity holdings and consequently governance could increase the confidence of the general public to take equity positions with the Development Banks as well as placing deposits with them.

Another avenue through which the Development Banks can mobilize resources is the issue of bonds. Again, institutional investors could be targeted but the general public could be facilitated with the issuance of bond denominations of a lower level than that issued for institutional investors. These bonds could have the guarantee of the respective governments in the same manner in which they guarantee the loans taken by the Development Banks from external sources. In fact, there are provisions in the statute which allow the governments to provide that kind of support for the Development Banks. With the passage of time and the increased profitability of the Development Banks there may be less of a reliance on the governments for such guarantees. But, in the initial phase, the guarantee of the governments could serve to raise the confidence of potential investors and reduce some of the perceived risk in investing in the Development Banks.

[26] In the context of the Eastern Caribbean these institutional investors would primarily include commercial banks, insurance companies, savings and loans institutions, and credit unions.

What could be of significance in this process is the existence of a secondary market for the securities issued by the Development Banks. Here, the Eastern Caribbean Security Exchange can be of assistance in preparing the Development Banks for listing on the exchange. In the case of the Grenada Development Bank the existing statute provides it with the power to engage in activities that would facilitate the development of capital markets. There is little reason why the Eastern Caribbean Stock Exchange and the Development Banks cannot work together to develop the capital market in such a manner that securities issued by the Development Banks can be publicly traded. Some views on possible efforts the Development Banks can consider taking to assist in developing capital markets will be mentioned later.

Reorientation of focus

It should be recalled that Development Banks are institutional instruments of public policy and their performance is not only be considered in the strict business sense but also in relation to the social benefit they generate as measured by indicators of social accounting. That being said, a new direction for the Development Banks in the Eastern Caribbean should be closer policy link with the governments. There appears to be no real discernable link between functionaries of the Development Banks and policy makers in government. Government policies tend to be developed, announced and implemented with little input from functionaries of Development Banks. The worst case is where the announced policy has the direct potential of influencing the operations of the Development Banks. To put it simply, there appears to be a disconnect between the public policy developmental objectives and the "developmental" objectives of the Development Banks.

Probably the first general line of reorientation is therefore the establishment of constant and structured dialogue between Development Banks and the governments. This dialogue would assist the Development Banks in fully understanding the policy priorities of the government and tailoring their policies to complement those priorities, while at the same time influencing government policies. The dialogue could also assist the governments in more fully understanding the difficulties faced by the Development Banks in realizing their developmental objectives and they would consequently be better able to appreciate the difficulties faced by the Development Banks. The basic idea is have a greater degree of policy complementarity between the governments and the Development Banks.

Similarly, the Development Banks in the Eastern Caribbean should deepen their networking structures. While there is an annual meeting of Development Banks officials, there is still the need to expand the level of contact and co-operation among the Development Banks. Including in that expanded co-operation should be the establishment of expert groups on matters of common concern to the Development Banks; for example, an expert group on credit analysis and risk management. At the wider level the Development Banks in the Eastern Caribbean should establish strong working relations with the World Federation of Development Finance Institutions (WFDFI) as well as regional associations of Development Banks.[27] These networks, together with the expert groups could be used by Development Banks to assist each other in policy formulation and development banking practices based on their collective experience.

Critical in this reorientation of focus may be the need for a redefinition of role and function of the Development Banks. As it currently stands the vision for the Development Bank, developed in the decade of the sixties, may need to be revisited. Those were the days of fairly generous flow of concessional funds and a particular paradigm of development. Based on these, the focus was on the "development" side of development banking. However, developments over the past two

[27] For example, the African Association of Development Finance Institutions (AADFI), the Latin American Association of Development Finance Institutions (ALIDE), the Association of Development Finance Institutions inn Asia and the Pacific (ADFIAP), and the European Development Finance Institutions (EDFI) among others.

decades, especially as they relate to sharp decline in concessional financial flows, have been such that the "banking" side of development banking may need to be given greater emphasis. This is not to suggest that the "development" side should be ignored at the expense of the "banking" side. It is simply to suggest that there should be a reorientation which will have to accord added attention to the "banking" side of development banking in the Eastern Caribbean. This proposition would have particularly stronger merit if the Development Banks are to mobilize resources in the manner suggested before. All of this will necessitate the redefinition of the role and function of the Development Banks.

With regards to the increased attention to the "banking", or more generally, financial, side of development banking, there are a number of activities which the Development Banks should consider engaging in so as to reorient their focus. These should include, among others, the following:

- Branching into the field of investment banking.
- Developing existing advisory services and even entering into new fields. More will be said on this later.
- Selective and careful provision of working capital financing and bridge loan financing.
- The creation of non-bank financial intermediaries as subsidiaries or affiliates that can engage in pension fund management, venture capital, credit card sponsorship and administration, debit cards for point of sales transactions, and credit rating, among others; the so-called "financial supermarket function".
- Programmes for entrepreneurial and managerial development, human capital formation and institution building.
- Providing technical assistance in the restructuring and rehabilitation of troubled enterprises.

Needless to say, the involvement of the Development Banks in these areas as part of their reorientation would have deep implications for their own capacity building. Involvement in these suggested activities would certainly make the operations of the Development Banks more complex and would require a greater degree of technical and managerial sophistication. In turn, this would have implications for the remuneration of staff. Current remunerations are such that Development Banks would not be able to attract and keep competent personnel to run such undertakings. There would also have to be radical changes in the institutional culture of the Development Banks. Presumably, this change can be facilitated by the infusion of new governance arising out of the equity form of resource mobilization suggested before.

Another and probably final aspect of the advocated reorientation of the Development Bank is their departure from the field of mortgage financing. Over the past two decades a number of financial institutions in the Eastern Caribbean have gotten involved in that area of lending, making it less appropriate for the continued involvement of Development Banks in that area of operation. As a general principle, Development Banks in the Eastern Caribbean should not make available their long-term resources for any project for which funds are available from other sources. In this way, Development Banks act as a "lender of last resort" for socially worthwhile projects which are consistent with the developmental objectives of the governments and which would otherwise not receive financing.

Based on this general principle, reconsideration should also be given to their stance in relation to the agricultural and industrial sectors. A singular failing of policy in the Eastern Caribbean is the insufficient conceptual clarity, and consequently policy direction and implementation, as it relates to the role of the agricultural sector. There appears to be the lingering

but relative strong view among some influential policy makers that the agricultural sector can be internationally competitive. A similar view is held in relation to the traditional industrial sector. In the global economy as it has come to be known both the agricultural and industrial sectors of the Eastern Caribbean are internationally uncompetitive and should not be supported with long-term finance from the Development Banks with a view to making them internationally competitive. Of course, both sectors could be supported through the financing of agro-processing where there appears to be some niche competitiveness. The resolution of these will however turn on a clear articulation of governments' policy; and it is here the dialogue between the Development Banks and the governments could be of added importance.

What seems to be clear from developments globally as it relates to production processes is that the use of technology separates a competitive enterprise from a non-competitive one. In addition, the composition of output has shifted in favour of services as the production of good has been made much les expensive with the application of technology. What is also clear is that there has also been a decisive shift in the structure of output in the Eastern Caribbean away from agriculture and manufacturing and into services. Besides, the political directorate in the Eastern Caribbean has repeated the view, in one way or another, that human capital formation is essential to the future growth and development of the Eastern Caribbean; and revealed comparative advantage indices have indicated that the Eastern Caribbean has a competitive edge in services. If these are so, then the focus of the lending policy of the Development Banks should be on human capital formation, selected sub-divisions of the services sector and enterprises with a technological and scientific bias. Those are the areas in which lending by the Development Banks should be concentrated. Those areas are on the leading edge of economic growth and development; they appear to be consistent with governments' general developmental programme and they appear to be comparatively advantageous to the Eastern Caribbean. Development Banks in the Eastern Caribbean should therefore consider reorienting their lending focus to adequately reflect these.

Advisory service provision

A major shortcoming of development banking in the Eastern Caribbean has been the inadequate provision of advisory services to enterprises, especially those that are clients of Development Banks. Where that has been the case it may have very well contributed to the failure of their clients' enterprises and consequently affected the profitability of the Development Banks. Of course, failure of clients' enterprises would have also been linked to general macroeconomic conditions. However, client firms, especially new and small ones with little or no business experience, tend to be more vulnerable to failure relative to other enterprises which would have received advisory services; be it from the Development Bank or otherwise. The provision of advisory service by the Development Banks should now be an elevated part of their reorientation.

Statutorily, provisions exist in the Grenada Development Bank Act 1976 to empower the Bank to provide advisory services. Under Part II(4)(5) of the Act, the Grenada Development Bank may "furnish financial advice and provide or assist in obtaining managerial, technical, and administrative services for development enterprises". Similarly, the Saint Lucia Development Bank Act 1981, under Part II(14)(1)(d) is authorized to provide "assistance to any development enterprise whether in the form of financial or expertise or technical or managerial advice …" So, there is a statutory basis for the Banks involvement in the provision of advisory services.

While attempts have been made by the Development Banks to provide some form of advisory services to their clients the scope of such services was limited and was less continuous and effective as would have expected. A new direction for the Development Banks in the Eastern Caribbean would be to expand and strengthen its advisory services. In the first instance a full department of advisory services should be established.

The advisory services provided by the Development Bank should be for sale to the entire business community, and not just to their clients as a new form of intervention. In the first instance the Development Banks should consider introducing advisory services into their loan agreement with their clients depending on their assessment of the business acumen of the promoters and managers of the enterprises they are financing. Part of the loan funds would thus be used to cover the advisory services provided by the Development Banks. Beyond their loan clients the Development Banks should aggressively seek to market its services to the entire business community.

The type of advisory services which the Development Bank should consider offering include:

- The development of business proposals.
- Financial accounting and financial analysis.
- Staff relations management.
- Portfolio management.
- Working capital and liquidity management
- Business strategy.
- Operations and logistics management.
- Applied use of information technology.
- Business law.
- Management.
- Entrepreneurial and leadership skills.

The provision of advisory services could also take the form of training in some or all of the areas of advisory services suggested above. Over time the Development Banks should aim to become a center of learning and excellence if the general field of business.

Reorientation of the Development Banks to provide the kind of advisory services suggested above would necessarily raise the issue of professional requirements and qualifications of senior staffers. It would also have implications for the expansion of the staff as well as a substantial improvement in their technical capacity. This obviously cannot be done overnight and investment on the part of the Development Banks would be required to strengthen its capacity over time. What the Development Banks may consider doing is prioritizing the areas of immediate importance and begin the process of building their capacity in those areas. Incrementally, the entire range of services should be available to businesses. One novel approach to developing the technical capacity in selected fields of first choice could be to offer financing for training in those fields and covenanting the trainee who accessed such financing to work with the Banks for a specified period of time.

Finally, one of the most important problems associated with development banking is risk. Risks faced the Development Banks come in three forms. The first, and probably most important, is credit risk; i.e., the risk that clients would not be able to service their debts or the high accumulation of arrears on outstanding loans. The second is market risk which relates to the possible losses associated to fluctuations in financial variables, including interest rates and exchange rates, especially if the Banks operate foreign currency and on the international financial market. The third is related to the pure internal operations of the Development Banks which are not related to credit or market risk. The ability to extensively capture and measure risks, to monitor them in real time and to manage them is increasingly becoming a decisive competitive factor in the financial sector. In

the final analysis the profitability of the Development Banks hinges, in no small way, on the extent to which they can adequately manage risks.

An element of the new directions for development banking in the Eastern Caribbean is in the establishment of a division specifically dedicated to risk management. That division should, as much as possible, be centralized and fairly independent of the pure business function of the Development Banks. This would be important to ensure the integrity and objectivity of the assessments made and advice given by the risk management division.

The risk management division should be involved in the four broad areas of credit policy, credit risk assessment, credit portfolio monitoring, and problem accounts review. Implicit is this new direction is the necessity to have sound technical expertise and analytic sophistication to provide the best of possible risk management. The following should therefore be the prime responsibilities of the risk management division.

- In credit policy field:
  - The establishment of policies, methods, guidelines and procedures for the determination of risk rating, risk classification for equity investment and the pricing of such financing, capital adequacy levels and loan loss provision requirements.
  - The establishment of portfolio objectives and risk tolerance level.
  - The recommendation of credit risk pricing consistent with the level of risk assumed.
  - The assessment of borrowers' credit risk and the rating of those risks.
  - Ensuring compliance with policies on eligibility criteria and limit of exposure.
  - The review of credit approval and review processes bearing in mind governance structure and internal control systems, and make recommendations to management in those areas.
- In the field of credit risk assessment the provision of :
  - Assessment of the completeness and quality of relevant information required for an analysis of new credit proposals.
  - Critical risk profiles and recommendations on appropriate risk mitigation measures to management of the Banks
  - Technical assistance to project officers and management with respect to terms and conditions of loan, equity investment and guarantee proposals, including pricing, security packages and specific loan covenants
  - Credit opinion to management and signing-off on credit decisions.

- In the field of credit portfolio monitoring:
  - The establishment of a system for monitoring economic and financial conditions that are likely to affect credit of various portfolios.
  - The monitoring of borrowers' financial conditions to determine their ability and willingness to service their debts.
  - The establishment of a system to assess borrowers' credit rating and performance assessment.
  - Alerting management as to the possibility of imminent default as well as the non-performance on debt service.
  - Regular assessment of the fair value of collateral provided by borrowers.
  - The calculation of rates of return on a risk-adjusted basis.
  - Ensuring the adequacy of loan loss provisioning.
- In the field of problem accounts:
  - The establishment of an efficient early warning system to identify deteriorating credit exposure; including a rating that could be utilized as a trigger for classifying an account as a problem account.
  - Analyzing the causes and symptoms of problem accounts.
  - Recommending ways of dealing with identifies problem accounts.

Now, it is fairly clear that individual Development Banks in the Eastern Caribbean may not be able to undertake the full range of the advisory services as part of the new directions in development banking, especially as it relates to the risk management proposal. What should therefore be given serious consideration is the regionalization of the advisory services of the Development Banks. The regionalization of that aspect of the new directions would reduce the unit cost of the service and could lead to the attraction of qualified and competent personnel if the relevant fields. Once it is built on a regional basis the advisory service, to the extent that it would have established a good track record, could offer the services beyond the Eastern Caribbean and into the larger markets of CARICOM. This is a bold strategic position the Development Banks may want to give mature considerations to. This strategic positioning is even more critical in a context where one of the fastest expanding sub-sectors of the services sector in the CARICOM region is the financial sector. A niche could certainly be created in this area with the pioneering efforts of the Development Banks in the Eastern Caribbean.

Individual Development Banks should still, however maintain some degree of capacity to do some of the in-house work relating to the advisory services suggested. In this regard, special attention should be given to the management of portfolio with a new dimension. Individual Development Banks should be fully cognizant of the fact that managing a profitable portfolio is largely about managing individual customer relationships. Numbers can tell one thing, but early notification of customer behaviour would actually help the Development Banks to better understand how they can acquire, manage, and retain customers. The more and better customer relationships Development Banks can establish with their clients, the less inclined they would be to sever their relations with the institutions. But, the Development Banks must also be astute as to determine when a relationship is deteriorating and be prepared to take appropriate remedial action which could allow them a greater degree of control over their portfolio.

If the development Banks wish to survive in the future there will be a need for them to diversify their operations beyond borrowing in the traditional form (which is currently more

difficult to access) and simply lending to enterprises. Enterprises in the Eastern Caribbean need more than financing; they need nurturing with sound business advice based on good analysis and experience. Creating a broad network with other Development Banks outside of the region could be of assistance. Above all, Development Banks in the Eastern Caribbean should consider beginning the process of providing a range of advisory services to their clients and enterprises, including enterprises in the region as a whole.

Governance

The issue of governance would certainly arise in new directions for the Development Banks. It will certainly arise if the new direction with respect to the resource mobilization is adopted. No longer could government exercise the level of control they currently do and expect the Development Banks to be viable as governments themselves are increasingly facing tight fiscal conditions. Indeed, it is not unreasonable to argue that governments would want the Development Banks to be profitable. The difficulty the governments may face is not being able to influence the policy directions of the Development Bank in a manner in which they are accustomed to, given a different pattern of resource mobilization and consequently ownership of the Development Banks.

The issues of control and direction on the part of governments could be particularly sensitive in small economies which tend to be highly resource constraint. This characteristic tends to pressure governments to “mobilize” every possible resource avenue in their desire to execute their developmental objectives. Of course, one way for governments to continue exerting its influence is by taking equity positions in the Development Banks themselves. Another avenue through which governments can exert control and direction over the Development Banks is with the guarantees of their bond issues.

So, the first issue has to do with the degree of governments’ control and direction of the Development Banks. With the new direction undertaken by the Development Banks the governments’ control and direction (in the form of membership on the Board of Directors) would be limited by the extent of their equity participation and level of guarantee given to the Banks bond issue. A mechanism would then need to be created for determining the allocation of governments’ board members in relation to the level of guarantee the governments would have given to the bond issue of the Development Banks. Once the debt on the bond issue has been discharged then governments’ representation on the Board of Directors would change to reflect the change in the contingent liability which the governments assumed with the bond guarantee. Membership on the Board of Directors would also be opened to institutional investors that would have taken equity position in the Banks. With the passage of time the composition of the Boards would reflect a combination of government directors (based purely on equity and guarantee), institutional investors and the general public (both bases exclusively on their equity contribution).

Under the new director another crucial issue would be the role of government ministers. Once the Development Banks have reoriented the mobilization of their resources in the manner suggested above then arguably there would be no role for a government minister. The legal edifice of the Development Banks would thus have to be one of a corporation established by statute with private and public sector participation, control and direction. In such an arrangement the Development Banks should operate in a manner not too different from a pure private corporation. The distinction in this case would be the participation of governments via their equity contribution, provision of bond and other loan guarantee and the resulting participation in the policy directions of the Banks through their appointed directors. No longer would a minister of government be responsible for appointing directors (except in the case of government directors based on their equity contribution and loan guarantee provision) or approving the appointment of a director. In the same vein no minister would have the

power to remove a director from the board. The terms and conditions affecting the engagement of board members would be set collectively by the management of the Development Banks.

With all businesses, there need to be a clear delineation of responsibilities of the Board of Directors and the management of the corporation. Too often is the case that, especially where the lines are not clearly drawn, a Board of Directors operates as management. Such a situation creates fertile grounds for governance conflict in any enterprise, ultimately resulting in negative consequences for the profitability of the enterprise. The basic point is that the Board of Directors should be clearly restricted to pure policy issues of the Development Banks and absolutely no interference in their day to day operations. Crucial in this regard would be the role of the Chairman of the Board of Directors. The powers of the Chairman of the Board should not be extended in any way as to remotely suggest the possibility of involvement in the day to day operations of the Development Banks.

This does not necessarily mean total autonomy of the management of the Development Banks. Rather, the management of the Development Banks would be under an oversight role of the Boards; an oversight which could involve the removal of management following specified procedures. Management of the Development Banks would therefore have to perform or be subject to dismissal. This is a position which may be different from the case where the Development Banks were under the direct and total control of the governments. This approach would necessarily imply clearer direction on the functions of management and distinct from the Board of Directors.

Selection of management would also be an issue related to governance which the new Development Banks would have to give more serious considerations to. Under the direct control of governments the management of the Development Banks tends to fall in the hands of people with less than sufficient preparation for the job. They often have relatively short tenure and tend to display relatively little serious interest in the institutions. To put it bluntly, their appointment tend to be political as personal are chosen on the basis of the extent to which they can toe the line of the ruling party. The result of this tend be an erosion of the professionalism of the Development Banks, and a lowering of productivity and moral; all ultimately negatively affecting the profitability of the institutions. Too many institutions in the Eastern Caribbean with a government influence suffer this fate of having “square pegs in round holes”. Selection of management personnel for the Development Banks under the new direction would have to be closely in line with a sensible combination of qualifications, competence and professionalism. Anything short of that would minimize the extent to which the Development Banks can transform themselves into viable and profitable entities.

A final element of governance in the new direction on development banking in the Eastern Caribbean which should be considered is openness to the public. In a sense this could be part of the marketing approach of the new Development Banks. The general public should be made aware of the purposes, functioning and performance of the institutions. It they are to more successful in their resource mobilization, lending activities and provision of advisory services they must foster a deeper connection with all potential lenders and clients. In some sense, a version of village development banking must be pursued by the institutions in order to tap on all possible potential resources, lending opportunities and the maximum provision of advisory services; all with the ultimate goal of assisting in the growth and economic development of the Eastern Caribbean. The new Development Banks must not be distant from potential sources of funds and agents of growth and development. Fostering such closeness would require the new Development Banks to be more public in their disclosure; much more than they are currently doing.

With all of the issues suggested under the possible new directions for Development Banks in the Eastern Caribbean, consideration may need to be given to at least harmonizing the legislation pertaining to the Development Banks in the Eastern Caribbean. At best, there should be common legislation analogous to the Banking Act and the Company Act in the Eastern Caribbean. Making the legislation common would indeed be consistent with the announced policy course of forming an

economic union in the Eastern Caribbean and would go some distance in creating the conditions for greater cross-border financial transaction on the part of the Development Banks.

Summing up

The possible future direction for Development Banks in the Eastern Caribbean ought not to be that complicated. What may be required is strong will on the part of the political directorate and aggressive pursuit of objectives given the new directions. The networking with other Development Banks could be informative and lessons can be learnt from Development Banks which have similarly transformed their operations. In the case of East Asia Stiglitz and Uy (1996) suggest that some of the lessons which can be learnt from that region are the following:

- For development banks to succeed they must use commercial standards in their lending procedures. In other words, they must act more as market-oriented financial enterprises than as government agencies. The basic problem with SMEs in developing countries is lack of access to long term finance at market-related interest rates. They do not require subsidy.
- Development Banks must seek to complement financial markets, rather than to replace them, stimulating private banks to lend alongside public ones.
- They must lend basically to the private sector, and within the private sector, to firms without adequate access to private markets.
- They must insist on the long-term profitability of their client firms.
- They must monitor their investment closely.

In the final analysis, the generation of profits by the Development Banks will be the test of their survivability and effectiveness. Chief Executives of Development Banks, meeting in Washington in 1995 was the view that profitability of Development Banks is required so as to ensure:

- Sustainability of Development Banks as with continual losses they will eventually disappear
- Autonomy; Development Banks that are not profitable are likely to turn to governments for their capital. The dependence on governments will likely compromise their autonomy.
- Respectability. A Development Banks which is unprofitable will not be taken seriously in the financial community and will be hindered in attracting and retaining quality staff and managers.
- Effectiveness: As there are more commercial opportunities than available capital, Development Banks avoid financing those activities which are unprofitable.
- They must exit successful investment and make provisions for bad investment, as soon as possible

If the Development Banks in the Eastern Caribbean are to succeed in fulfilling their mission there would certainly have to be some repositioning. The suggestions made here with respect to possible new directions for the Development Banks could serve as a starting point for policy dialogue on the future of the Development Banks. It is the hope that sooner, rather than later, Development Banks in the Eastern Caribbean can positively begin the process of repositioning themselves to be more viable and consequently be in a better position to aid in the growth and development of the economies.

Appendices

TABLE 22

SCHEMATICS OF EASTERN CARIBBEAN FINANCIAL SYSTEM

Non bank financial institutions	Development Banks	Credit Unions	Insurance Companies/ Agencies	National Development Foundations	Finance Companies
Member territories					
Anguilla	1	2	20	-	-
Antigua & Barbuda	1	5	24	1	3
Dominica	1	16	20	1	1
Grenada	1	18	25	1	1
Montserrat	-	1	7	1	-
St. Kitts & Nevis	1	4	12	1	1
Saint Lucia	-	21	25	1	6
St. Vincent & the Grenadines	1	9	13	1	2
Total	6	75	146	7	14

	Clearing banks (commercial banks)	Offshore banks
Member Territories		
Anguilla	4	3
Antigua & Barbuda	8	16
Dominica	4	1
Grenada	5	0
Montserrat	2	13
St. Kitts & nevis	6	1
Saint Lucia	6	4
St. Vincent & the Grenadines	4	9
Total	39	47

Type of bank		Number
Private	Domestic	16
	Foreign	20
State owned		3
Total Commercial Banks		39
NBFI's		14

TABLE 23

SAINT LUCIA DEVELOPMENT BANK
ASSETS AND LIABILITIES

	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Assets	15.4	17.9	19.9	21.7	26.2	30.2	32.9	37.8	42.0	49.4	57.5	49.4	84.1	97.4	119.3	129.2	140.6	156.6	173.2
Liabilities	12.3	14.1	15.1	16.4	19.6	23.9	26.4	29.4	33.8	40.8	47.9	40.8	69.9	80.9	99.1	105.2	112.2	126.4	141.1
Difference	3.1	3.8	4.8	5.3	6.6	6.3	6.5	8.4	8.2	8.6	9.6	8.6	14.2	16.5	20.2	24	28.4	30.2	32.1

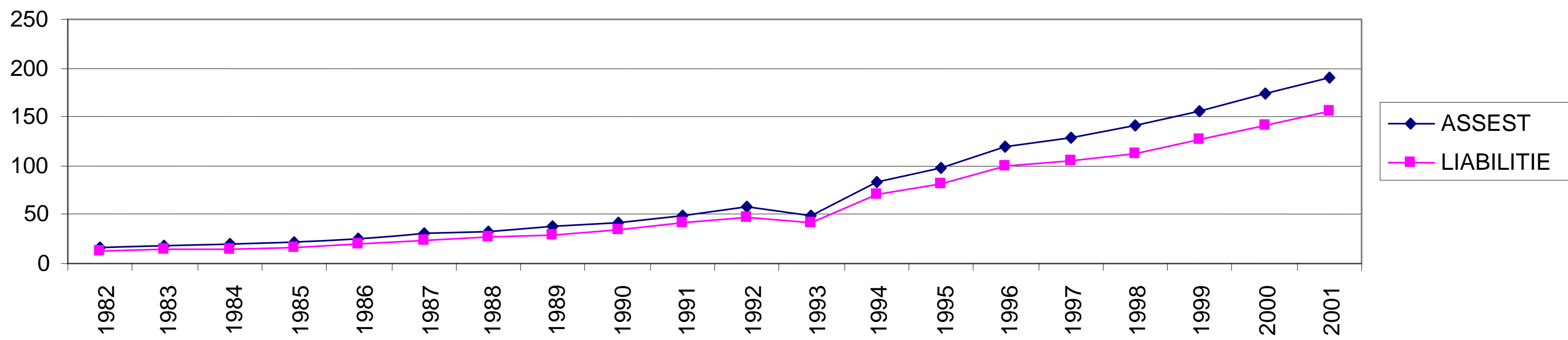

TABLE 24
SAINT LUCIA DEVELOPMENT BANL
FINANCIAL RATIOS

Year	Loan interest income/capital employed	Debt equity	Loan interest received loans & advanced	Administrative expenses/loans & advanced	Staff/cost loans & advances	Interest expenses/interest income	Return on capital employed
1982	0.917:1	3.889:1	0.052:1	0.011:1	None	0.591:1	(0.057:1)
1983	0.613:1	3.744:1	0.066:1	0.016:1	None	0.590:1	(0.028:1)
1984	0.517:1	3.111:1	0.079:1	0.013:1	0.049:1	0.504:1	(0.017:1)
1985	0.527:1	3.107:1	0.090:1	0.011:1	0.048:1	0.487:1	(0.129:1)
1986	0.511:1	2.999:1	0.105:1	0.010:1	0.044:1	0.432:1	(0.041:1)
1987	0.608:1	3.792:1	0.104:1	0.011:1	0.046:1	0.469:1	(0.056:1)
1988	0.564:1	3.827:1	0.103:1	0.011:1	0.041:1	0.491:1	(0.069:1)
1989	0.606:1	3.463:1	0.108:1	0.013:1	0.041:1	0.392:1	(0.103:1)
1990	0.591:1	4.092:1	0.097:1	0.015:1	0.047:1	0.392:1	(0.036:1)
1991	0.691:1	4.748:1	0.118:1	0.014:1	0.042:1	0.420:1	(0.078:1)
1992	0.755:1	4.996:1	0.081:1	0.013:1	0.032:1	0.409:1	(0.005:1)
1993	0.851:1	5.389:1	0.085:1	0.009:1	0.027:1	0.430:1	(0.072:1)
1994	0.696:1	4.921:1	0.087:1	0.009:1	0.025:1	0.497:1	(0.065:1)
1995	0.691:1	4.913:1	0.089:1	0.009:1	0.022:1	0.461:1	(0.023:1)
1996	0.695:1	4.885:1	0.901:1	0.008:1	0.022:1	0.474:1	(0.171:1)
1997	0.719:1	4.209:1	0.090:1	0.007:1	0.019:1	0.494:1	(0.175:1)
1998	0.713:1	3.950:1	0.091:1	0.008:1	0.018:1	0.470:1	(0.157:1)
1999	0.751:1	4.180:1	0.086:1	0.140:1	0.018:1	0.487:1	(0.112:1)
2000	0.867:1	4.402:1	0.090:1	0.129:1	0.016:1	0.470:1	(0.250:1)
2001	0.901:1	4.283:1	0.088:1	0.129:1	0.017:1	0.509:1	(0.212:1)

TABLE 25

SLDB: SECTORAL PROPORTION OF LOANS OUTSTANDING TO TOTAL LOANS OUTSTANDING. 1993-2001

Agriculture/Total	Tourism/Total	Industry/Total	Housing/Total	Education/Total
25.49	NA	8.32	51.57	11.47
20.81	NA	11.84	52.71	11.46
17.41	NA	12.07	45.56	9.81
15.49	NA	15.03	45.25	8.43
14.68	NA	23.16	51.83	8.13
13.39	NA	26.67	50.80	7.75
13.13	NA	27.54	51.39	7.40
12.25	NA	27.65	51.26	8.47
10.43	NA	24.62	54.04	10.16
8.73	NA	21.53	56.77	11.94
10.83	NA	20.56	55.17	12.38
10.87	10.55	8.93	54.64	14.07
9.69	14.07	7.18	51.71	16.77
7.46	17.59	6.83	46.31	20.25
6.46	17.24	7.25	45.41	21.01
6.43	16.56	6.59	44.45	22.84
6.59	15.93	6.76	43.45	24.84
6.91	15.90	6.60	42.61	25.68
6.56	17.54	7.20	40.08	26.75
Average 11.77	15.67	14.54	49.21	14.72

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