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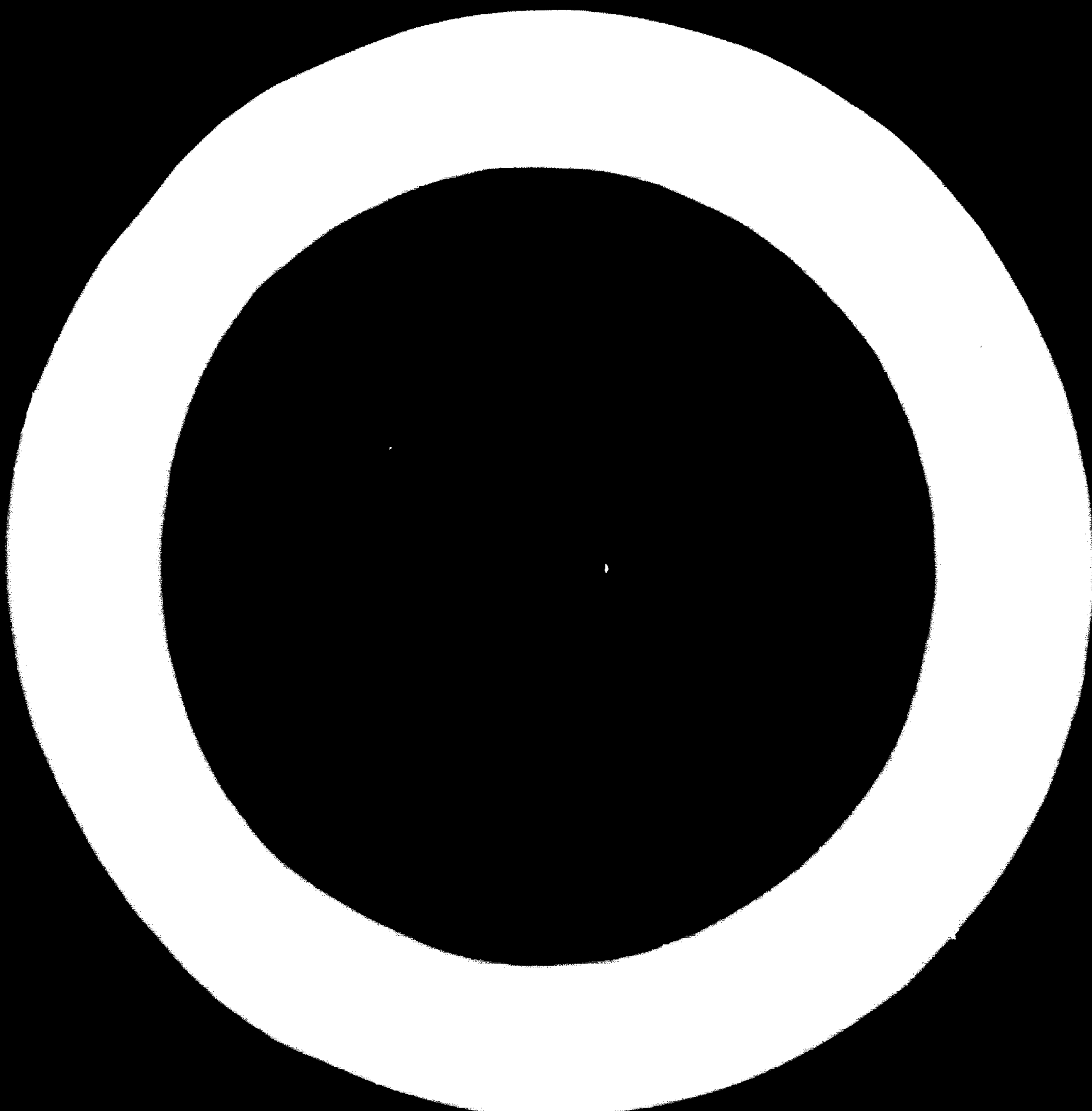

Characteristics of Industrial Development Banks
and Their Role in Economic Development *

The Emergence of Industrial Development Banks

Although many of the basic elements of development banking can be traced to institutions in the older industrialized countries dating from the early part of the 19th century, their employment in developing countries appears to have originated with the organization of corporaciones de fomento in several Latin American countries before and during World War II. The sharp decline in the prices of primary commodities during the 1930's led the governments of a number of Latin American countries to adopt policies deliberately designed to promote industrialization. Efforts to encourage domestic industry by means of restrictions on imports were only partially successful. Domestic industrial capital formation was aversely affected by the interruption of foreign capital inflow and the reduced earnings from exports of primary commodities. Private capital formation in domestic industrial activities was also limited by the shortage of domestic entrepreneurs with capital available for investment in industry and by the shortage of foreign exchange required for the importation of capital equipment and raw materials. Although World War II was accompanied by an increased demand for at least some primary products, the need for industrialization was enhanced by the unavailability of industrial commodity imports from the developed nations of North America and Western Europe. Latin American governments were therefore led to the creation of institutions designed both to establish publicly owned or mixed industrial enterprises and to provide financing for private industry. Thus, Mexico's Nacional Financiera was established in 1934; Chile's CORFO (Corporacion de Fomento de la Produccion), in 1939; Columbia's Instituto de Fomento Industrial, in 1940; Argentina's Banco Industrial de la Republica Argentina, in 1943; and Venezuela's Corporacion Venezolana de Fomento, in 1946.

Most of the industrial development banks in existence today, both in Latin America and elsewhere in the underdeveloped world, have been established since 1950. This surge in the creation of development financing institutions has paralleled the growing national interest in rapid industrialization and the rapid rise in the number of new independent nations. Governments have established or promoted the formation of industrial development banks as a means of channeling government capital and private domestic savings into industry and of attracting external capital for industrialization. As has already been mentioned, external public lending agencies have played an important role in assisting and encouraging the creation of such institutions.

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* Bureau of Business and Economic Research, Public External Financing of Development Banks in Developing Countries, University of Oregon, Eugene, Oregon, 1966, pp. 6-23.

Principal Functions of Industrial Development Banks

The motivation for the creation of industrial development banks has arisen from those conditions generally found in less developed countries which inhibit the formation of industrial capital. These conditions include:

(1) The absence of private capital markets for raising equity and long-term loan capital;

(2) The unwillingness of commercial banks oriented toward trade financing to provide even short- and medium-term loans to any but well-established foreign and domestic firms;

(3) The relatively low rate of profits in relation to risk in the field of industrial investments compared with alternative uses of financial capital, such as construction, land speculation, trade, and loans for consumptive purposes;

(4) An unfavorable climate for foreign investment;

(5) Limited markets and high production costs as a consequence of a shortage of skilled labor, technicians, and managerial competence;

(6) The need for pre-investment surveys and adequate assessment of industrial ventures; and

(7) For at least some countries, the inability to obtain foreign exchange for imports of industrial equipment and materials.

This list could be extended, but it would include conditions which are common to all underdeveloped countries and which explain in large measure why they are underdeveloped.

Many of these obstacles to industrialization lie outside the ability of financial institutions to correct or ameliorate. Although there are notable exceptions, industrial development banks generally do not play an entrepreneurial role in initiating industrial projects or in managing new industrial ventures. However, their activities frequently extend to assistance in mobilizing other sources of capital and in providing various forms of technical and advisory services in connection with proposed new industrial ventures or the expansion of existing ones. Yet, the role of industrial development banks is essentially a supplementary one in the industrialization process in the sense that in the absence of a large number of conditions favorable to the creation of productive private industrial enterprise, their existence by itself will not create such enterprise.

The majority of industrial development banks are concerned mainly with the provision of financing for new or existing enterprises. Nevertheless, in varying degrees they do provide other services, many of which are essential to their own decisions with respect to applications for financial assistance. In addition to investigating and determining the feasibility of projects, they may assist applicants in securing capital from other sources, and may provide technical assistance to the firm or help the firm in obtaining technical and managerial services. In some countries industrial development banks function in close cooperation with industrial development centers or other sources of technical assistance. Some industrial development banks may, either by themselves or in cooperation with other agencies, undertake surveys for the purpose of identifying industrial opportunities and may even play an active role in bringing them to the attention of potential investors. Such promotional activities do not in general loom large in the activities of these institutions.

In the field of purely financial operations, our empirical research reveals a variety of types of financing, ranging from relatively short-term loans to equity participation. Some public development banks that are heavily committed to promotional activities or operate in close cooperation with governmental ministries and planning authorities may provide nearly all or the vast bulk of the equity and loan financing of new enterprises, with the intention of selling their equity investments to private investors after the enterprise has become established. But such practices are rare for industrial banks, and the enterprises promoted in this way are likely to be large-scale undertakings such as steel plants. Many public industrial development banks are multi-purpose institutions and finance activities in the public sector, such as power and transportation facilities, which lie outside the scope of activities covered by our definition of industrial development banks.

Industrial development banks provide financing in the form of both local currencies and foreign exchange; in some cases a loan may take the form of a combination of local currency for covering domestic expenditures related to the project and of foreign exchange required for components imported directly by the borrower. In countries without exchange controls or where import licenses and foreign exchange are readily obtainable for industrial imports, borrowers have a distinct preference for local currency, since it does not involve an exchange risk. On the other hand, in countries where foreign exchange is difficult to obtain even for capital projects, borrowing from industrial development banks may be the easiest, or perhaps the only, way firms can obtain foreign exchange for the imports they require. In fact, we suspect that in a number of instances firms may seek loans from industrial development banks more as a means of obtaining foreign exchange for imports than for the purpose of supplementing their capital resources. In other words, they may have sufficient local currency resources for financing their capital expenditures if their local currency were readily convertible into foreign exchange. In such cases industrial development banks provide a source of foreign exchange for private industry, usually made available by loans from external lending agencies to the industrial development bank, and also perform the function of allocating scarce foreign exchange among alternative uses. The role played by the external lending agencies in this process will be discussed in Chapter IV.

Areas of Investment Activity

While by definition all industrial development banks make loans to the manufacturing sector of the economies in which they operate, they are by no means highly specialized. Most of them, as revealed by our sample, indicate financial assistance to sectors other than manufacturing, and in a number of cases their investments in such fields as agriculture, mining and smelting, housing, and in economic overhead facilities such as electric power and transportation, are substantial (see Table I). The frequency distribution of loans to each economic sector as presented in Table II corresponds roughly with the composition of investments by economic sector noted in Table I.. While loans to manufacturing enter-

Table I

Composition of Investments Made by Development Banks by Activity of Enterprises Financed

Activity	Substantial	Small	Negligible	None	Total*
Agriculture..............	8	3	2	3	16
Commerce................	1	2	2	5	10
Manufacturing...........	24	0	1	0	25
Mining..................	4	8	3	1	16
Fisheries...............	2	5	7	2	16
Housing.................	5	1	3	2	11
Electric power..........	6	4	3	4	17
Transportation..........	5	3	3	5	16
Communication...........	0	3	3	5	11
Office buildings........	1	1	2	5	9
Refining................	2	3	2	5	12
Smelting................	3	4	3	4	14

* Total number of responses.

Source: Replies to questionnaire.

prises apparently account for the largest proportion of total loans by industrial development banks, many of them make a substantial number of loans in such fields as agriculture, mining and smelting, housing, and fisheries. Loans to such fields as electric power and transportation tend to be made only by publicly owned development banks or corporations that are employed extensively as a channel for financing public enterprises, since in most developing countries economic overhead facilities are in the public sector of the economy. Moreover, as noted in Table III, only 5 of the banks in our sample indicated that loans for electric power were specifically permitted. In the case of commerce, office building construction, and housing, a high proportion of the development banks in our sample were proscribed from making loans in these fields. Moreover, in many cases the fields in which development banks may be permitted to make loans are governed by conditions imposed by the governmental or external institutions which supply a large portion of their loanable funds.

Table II

Frequency of Loans in Each Category Made by Development Banks

Activity	Very frequent	Many	Few	None	Total
Agriculture............	4	1	4	4	13
Commerce...............	2	1	2	5	10
Manufacturing..........	20	2	1	0	23
Mining.................	..	4	7	1	12
Fisheries..............	1	2	8	2	13
Housing................	3	1	2	3	9
Electric power.........	1	3	8	3	15
Transportation.........	2	2	6	4	14
Communication..........	..	..	4	5	9
Office buildings.......	..	..	4	4	8
Refining...............	..	1	7	3	11
Smelting...............	...	4	6	3	13

Source: Replies to questionnaire.

Table III

Areas of Economic Activity Eligible for Finance at 23 Industrial Development Banks*

Activity	Permitted	Not permitted
Agriculture..............................	11	11
Commerce.................................	4	17
Manufacturing............................	13	..
Mining...................................	12	2
Fisheries................................	11	6
Housing..................................	8	11
Electric power...........................	5	9
Transportation...........................	9	8
Communication............................	9	9
Office buildings.........................	3	10
Refining.................................	11	3
Smelting.................................	12	1

* Many banks did not answer this inquiry. Some banks indicated that the question of their extending finance to an activity in some of our categories has not yet arisen.

Source: Replies to questionnaire

Loan Terms

Although several of the banks in our sample indicated that they made loans with maturities of less than a year, and in two cases such loans constituted more than 25 per cent of their portfolio, more than 80 per cent of the banks providing information on loan terms made loans with maturities in excess of five years, and nearly 60 per cent made loans with maturities of more than ten years (see Table IV). Moreover, for more than 60 per cent of the banks reporting information on

Table IV

Composition of Debt Financing Made Available During a Recent Year by 21 Development Banks, by Maturity of Financing*

Percent of portfolio	Less than 1 year	1 to 5 years	5 to 10 years	More than 10 years
0-10....................	C,D,P	[illegible],C,[illegible],E,[illegible]	K,L,[illegible],U	[illegible],[illegible]
10-25....................	[illegible]	[illegible],F,U	F,[illegible],[illegible],[illegible]	A,G,D
25-50....................	[illegible]	[illegible],K,I	C,[illegible],T	T
50-75....................	U	J,[illegible]	[illegible],[illegible],[illegible]	[illegible],[illegible],[illegible],S
75-100....................		[illegible],[illegible],[illegible]	L,C,H,I	K,L

* Letter symbols represent banks responding to our questionnaire.

Source: Replies to questionnaire.

loan terms, more than 50 per cent of the value of their loan portfolio constituted financing with maturities of over five years, and 6 of the 21 development banks providing information on the maturities of their portfolios indicated that over 50 per cent of their portfolios constituted loans with maturities of over ten years. Nevertheless, the weighted average maturity of the loans of the banks for which information was available was not much over five years. This, together with the relatively small amount of equity participation by industrial development banks, indicates a tendency to avoid long-term financial commitments to enterprises, at least in terms of the periods associated with long-term financing in developed countries.

Interest rate charges on new loans by 22 banks in our sample providing such information by maturity of loans are clustered in the 6 to 9 per cent range. For loans with a maturity of more than one year there appears to be little progression of interest rates with the length of loan maturities (see Table V). While these rates may appear somewhat high relative to long-term loan and bond rates in developed countries, they are low in relation to the relative scarcity of capital and interest rates in both controlled and uncontrolled markets prevailing in the less developed countries. In many cases the rates charged by development banks were found to be less than those charged by commercial banks for substantially shorter maturities. Development banks operating in countries undergoing a significant amount of inflation (in excess of 5 per cent per year) were found to charge rates in the 10 to 18 per cent range. Three of the development banks in the total sample require borrowers to adjust their interest and principal payments to changes in the dollar value of the domestic currency, even on local currency loans derived from domestic sources. [illegible] development banks in countries experiencing high rates [illegible] service payments to changes in the cost of living index. [illegible], [illegible] cedure has been instituted by the [illegible] (BNDE) of Brazil, and by CORFO of Chile.

The ability of development banks to charge rates [illegible] market rates of interest arises from the fact that [illegible] funds, and in many cases virtually all of their funds, are derived from [illegible] public sources or from international lending agencies. [illegible] or no-interest loans or capital contributions [illegible] by the [illegible] governments, and in some countries the central bank permits its industrial banks to rediscount [illegible] at low interest rates. These sources of funds will be discussed [illegible] chapters.

Loan Collateral and Profit-Sharing Arrangements

Although more than half of the 26 banks in our survey reported that they had made some loans without requiring security, 12 respondents noted that they made unsecured loans infrequently, and only 4 banks reported that the total value of their unsecured loans surpassed 5 percent of the value of all loans made. In most cases unsecured loans were made only in conjunction with equity participation.

Various types of collateral are accepted by development banks, with mortgages on property or equipment being the most frequently used. In some cases the banks require options to purchase equity shares or accept debentures convertible into equity shares, provided their charters permit the holding of equities. Such practices are employed to an increasing degree as a means of enabling development banks which make high risk loans for new ventures to share in the extraordinary profits of successful enterprises. Seventeen of the development banks responding to our questionnaire reported that they employed one or more of the following arrangements in their lending operations: a) accelerated amortization in cases of substantial profits by borrowing enterprises; b) debentures convertible into equity shares; and c) options to purchase equity shares at the discretion of the bank.

Size of Loans

We found no uniformity among the industrial development banks with respect to the size of loans. However, the size and sources of financing of the individual banks tend to determine in practice the minimum and maximum size loans that they will make. For example, a large publicly owned development bank such as Brazil's BNDE, which has substantial sources of revenue from the government and from P.L. 480 local currency receipts, might make loans of $1 million or more to a private steel corporation. The normal range is from $20,000 to $200,000. The maximum size loan depends upon the assets of the lending institution. Typically, a private development bank could not appropriately provide assistance to any one project in an amount exceeding 15 to 20 percent of its capital and reserves.[1] Sometimes larger loans than a development bank would normally make out of its own resources are arranged by participation of international lending agencies which

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1 For a discussion of the size of loans of private development banks, see International Finance Corporation, Private Development Finance Companies, Washington, D.C., June 1964, p.8. The average size of loans made by the Corporacion Financiera Colombiana de Desarrollo Industrial over the past five years is about $84,000.

provide funds for specific loans to local private enterprises, either alone through the domestic development bank or in participation with it. Industrial development banks have been created, usually by the government. For example, the Banco Popular in Colombia and the Fondo de Garantia y Fomento a la Industria Mediana y Pequeña in Mexico are prototypes of small-business credit institutions. Thirteen of the banks in our sample stated that they do not make loans smaller than a certain minimum, usually a sum equivalent to $2,000, whereas in certain banks the minimum was $20,000 to $30,000. As a rule, private development banks are unable to make loans of a size much less than the equivalent of $20,000 unless their operation are subsidized, perhaps on a fee basis, to cover the high cost of such operations.

Losses

Although the industrial development banks covered by our sample were reluctant to answer questions relating to their losses, we have the impression that losses have not been so substantial as to constitute a major problem or barrier to operations. Usually losses on particular loans can be covered from profits so as not to impair the financial soundness of the bank. Perhaps more significant than losses resulting from failure to repay loans has been the inability of banks engaging in equity participations to sell their securities at cost. The desire to avoid showing a loss has thus led to a congealing of equity portfolios.

Loan Criteria and Priorities

The replies of industrial development banks to our questions concerning the criteria employed in providing financial assistance are in determining priorities among loan applications provide only partial evidence with respect to the role of industrial development banks in the allocation of financial resources. As indicated in Table VI, 23 of the 24 banks responding to questions relating to loan criteria indicated that they attach high priority to investment in certain industries. In addition, 14 of the banks note that they attach priorities to certain geographical areas within their countries. All respondents denied that they lend to enterprises that can pay the highest rates of interest, but these replies probably mean little more than the existence of more or less standard interest rate terms for all loans with the same maturity and falling within a particular industrial or geographical category. It is unlikely that interest rates reflect the relative degree of risk involved in the ventures financed.

Table VI

Criteria Used by Development Banks in Allocating Loans Among Enterprises

	Yes	No	Total
1. Lends to enterprises that can pay the highest rates of interest	0	20	20
2. Attaches high priority to certain industries	23	1	24
3. Attaches high priority to certain sizes of loans	3	16	19
4. Attaches priority to borrowers of relatively low but acceptable net worth	6	11	17
5. Attaches priority to certain geographical areas within the country	14	9	23

Source: Replies to questionnaire.

Only 8 of the 24 responding banks use interest rate differentials to favor certain industries. In most cases these differentials are 2 per cent or less; however, one bank uses differentials of up to 4 per cent. Only three banks use differentials in interest to favor loans of certain size or borrowers of certain net worth. Only two banks use differentials in interest charges to favor specified geographic areas in their countries.

Seven banks note that their priorities are based both on their charters and on policies adopted by the bank. Only two banks rely solely on the provisions of their charters for their priorities in supplying finance. Fifteen note that the priorities they follow at the present time have been evolved as a matter of policy. A few banks note that they give priority to consumer goods industries, taking account of the present stage of development of their country. Several banks note that their lending and investment priorities are in general agreement with the national development plan.

Equity Financing

Twenty industrial development banks in our sample of 28 indicated that they had subscribed to equity shares in private enterprises. While undoubtedly the majority of industrial development banks provide some equity financing, the relative importance of such financing differs greatly among development banks, and except for those banks whose investments are largely in publicly owned enterprises, equity financing tends to constitute a relatively small proportion, less than 20 percent, of their total investments. Usable data for 17 industrial development banks in our sample indicate that for 10 of these institutions the ratio of equity financing to total investments was less than 20 per cent and two of the fours banks with equity investments exceeding 40 per cent were publicly owned institutions with large commitments in public enterprises. (See Table VII.) Among the group of 10 banks with ratios of equity to total financing of 20 per cent or less, three banks indicated that they did not prefer to engage in this type of financing; these banks possess moderately low ratios of equity finance to "own" capital. However, three banks in the group preferred to extend equity financing in appropriate circumstances, but only one bank expressed unqualified preference for equity financing as compared with loan financing.

Table VII

Ratio of Equity Financing to Total Investments
for 17 Industrial Development Banks

Ratio in per cent	Number of banks
0-10	6
11-20	4
21-40	3
41-60	1
61-80	1
81-100	2

Source: Replies to questionnaire.

The majority of the banks, 22 of the 25 replying, indicated that they do not retain profitable equity securities for the purpose of increasing their earnings, and expressed a policy of selling equities once the firms were established to the point at which the equities could be readily marketed. There is considerable evidence, however, that equity financing ties up the resources of development banks and impedes the flow of funds to banks for reinvestment in other enterprises. Five banks in the group of 15 extending substantial equity financing noted that their efforts to sell holdings of equities have been impeded by a lack of developed capital markets. The other five banks in this group indicated that they were satisfied with their ability to market equities of firms after they had become profitable enterprises. Three of the five noted especially that they had not experienced difficulty in selling equity shares, whereas the other two apparently had not pushed the sales of their equity holdings. (In the case of equity holdings of public or quasi-public enterprises, there may be political obstacles to selling shares to private investors.)

An important argument for investment in equity shares is that in developing countries there is a shortage of equity capital available for industrial enterprise. Yet the basic difference between equity financing and other types of risk capital, such as, for example, participating debentures or long-term loans with a suitable grace period, is participation in the control of enterprises. Thus, there would seem to be two advantages in employing equity financing. First, an industrial development bank supplying a substantial portion of the total capital of an enterprise may find it desirable to retain a measure of control and representation on the board of directors of the enterprise during the early years of its existence, or following a major expansion. Second, the purchase of equity shares by an industrial development bank may facilitate the subsequent sale of these shares to private domestic or foreign interests. In some cases, this latter function may be accomplished by underwriting the issue of equity shares, with the industrial development bank and perhaps other participants in the underwriting having to absorb and to hold the unsold securities for a time. In fact, a number of industrial development banks do engage in underwriting activities. It is well, however, to keep these basic factors in mind in considering the relative advantages of loan and equity financing. In other words, if the objective is solely one of providing long-term financing without an interest either in a temporary period of control or in facilitating the distribution of equity shares to other investors, some form of debt financing would appear to be preferable to equity financing. The reasons for this conclusion are twofold. First, indiscriminate equity financing may well tie up the funds of the development bank for an indefinite period of time, and the enterprise, even though moderately successful, may feel under no compulsion to pay dividends or retire its equity capital; and second, if the enterprise pays substantial dividends, the industrial development bank may be less than eager to sell a high-yielding asset.

Pre-Finance Investigation and Investment-Opportunity Surveys

Industrial development banks differ widely with respect to their activities and policies in the field of pre-finance investigations relating to specific loan applications and to investment-opportunity surveys undertaken independently of requests for financial assistance. A few development banks do extensive work in uncovering investment opportunities because they are charged with broad responsibilities in this field and are provided with financial support from the government to defray the costs of such activities. Among the publicly owned development banks that are heavily engaged in investment-opportunity surveys are the Corporacion Venezolana de Fomento, the Corporacion de Fomento de la Produccion of Chile, and the Nacional Financiera of Mexico. However, most development banks do not undertake studies unrelated to specific applications for financial assistance.

Nevertheless, broad investment-opportunity surveys and feasibility studies are of great importance to the approval of particular project proposals. In some cases governmental agencies other than industrial development banks provide investment surveys, often with the assistance of external technical assistance agencies such as the U.N. Special Fund. In several Latin American countries, certain industrial development banks may rely on broad surveys undertaken by another national development bank. For example, the Banco del Estado in Chile, the Banco Industrial de Venezuela, and the Fondo de Garantia y Fomento a la Industria Mediana y Pequeña in Mexico are able to avail themselves of industrial investment-opportunity surveys undertaken in their respective countries by the institutions mentioned earlier in this paragraph.

In countries which have experienced considerable industrial development, the industrial bank may require applicants for financial assistance to present an analysis of the technical, financial, and economic feasibility of their proposals; this analysis involves information of the type normally included in broader industrial and market surveys. Thus, the Banco Nacional do Desenvolvimiento Economico of Brazil states that:

> It should be emphasized that the BNDE's requirements with regard to projects submitted to it for consideration led to the establishment here of firms specializing in the formulation of such requests. Since then, there has been a remarkable improvement in the documentation normally attached to financing applications.[2]

In similar vein, an official of Mexico's Nacional Financiera stated that:

> Nacional Financiera is particularly concerned that market projections take into account realistic appraisals of existing methods and processes of production, capital equipment and requirements in existing industries, and that due consideration and analysis be made of product breakdowns and consumer and industrial preferences.[3]

Some industrial development banks, while not heavily engaged in broad investment-opportunity surveys, undertake limited studies on behalf of clients. Thus, the Banco Gubernamental de Fomento para Puerto Rico notes that:

> As a general rule we only consider studies with respect to particular clients, that must be carried out prior to financing by the client and at his expense; ...the costs of operation of our Loan Department involve some forms of pre-investment or pre-finance expenses which are not passed on to the applicant.[4]

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2. Banco Nacional do Desenvolvimiento Economico, Information Submitted at the International Bank's Meeting on Development Banks, May 1958, p. 52.
3. A. Alfredo Navarrete, Jr., "Nacional Financiera: Policies and Practices in the Field of Industrial Promotion" (Address to the American Club), Mexico City, August 28, 1962, p. 10.
4. Reply to Part II, questionnaire.

The Pakistan Industrial Credit and Investment Corporation also defines a middle round, stating that ... necessary and desirable ... investment and pre-financing investigations are undertaken by its own staff and at times through the employment of outside consultants.[5] The Economic Development Financing Organization of Greece notes that:

> A market analysis of the various sectors of industry is undertaken by EDFO's research department from time to time. EDFO's officers employed for this purpose belong to its regular staff and the expenses involved are shown under "overhead". No separate records of expenses for the above purpose are kept.[6]

Perusal of annual reports and questionnaire replies suggests that the majority of industrial development banks undertake pre-investment surveys of particular industries only in exceptional cases.

In industrially primitive countries there is a need for investment-opportunity and feasibility surveys to provide information that cannot be expected from applicants or prepared on an ad hoc basis by industrial development banks. We shall examine briefly three arrangements employed by countries seeking to accelerate industrial development.

In 1961 the governments of Ecuador and the United States entered into agreement establishing the Centro de Desarrollo de Ecuador (CENDES). The principal task of CENDES is the promotion of industrial projects chosen by the Planning Council of Ecuador. The principal functions of CENDES are to conduct investment-feasibility surveys and undertake promotional activities in order to attract investors into certain industries.

During 1962, CENDES completed five feasibility studies and had undertaken promotional efforts in 12 industrial fields, including production of glass containers, chemical fertilizers, farm hardware, and batteries. For some technical studies, foreign consulting firms are hired by CENDES because of the limited variety and number of its own personnel. In addition, CENDES provides technical assistance services to investors; it does not, however, provide any financial services. Up to the present, no industrial development bank exists in Ecuador, although proposals for the creation of one or more such banks have been under study.[7]

The second type of arrangement for reconnaissance of investment opportunities is that prevailing in El Salvador. In that country a development bank devoting its attention solely to industry, the Instituto Salvadoreno de Fomento Industrial (INSAFI), was created in 1961. During 1962 INSAFI completed 13 technical-economic feasibility studies, ranging from wood alcohol, corn products, and stockings to caustic soda, light bulbs, and plastic buttons. INSAFI calculated that the seven new industrial enterprises founded as a result of its studies during 1962 would have a direct and indirect impact on the economy of El Salvador equivalent to a 2.3 per cent increase in national product.[8]

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5. Reply to Part II, questionnaire.
6. Reply to Part II, questionnaire.
7. Centro de Desarrollo, Informe Anual de Labores, Quito, 1962.
8. Instituto Salvadoreno de Fomento Industrial, Memoria, 1962, San Salvador, February 1963.

A third type of arrangement is that existing in Nicaragua. The Instituto de Fomento Nacional (INFONAC) was created in 1953 and given the task of "increasing, diversifying, and rationalizing national production in all its aspects."9 In 1960 INFONAC contracted the services of the Stanford Research Institute to prepare a Five-Year Program of Industrial Development in Nicaragua. The completed study contained over 150 suggestions for industrial operations suited to Nicaragua. INFONAC states, "Our Department of Technical Studies is prepared to give ample assistance in the preparation and evaluation of industrial projects."10 In the same publication INFONAC presents 22 projects which its studies have suggested as being feasible; these include cotton and rayon textiles, harwood lumber, refrigerators, metal cooking utensils, and agricultural hardware.

The existence of broad industrial surveys covering existing and potential markets for the product, production and transport costs, and various technical problems relating to the industry is often essential for an adequate investigation of loan applications. The undertaking of such surveys and the provision of all of the relevant data by the applicant is usually not possible except in the case of sizable firms with personnel or resources for hiring domestic or foreign consulting firms for undertaking such studies. Only the largest industrial development banks and perhaps those receiving government subsidies or those having access to technical assistance from other agencies are in a position to undertake such investigations themselves. For example, in discussing the operations of the Pakistan Industrial Credit and Investment Corporation(PICIC), Professor Nyhart states that after "the appraisal committee decides in favor of a full investigation, the first step is a preliminary analysis of the product's potential market. If no satisfactory market exists, further investigation is halted."11 Referring to the operations of South Africa's Industrial Development Corporation, Professor Nyhart states that:

> The financial, the marketing or the engineering department is assigned primary responsibility to see that the basic assessment is completed on schedule and to move the project forward if it receives a full investigation. This assignment depends upon whether the project involves mainly marketing, financial, or engineering problems.12

The cost of maintaining trained specialists in each of a number of fields is substantial, and only the largest industrial development banks are in a position to have them on their staffs. The cost of using outside consulting firms for investigations of applications, a substantial portion of which do not result in the making of a loan, may be prohibitive. In cases where industrial development banks make loans with funds derived from international lending agencies such as the World Bank Group, AID, or IDB, full information regarding the project and its relationship to the industry as a whole, as well as its probable economic impact, is

9. Instituto de Fomento Nacional, Nicaraguense: En Sus Manos Nuestro Progreso Industrial, Managua, July 1962, pp. 9-10.
10. Ibid., p. 25.
11. J. D. Nyhart, Toward Professionalism in Development Banking, Massachusetts Institute of Technology, Cambridge, Massachusetts, 1964, pp. 14-15.
12. Ibid.

required for loans which must be approved by the international agency. Yet few development banks possess such contingent of skills and trained personnel, or access to them from other agencies, for adequate project appraisal, and in most economies basic studies have not been undertaken in the wide range of industries represented by projects submitted to development banks for financing.

Technical and managerial assistance

Technical and managerial assistance may be provided both in promotional activities, including assistance in the preparation of a project suitable for a loan application, and in assistance to the enterprise after the loan has been made. We have noted that few industrial development banks have the staffs or additional financial resources to undertake the former type of technical assistance, although undoubtedly in reviewing and appraising loan applications the staffs of development banks make suggestions or recommendations to prospective borrowers which would improve their chances of obtaining financing. The provision of technical and managerial assistance by industrial development banks or agencies operating in close cooperation with them constitutes an ideal way of supplying such services, both as a means of enhancing the contribution of financing to productivity and because an adequate loan appraisal by a bank will reveal areas where the applying enterprise is in need of advisory services. Twelve of the 28 banks in our sample noted that a portion of their staffs were occupied in providing technical and managerial assistance to enterprises being financed by the bank. Six banks among those in the group not supplying such services noted that firms they are financing avail themselves of the services of consulting firms or of other agencies. Four of the 16 banks that did not maintain permanent staffs for providing technical and managerial services and advice to enterprises which they financed indicated that these firms did not usually rely on the services of consulting firms or other agencies.

Unless an industrial development bank is subsidized by the government or is able to make the technical assistance and advisory service functions self-supporting through the charging of fees, the development bank, especially a private bank which is expected to show a profit to the owners on its operations, cannot as a rule provide such services. Even in the case of public industrial development banks that are subsidized or are under less pressure to show a profit, both the shortage of specialists needed for their own operations in investigating and appraising projects and the large overhead costs of maintaining on their payrolls a well-diversified group of specialists equipped to provide a great variety of services which may be required by their clients preclude activity in this area except for an occasional visit by specialists to the firms being financed and perhaps short-term assistance when they can spare the personnel. Of course where investment banks have a large equity commitment in a firm, they may hire managers and technicians who will be compensated by the firm.

Some of the aspects relating to the decision of a publicly owned development bank to provide technical services are summarised by the following statements by the Industrial Bank of Iceland:

> Frequent consideration has been given to the technological aspects of the bank's activities. Several times the bank has considered setting up a separate department of technical services, but has not yet done so. The main reasons for not doing this have been three: Technically trained people are specialists, with rather narrow specialisation. It would be necessary to hire several engineers in order to be reasonably self-sufficient. It has therefore been found to be more convenient to call in a specialist when required ... or to rely on public institutions .... Secondly, there is the

size of the institution and the cost. Iceland is a small country. The undesirability of an extravagant overhead is therefore always present in the minds of the people. And thridly, there is the fact of a very limited amount of funds really free for projects of novelty and great uncertainty. In such cases the bank [illegible] never [illegible]....[13]

Yet in domestic financing in underdeveloped countries as well as in external financing, not enough attention has been given to technical assistance, both before and after financing has been provided. External technical assistance and lending agencies can provide a limited amount of technical assistance to industrial development banks, particularly in the training of officials, and can assist in establishing productivity centers or in undertaking industrial and marketing surveys and the training of specialists in various fields. Just as external lending agencies cannot assume the function of retailing loans to industrial enterprises but must depend upon industrial development banks for channeling their capital, neither can they provide technical services to the clients of industrial development banks nor technical personnel for industrial banks themselves. In most cases, and particularly in the case of private industrial banks, technical and managerial assistance will have to be provided by domestic or foreign consulting firms or by government-sponsored productivity development centers and similar agencies dealing with marketing, financial, and other services required by firms seeking and obtainin assistance from industrial development banks.

Relation To National Economic Planning

Outstanding weaknesses in the formulation and implementation of national economic plans have been the failure of the planners to provide for adequate incentives for productive investment in the private sector and the failure of the private sector to meet target goals set for the plan. It is frequently stated that industrial development banks and other intermediate credit institutions can perform an important role in allocating capital in a manner which will assure, or at least promote, the objectives of national development plans. The majority of the industrial development banks studied affirm that they take the country's overall development plan into consideration in establishing priorities for loans, and ten of the development banks, in our sample indicated that they make special efforts to promote the goals suggested by the development plans. Moreover, two of these development banks, both publicly owned, reported that they are the major instruments for financing the nation's development program. Three other development banks (two of which are publicly owned) noted that they are subject to investment allocation systems established by the government in relation to the national development plan. Four of the privately owned development banks indicated that they followed the government's development plan in part but were not obligated to do so.

The relationship of development banks to national planning raises serious questions regarding the policies to be followed by industrial development banks. For example, should the industrial development bank give priority to less promising or even unsound projects for which loan applications are received, simply because they fit better into the scheme of the planning authorities as compared with more promising ventures? Planning authorities frequently emphasise the creation or expansion of industries which will produce substitutes for imports, regardless of the costs of production and long-run suitability of the industry for the country. Many students of development banking support the thesis that a development bank, whether privately or publicly owned and controlled,

> ....must be free to accept or reject specific projects; it must be free to set conditions under which loans will be made available and to demand modifica-

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13 Reply to Part II, questionnaire.

tions when unsound projects are presented to it; it must be free to enforce contract conditions under which borrowers receive credits; and, in some cases, it may even have to foreclose and assume possession of the assets of the company that it helped to finance. 14

May not an obligation to adhere rigidly to an industrial development plan compromise the principle of autonomy of development banks in selecting projects on the basis of sound economic and financial criteria? If a development bank is to attract domestic capital and secure financing from national lending institutions, it cannot be saddled with restraints placed on it by planning authorities and governmental agencies seeking to direct the allocation of the nation's capital. Development banks can certainly promote the broad industrial planning objectives of a nation by making capital available to the private industrial sector. Its promotional activities can uncover opportunities for investment if they exist in areas favored by the development planners. Other governmental policies, such as international trade and tax policies, can influence investment decisions. But a policy of forcing development banks to meet the requirements of the industrial plan by adhering to investment priorities that override sound criteria in appraising and deciding upon loan applications would not seem to be consistent with good development banking. This does not mean, of course, that development banks should not take into account the general economic impact of their investment decisions. Thus, the high profit probability of a luxury hotel or a firm manufacturing luxury goods should not necessarily take priority over sound, but less profitable, ventures for the production of fertilizer or farm implements. Industrial development banks should properly discriminate against the financing of speculative ventures which promise high yields but contribute little to socially productive investment.

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14. Ahmad Zial, "The Role of Industrial Development Banks in a Comprehensive Planned Economy," Conference on Industrial Development Banking (Istanbul: Central Treaty Organisation, July 1962), p.99.

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