# DEBT MANAGEMENT ANALYSIS: A CASE OF LOCAL GOVERNMENT AUTHORITIES IN MASHONALAND WEST PROVINCE, ZIMBABWE.

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### *ABSTRACT*

*The thrust of study was to examine the impact of debt finance on performance of local authorities in relation to Zimbabwe government local authorities, in Mashonaland West Province, Zimbabwe. The research adopted the mixed research methodology. Primary data was collected using interviews and questionnaires. The study's major findings were that debt finance was used for improvement of refuse collection and water reticulation system. The major challenges faced by local authorities were poor debt management, lack of commitment on debt management and poor staff training on debt finance procedures. The study also revealed that debt finance contribute 90% of major projects being implemented by local authorities The study recommended that Ministry of local Government should provide assistance in form debt finance training procedures basing on cost of debt and rate of return.*

### *KEYWORDS*

*debt management, local government authority, poor service delivery, increase in uptake of debt, poor financial records*

## 1. INTRODUCTION

A sound finance base for local authorities is critical for successful fiscal decentralization. According to Comrie (2014) local authorities play a significant role in economic development of their communities and more generally the country as whole. Furthermore, local authorities like any other organization require finances to meet their obligations. This view is supported by pay you deliver consortium (PYDC 2018), which highlighted that local authorities must continuously mobilise resources to ensure sufficient finance of their operations. Funding an organization's operations is a critical decision that consists of combination of debt and equity ( Rani, 2015) . The main objectives of local authorities are to provide quality service delivery such as clean water, collection of refuse and employment creation to the country. A study of Mashonaland West Province (rural and urban) local authorities is therefore critical given their immense contribution to country in form of service delivery, employment creation and local capital investment. Thus each local authority accounting systems are vital in determining cost of debt and return of investment. Access to external debt by local authorities is indeed important, just like other larger corporate, for capitalization and operating activities.

Local government is the lowest in the governmental hierarchy within the concept of federalism. The federal government is the sovereign national, the state government, a quasi-sovereign and local government, infra-sovereign. It is infra-sovereign, subordinate and subject to the control of the state government; yet it is a separate legal unit being a body corporate having a common seal, with powers to sue and to be sued, mainly providing obligatory municipal services (Samihah and Adelabu, 2011).

The local authorities which provide service delivery and fund its capital projects through external debt have serious challenge to policy makers who lack the requisite debt management systems to determine cost of debt in relation to return social protection and working conditions and productivity in the informal sector activities through regulatory framework, advocacy, training, access to credit and financial services(Pant and Suwal, 2009).

The local government system in Zimbabwe is a legislative rather than a constitutional creature. In practical terms, what this means is that Local Government is not an independent sphere of government, but an appendage of central government which determines the birth, development and death of this important sphere of governance. The activities of local government units are coordinated by the Ministry of Local Government, Public Works and National Housing (MLGPW&NH). The ten provinces into which the country is divided are administrative rather than political provinces and do not have elective structures. As such, no really significant powers have been devolved upon Provincial Councils and Provincial Committees, AFDB (2016).

The juridical framework for local government is set out in several pieces of legislation. The principal Acts governing local authorities in Zimbabwe, the Urban Councils Act and the Rural District Councils Act set local authorities as separate and fairly autonomous legal corporate institutions. The main Acts for local governance purposes are the Urban Councils Act (Chapter 29:15), Urban Councils Amendment Act (Chapter 29:16), Rural District Councils Act (Chapter 29:13), Chiefs and Headmen Act (Chapter 29:01), Communal Land Act (Chapter 20:04), the Provincial Councils and Administration Act, the Customary Law and Local Courts Act (No. 2) of 1990 and the Traditional Leadership Act of 1998. In addition, there are a number of statutory instruments defining the legal parameters of local government.

Zimbabwe has two main types of local authorities, the Rural District Councils in rural areas, and the Urban Councils in the urban areas. The institutional framework for local government in the country can be better understood in terms of three universes; the Centre, the Urban universe and the Rural universe, with the latter two orbiting around the centre.

The Ministry of Local Government administers all the Acts and Statutory Instruments promulgated in the local government area. The Minister retains a substantial supervisory role over all local government units (LGUs) and enjoys the ultimate power of intervention and suspension of any local council. In some sense, the LGUs in Zimbabwe operate at the behest and suffering of the Minister. In fact, the main legal instruments of local government invest the President and the Minister of Local Government with the power to suspend or act in place of a local authority and the power to nullify some decisions of local authorities, AFDB (2016).

The overbearing role of the ministry in local governance is particularly evident when it comes to the implementation of the decentralization programme, a pet project of the Government since independence. According to the Thirteen Principles to Guide the Decentralization Process adopted by Cabinet in 1996, the transfer of powers and functions by line ministries to RDCs is done by the line ministry concerned but the Ministry of Local Government co-ordinates and facilitates the effort.

Another critical ministry in the day-to-day functions of local government is the Ministry of Finance, especially in the area of development planning and public finance for capital projects. For instance, Section 290 of the Urban Councils Act provides that urban councils may, with the consent of the minister responsible for local government and the minister responsible for finance, raise the necessary funds by issuing stock, bonds, debentures or bills, or from any other source not mentioned in the Urban Councils Act.

Another critically pivotal institution in local governance is the Presidency. Throughout the various pieces of local government legislation, the President is empowered to intervene in a variety of cases, the ultimate being the dissolution of a council and dismissal of councillors and Executive Mayors.

Under the RDC Act, for instance, the President is empowered to declare, name, alter or abolish a district.

The fourth important national institution is the Local Government Board (LGB) established under the Urban Councils Act. This is six-member Board appointed by the central government to oversee the operations of local authorities but its visibility and authority is felt mainly in the appointment or dismissal of senior council employees. It provides guidance on the organisation, administration and personnel issues in local government and the minister may direct the LGB to institute investigations on any matter relating to local government administration. For avoidance of confusion, it must be clarified that local government staff are recruited by local authorities themselves and have the power to discipline and dismiss staff but the LGB must approve the appointments and dismissals of senior staff in urban authorities. For senior staff in the RDCs, the Ministry plays this role. To ensure some sense of fairness in the composition of the LGB, it has two public service commissioners (from the Public Service Commission – central staff agency); a representative from the Association of Rural District Council (ARDC); two representatives from councils; and one representative from the workers, AFDB (2016).

Also involved in staffing matters at the national level is the Public Service Commission. According to the 13th Principle to guide the decentralization process, “the Public Service Commission will manage the transfer of personnel from central government to rural district councils where this happens as part of decentralization.” In practice, the PSC has largely been invisible in the operations of local authorities and to this extent; its role has remained largely theoretical.

Other institutions provided for in the Rural District Council and Urban Council Acts are the two associations representing these areas: the Association of Rural District Councils (ARDC) and Urban Council Association of Zimbabwe (UCAZ). They have been very actively involved in research, training and advocacy with a view to strengthening local governance. They, for instance, made useful submissions about reforming the local government sector during the Presidential Constitutional Commission with both in strong favour of “constitutionalising” local government in Zimbabwe. UCAZ has established a committee that meets reportedly regularly with the Minister for Local Government to discuss matters of mutual concern. Unlike UCAZ, the ARDC is said to meet with the ministry on an ad hoc basis.

Another important national structure is the Portfolio Committee on Local Government, Public Works and National Housing. The local government portfolio committee exercises surveillance over the entire local government domain. It, like other committees, holds public discussions on pertinent issues that have arisen or are of public concern and report their findings and recommendations to the whole Government of Zimbabwe.

Mashonaland West Province in Zimbabwe is one of the biggest province with over twenty local authorities, and is expected to play a leading role in socio and economic development of the country Mambokoital, (2013). It is reported that for the past ten years, Mashonaland West has been heavily reliant on external sources of finance to bolster their operations resulting in external sources of finance constituting over 90% of its capital ( Government Of Zimbabwe and world bank , 2018) However, despite such huge borrowing, majority of residents in Mashonaland West have been experiencing perennial water shortage for over a decade, situation attributed to restricted pumping capacity at their water works as a result of inadequate resources

According to Obert and Olawale (2010) debt financing have merits and demerits on the growth or performance of any entity and its strategic investments. They state that some of the advantages of debt financing include tax deductibility of interest and the reduction of free cash flow challenges. The disadvantage associated with debt financing includes possibility of bankruptcy costs. Failure by local authorities to adequately keep proper records and proper management of debt finance has been the main causes of poor service delivery. Few or no researches have focussed on the lack of proper management of debt and its impact on performance of local authorities or service delivery. It is therefore upon this and other previous articulated research gap basis that this study is based upon.

In Making debt financing decisions, managers of local authorities endeavour to create a balance between the corporate tax benefits of debt financing (PYDC, 2018) and the costs of financial distress associated with bankruptcy risks ( Khalifu, 2014)

Boyle (2015) perceives performance as a measure of how well an organisation meets its obligation given the external constraints placed upon it. This view is shared by Hildebrand (2007) who noted that presently there exist multiple measures which serve different purposes. Many of these measures of performance are actually indicators of relative levels of activity and donot give any useful information on local authorities performance towards achieving its goals. For example economic indicators are primarily concerned with inputs, and show the costs of acquiring services such as staff or premises. On the other hand Efficiency indicators are concerned with the relationship between outputs and inputs.

The purpose of the study was to examine the management of debt by local authority's staff on the basis of poor service delivery to ratepayers.

The theme of debt management depicts any approach that facilitates repayment of debt ( PYD, 2018) For instance, Turleya et al, ( 2015) aver that debt instruments for financing government debt are determined by the public debt managers premised on the delegated authority from government. On the same breath, it is noted that debt portfolio composition is a policy instrument of public debt managers. Good Public debt management cannot only help in reducing borrowing costs but also aid in the development of domestic financial markets which are important in facilitating economic development and make the economy more robust to absorb external shocks, Comrie, 2014) Further to , it is utmost important to make debt management strategy that can be implemented for efficient management of debt. Strategies improve transparency and communication. In addition to improve governance framework, there is need for proper management and accountability for borrowed funds, as it vital for improving confidence in the financial markets and expansion of fiscal space

Local authorities require debt as a source of revenue. However, there are various issues to be considered when borrowing and these include grace period, interest rate, grant element as well as the absorptive capacity of the borrowing entity. Price Water house Coopers (PWC) asserts that lack of effective use of debt by local government authorities could be as a result of lack of knowledge and understanding pertaining to commercially acceptable level and application of debt. Fear of debt is also a major impediment to optimal use of debt financing in local authorities. Under- utilisation of debt is likely to result in under investment in local infrastructure. Argument for the local authorities to fully utilise the debt is largely perceived to be lack of knowledge by those responsible for managing debt, political inference by councillors or legislators. Lack of knowledge leaves other overheads unattended as it becomes difficult to cater for repayments as well as overheads, thereby leaving a gap in effective and efficient debt finance maintenance.

Obert and Olawale (2010) contend there is need for professional improvement of personnel through seminars or educational courses so as to overcome the challenge of inadequate knowledge on debt finance management and can be effective and optimal to improve the performance of the organisation.

## 2. STATEMENT OF THE PROBLEM

Insufficient knowledge of debt by local authority' staff has led to wrong maintenance of optimal debt ratios, increased uptake of external debt and non coverage of overheads costs resulting in perennial water shortage among other problems .What is the basis of running a local authority where perennial water shortages and uncollected garbage are the order of the day despite increased uptake of debt?

### 2.1. Objectives of the Study

To assess the debt management practices and their effects on performance of local authorities, based on a study of sixty (62) local authorities staff, in Mashonaland West.

### 2.2. Research Question

Are the debt accounting records effective enough to consider when making vital decisions by lenders on local authorities in Mashonal and West Province?

## 3. METHODOLOGY

The population of the study consisted of 62(sixty- two) members from local authorities staff drawn from managerial, accounting, water and refuse collection in Mashonal and West Province. A mixed method approach was used to examine the main cause of poor debt management and service delivery by local authorities.

A purposive approach to select 20 (twenty) members was used for the study as it enabled the researcher to consciously select a sample appropriate for the Study .In-depth interviews that allowed respondents to answer certain questions in order to secure desired information and questionnaires were the data collection tools.

## 4. DATA PRESENTATION, ANALYSIS AND DISCUSSION

The study wanted to find out challenges facing the local Authorities basing on poor delivery to rate payers despite increase uptake of debt. The following results were obtained

Table 1: Local Authorities' Challenges

| Challenges: | Agree | Not Sure | Disagree |
|---|---|---|---|
| 1. Do you havepoor debt management system? | 70% | 10% | 20% |
| 2. Is there lack of commitment by local authority's debt finance managers? | 85% | 5% | 10% |
| 3. Is there inadequate knowledge by debt finance officers? | 90% | 5% | 5% |
| 4. Staff trainings on debt finance procedures are critical? | 80% | 2% | 18% |
| 5. Debt capital is critical for capital projects? | 90% | 5% | 5% |

(Source: Primary data 2020)

The majority of respondents agreed (90%) that local Authorities face challenges of inadequate knowledge on management of debt, with a minority in disagreement (5%) and (5%) not sure.

In- depth understanding of local Authorities' challenges and their effect on service delivery provided by the respondents included, diverting debt to other purpose than for capital projects, inadequate staff training, poor bookkeeping records on debt, lack of commitment by local authority on use of debt and political interference on use of debt.

**Do local Authorities use debt for capital projects or its original purpose?**

The research intended to establish whether local Authorities use amount borrowed for capital projects or its original purpose. The following results were obtained:

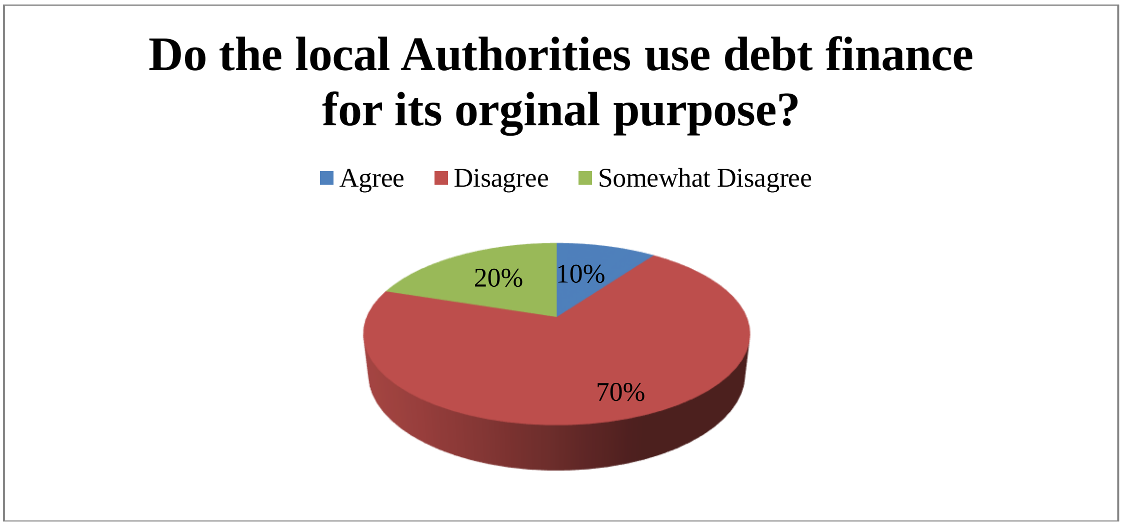


Fig 1: Do local Authorities use debt for its original purpose?

(Source: Primary data 2020)

Interviews data gathered with the local Authorities members indicated that they were aware of Exernal borrowings by the local Authorities, and requirement that they debt must be used specifically for capital projects such as water reticulation, robots improvements or refuse collection. One of the informants said "…it is reasonable given that the ability of an urban local authority to provide good service to the residents depends to a large extent on how well the national economy is performing”.

In addition they local Authorities are required to prepare and present proper records on debt finance to rate payers. Moreover, data gathered through questionnaires concurs with data collected from interviews. Thus, this shows that the respondents were aware of major challenges facing them of poor debt management, diverting debt for other purposes for example payment of local Authorities salaries, inadequate knowledge on part or local staff and political interference by councillors on use of debt.

Capital structure decision directly influences the financial performance of an organisation or entity as they determine key financial variables such as returns, risks, cost of capital and market price of a share. It is within this context that uptake of debt must taken were internal cash is insufficient to finance capital expenditure ( Harwood and Cheruyoit, 2015)The main aim of organisations is to maintain proper accounts and a complete set of financial statements that reveal whatever information an outside requires.A proper debt management system and proper staff training in debt finance are key factors that influence company performance and recommend whether the company should use short or long term debt or both.Generally, benefit such as tax shield is easily realised as interest payment is usually deductible, if properdebt finance management system is being implemented by an organisation. Debt management systems practices by local authorities play an important role in determine whether cost of capital does not exceed the required rate of return of an entity.

Furthermore, the study wanted to find out if Local Authorities were willing to obtain further debt despite poor service delivery to rate payers. Interview data gathered with the informants indicated that were willing to get funding so long it was for capital projects such as to expand or improve infrastructure such as resurfacing of roads or improvement of water reticulation systems. Moreover, data gathered through questionnaires concurs with data collected from interviews.

Insufficient knowledge of debt has led to wrong maintenance of optimal debt ratios, maximisation of profits hence making it hard to improve profitability. Thus inadequate or lack of knowledge and expertise concerning debt finance maintenance techniques prohibit coverage of overheard and monthly labour costs, Comrie, (2014).

Circumscribed financial and administrative decentralisation had been cited as the major challenges in improving service delivery in the city of Lusaka in Zambia (Resnick, 2010). The effect of circumscribed financial and administrative decentralisation had been exacerbated by the fact that the city of Lusaka had been run by the opposition party which was vulnerable to the ruling party’s influence through the regulatory powers of the central government. For instance, Resnick (2010) observed that the Lusaka City Council’s (LCC) decisions on expenditure priorities were ultimately subject to the approval of Zambia’s Ministry of Local Government and Housing. Resultantly, interparty wrangles turned LCC into a platform for political competition rather than an institution for improving the welfare of the city’s residents (Resnick, 2010). Also undue political interference in Nigeria’s local government affairs coupled with lack of financial autonomy caused local governments to behave like extensions of state ministry (Agba et al, 2013).

## 5. FINDINGS

The study revealed that rate payers and other external debt financiers require proper management of debt and first class service delivery by local Authorities, thus it complies with the understanding at the continental level. The local Authorities were not able to give proper service delivery because of inadequate knowledge by debt management personnel and political interference by councillors.

## 6. CONCLUSIONS

The study concluded that proper debt accounting records must be maintained by qualified personnel, and no political interference should be tolerated in the use of debt , but the debt to be used for the purpose it was borrowed. Financial performance of local authorities must not be hindered by lack of knowledge by local authority's personnel.

## 7. RECOMMENDATIONS

This study recommends that the Ministry of local Government should provide assistance in form of training on local authority's staff members relying on amount debt finance of each local authority.

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