OCCASION

This publication has been made available to the public on the occasion of the 50th anniversary of the United Nations Industrial Development Organisation.

DISCLAIMER

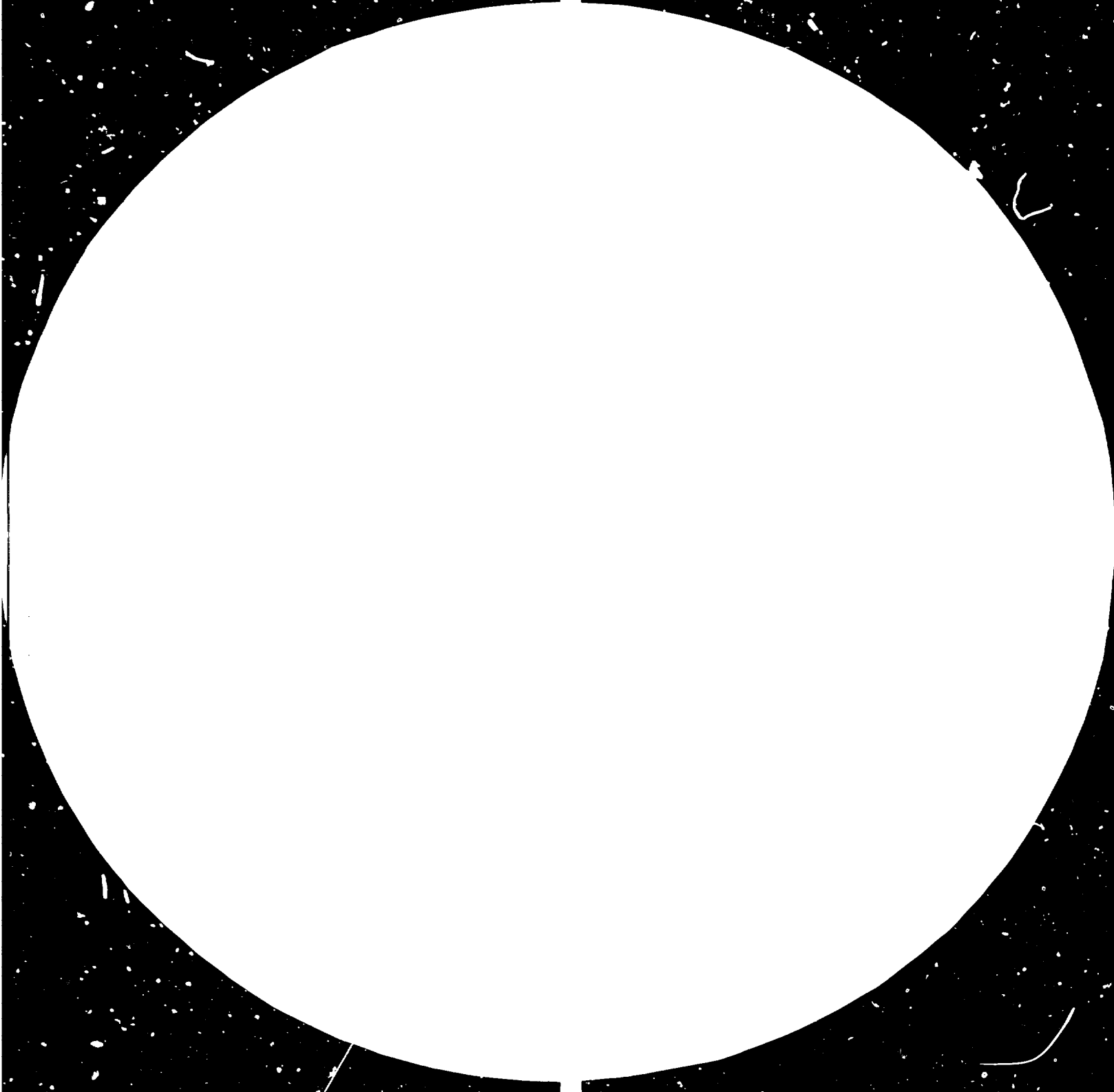
FAIR USE POLICY

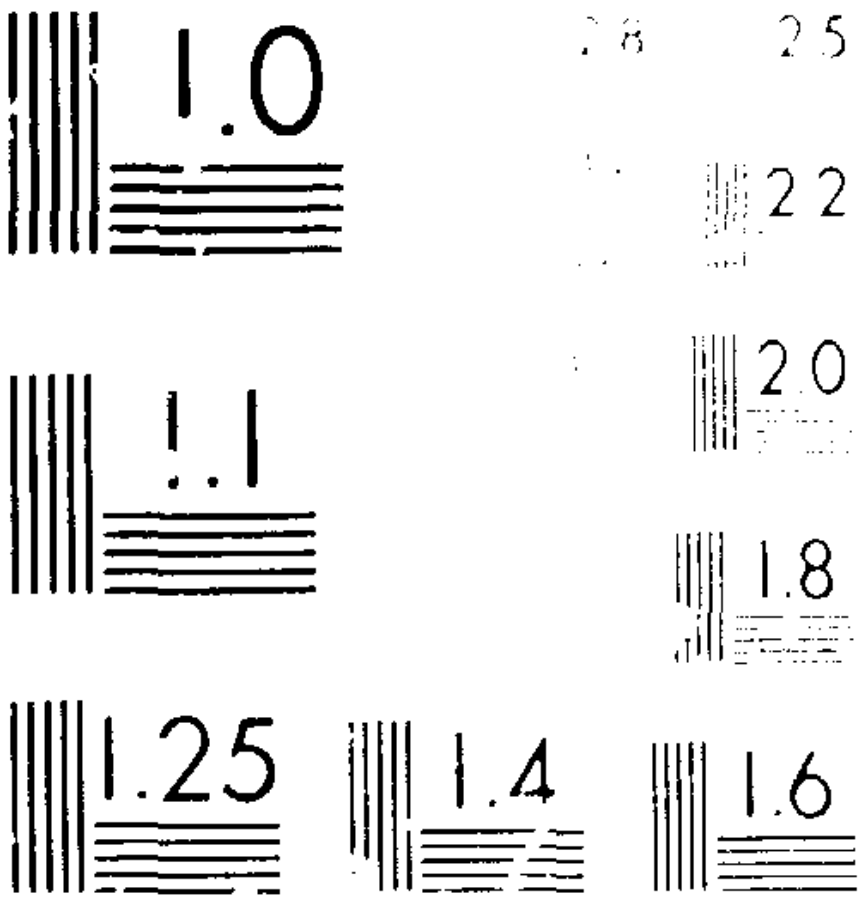
CONTACT

Please contact publications@unido.org for further information concerning UNIDO publications.

For more information about UNIDO, please visit us at www.unido.org

UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION
Vienna International Centre, P.O. Box 300, 1400 Vienna, Austria
Tel: (+43-1) 26026-0 · www.unido.org · unido@unido.org




1.0
1.1
1.25
1.4
1.6
1.8
2.0
2.2
2.5

11C88

United Nations Industrial Development Organization

Distr.
LIMITED

ID/WG.362/7
13 January 1982

ENGLISH

Preparatory Meeting of Directors of
Industrial Development Finance Institutions (IDFI)
on the Creation of a Technological Information
Exchange Network (TIEN)

Bridgetown, Barbados, 26 - 28 January 1982

COUNTRY BRIEF: MALTA*

prepared by

J.C. Caruana**

* The views expressed in this paper are those of the author and do not necessarily reflect the views of the secretariat of UNIDO. This document has been reproduced without formal editing.

** General Manager, Investment Finance Bank Limited, 168 Strait Street, Valletta, Malta.

V.82-20453

TABLE OF CONTENTS

(1) Industrial Development Financing Activities

The island of Malta is small, with an area of only 122 square miles, with no natural resources and a home market too tiny to support on its own an industrial project. For these and historical reasons, the record of industrial activity in Malta is not one of long-standing. In fact, the first serious activity of an industrial nature started about 20 to 25 years ago. We are almost exclusively dependent for technology and our supplies of machinery, equipment and raw materials on imports, and for our survival substantially on maintaining a competitive edge and an ability to exploit such advantage in order to export.

The importance of directly productive activities to Malta is immediately recognised when one considers that almost 50% of our gross domestic product is contributed by this sector. Value added by the manufacturing sector accounted for some 30% of GDP. Malta offers the potential entrepreneur the undoubted quality of its disciplined labour, at a cost which compares very favourably with European actual and social wages. It is also a manufacturing location which is close to Europe, and to the North African and Middle East markets. These factors have been to a large extent responsible for attracting industrial enterprises from various European countries to set up subsidiaries and joint ventures with Maltese interests. They manufacture a range of products from clothing items to metal fabricated goods, machinery and equipment, electronic components, paper and paper products, printing activities, leather goods, wood products and furniture, food and beverages items, plastic and other chemical and rubber products, and ships.

Naturally, with our climate and the sea, the tourist industry has flourished beyond our own expectations, but this industry does not perhaps strictly fall inside the parameters for which this paper is intended. However, it too, like manufacturing industry which has grown and expanded, was to a large extent financed by the banking system in Malta.

The structure of the banking system in Malta is a simple one. Apart from the Central Bank - which carries out the normal functions of a central bank - there are the commercial banks on the one hand, and the medium and long-term lending institutions on the other. The commercial banks are authorised to take deposits, and to make finance available for industrial development, and other purposes, on a short-term basis for a maximum of three years. Therefore, their function primarily is to provide working capital facilities, and in this way they finance the purchase of raw material for industrial enterprises, and they finance their production processing, debtors, and provide export finance through pre-shipment and post-shipment loans or overdraft. An important technique used extensively in financing industry, introduced with the advent of manufacturing industry in Malta, is the "merchandising" method.

New industrial units more often than not have no security to offer to the commercial banks, having generally charged their equipment to the long-term lenders, and being unable to mortgage their factory on account of its being held on lease from the Government, as part of the latter's incentives package to attract industrial activity. Through the "merchandising" overdraft the commercial banks will finance about 75% of the cost of raw materials on the latter being pledged as security. This is then released to the customer as it is gradually required for processing, and replaced eventually either by finished goods, or shipping documents or other paper evidencing sale, or at times where necessary a simple undertaking to hold the goods under process in trust for the bank, accompanied by a general legal charge on the moveable assets.

The commercial banks offer a complete range of normal banking services to industry, compatible with those expected in the industrialised countries of Western Europe. For although Malta is regarded as an advanced-developing country, its banking sector is a well developed one. It is relevant to mention that the availability of funds in the banks for financing industrial and commercial activity has so far never been a problem in Malta. The banks can in fact be safely said to be highly liquid, and demand of the level experienced in the past should in my opinion continue to be amply catered for by the local banking sector.

Finance for capital-formation purposes (the purchase of machinery and equipment and for industrial property) is provided basically by the Investment Finance Bank Limited (I.F.B.). Its terms of reference are to make loans available for a term in excess of 3 years, up to a maximum of 20 years, although in practice the duration of a loan is tied to the expected useful life of the asset being financed.

The Investment Finance Bank Limited considers loans to, and sometimes also takes a minority equity in, industrial projects which are expected to contribute directly or indirectly to the foreign exchange earnings of the Country, or to increase employment, or to create productive activity in line with the stated objectives of the authorities. Such loans normally are for a maximum of two-thirds of the capital expenditure involved in setting up or expanding an industrial project.

It is relevant to state that the Investment Finance Bank is not a development bank in the strict sense of the word, but it is the only operating institution of finance which comes nearest in its financing policy to the normally-accepted function in this particular area of development banks. The Investment Finance Bank, in fact, sets out to operate on a commercial basis, in that it will consider funding an industrial project on commercial criteria and strictly provided such project can prove that it expects to be a viable venture.

(2) Current experiences and methodology of evaluation of the technological contents of the industrial projects.

The requests for finance made on Maltese banks until 20 years or so ago were purely of a commercial nature. Our businessmen were importers of commodities required for consumption in Malta, but with the initiation of industrial activity in the late 1950's and during the two decades that followed the banks were called upon to operate in areas hitherto unknown. They had to learn through hard experience. This, no doubt, is the experience of every developing country.

As a developing country evolves as an industrial society, it moves into successive phases of industrial activity. This progression involves more sophisticated choices of technology and final product, and industries become more complex. The financing institutions for industrial projects will need therefore to keep pace with the development which is taking place in the various sectors of industry.

In practice, the banks in the developing countries are often unable to afford the specialisation necessary to evaluate the technological content of a project. It is well known that large international banks now employ specialists in energy departments, shipping, agriculture, commodity, insurance and other sectors of industry. The American banks have been doing this for a long time. The banks in Malta are neither in a position to call on such expertise at home, nor are they so financially large as to be able to afford employment of various specialist services. Besides, it is unlikely that the demand for such services would ever be of sufficient volume in any one segment of the economy as to justify the employment of several specialists, bearing in mind the inevitable limitation imposed on the growth of our industrial activity by the size of the Country.

In assessing the viability of a project, and in the process therefore the validity of its technological content, the banks in Malta apply any one or a combination of some of the following tests:-

(a) The fullest possible reports are obtained from foreign banks and agencies specialising in giving financial and other relevant information on the promoters, when these are non-Maltese. In this way the banks endeavour to establish to some degree the integrity, creditworthiness and technical knowhow of the sponsors behind the project.

(b) The shareholders are expected to be deeply committed to the project frequently, but not exclusively, in money-terms. This aims at eliminating the speculative element, by ensuring that the sponsors have an appreciable stake to lose, in absolute terms if not also in proportion to bank lendings.

(c) Where the project is a subsidiary of or in some way associated with a foreign company, as is often the case, the balance sheet and trading results for the preceding three years are requested. This documentation serves as a guide to what we can expect in the management of the local subsidiary, its procurement and marketing potential, whether exports are assured if the local unit is to produce for the parent company's existing market, or if not, whether the latter's sales organisation will enhance the local concern's export prospects.

(d) To this information, gathered from a study of past track-records, is then related the forecast information which is called for. This generally consists of any feasibility study made, including projected Profit and Loss Accounts and balance sheets for three years, and a cash flow for the first year of operations.

(e) Occasionally, where for instance unusually high reliance is placed on the security of the equipment, the opinion is obtained of an independent person, who is experienced in the line of business concerned, on the value and general technological validity of the plant machinery and equipment.

(f) Reference is sometimes made to friendly, foreign banks who advise us on the international situation of some aspect or other in a particular sector of industry, or on their normal approach to lending to that particular industry, which might be a new activity to Malta.

As can be seen, the method of evaluation used is more in the nature of "a circuitous" way, leaning heavily on the past ability of the sponsors of the project, rather than a direct assessment of the technology content of the project and whether this is able to achieve the forecast results. So far, our experience of bad debts has been a positive one and the methods of overall evaluation of industrial projects have served us well. But will these methods continue to be sufficient, as we move into another phase of our industrial development, where projects become more complex as a result of higher technological content?.

(3) Information required for technological evaluation of the projects submitted for financing, and the existing gaps for obtaining such information.

With the progress and development of industrial activity in a developing country from one phase to a higher one, the technology involved becomes more complex, and with it the problems for the financing institutions. In evaluating this particular aspect of a project, the banks in Malta find themselves often dealing in some grey areas, which could be broadly gathered under four heads.

(a) Plant machinery and equipment.

(b) Production

(c) Procurement and marketing

(d) Management

As intimated earlier on, it is essential for a bank to be able to gauge the real value of plant machinery and equipment, its production capacity and capability, whether it is considered of modern technology and how soon it can be expected to become obsolete. This will influence the "payback" period set by the bank, and the reliance it can place on the equipment as security. More important, the information should be able to indicate to the bank whether demand anticipated in a market research can be satisfied by the plant machinery chosen. This represents one of the essential supporting and substantiating justifications for the bank's decision to fund the project. Diametrically it could show that the capacity of production of the machinery is far too much for the market expectations, and consequently the machinery will be under-utilised, and losses occur.

It sometimes happens when studying the projected cash flows and profitability estimates that the financing institution is dazzled by the expected end-results into approving the loan, only to find at a later stage that production has run into difficulties because of over-runs in costs. Relating the employment level required to achieve the production for which the sponsors are aiming is, more often than not, not within the bank's ability. Nor can a non-technical banker test in a forecast Profit & Loss Statement the figures quoted for power or fuel consumption for the particular plant machinery involved in a project. These two elements of production are by no means an exhaustive list, but-apart from raw materials-are perhaps two of the major constituents of the agents of production in terms of value.

To a small country like Malta, where not only the home-market is negligible but the units of production are also relatively small-to-medium, the procurement of quality materials is often a problem, due to volume requirements.

Purchasing methods need to be carefully examined by lending banks, because the correct systems can make a significant contribution to a unit's cost-effectiveness. Similarly, the banks must be in a position to assess the reliability of the marketing expectations of an enterprise, in the absence of a professionally executed market survey by a specialised institution. The undertaking of such studies by "startup" industries in developing countries is not diffused, mainly no doubt due to the expense involved. Nor for that matter is expert service in this field easily available in such countries. Banks in developing countries need to be able to refer to a point which can authoritatively give an opinion on the price and quality of raw materials, and help in their procurement if they are not available to developing countries. Such an agency should also be able to advise on the possibilities of penetration of the target-markets, at the selling prices at which the particular enterprise intends to go to those markets. And in the event that the outcome is negative, what lower price (if at all) could attract a market.

In view of the youth of our industry, there is a scarcity of quality in the area of management, and in particular in the management of production, and therefore to carry out policy and operating decisions. This applies also for designing, which would enhance the chances of industry moving up-market, such as in the garment-making industry, of which in Malta there are many units, and whose continued existence and viability could in the future very much depend on their ability to produce higher quality goods.

The inexperience in the general industrial processes of production has so far resulted in the absence of consulting agencies which are qualified in the matter, to test and advise enterprises on their systems which link policy with operations. Banks therefore face a gap in that they are unable sometimes to gauge the quality of management, and its ability to veer course when things are not moving the right way.

(4) Brief outline proposal for a technological information exchange network including suggestions for the method of operation.

The Exchange Network would consist basically of the pooling and dissemination of information at U.N.I.D.O., gathered from "member" developing countries, but also, and more significantly, from industrialised countries.

An equally important function would be the availability of specialised, technical personnel who will be able to give their advisory services to member banks, or to whom, through the intercession of U.N.I.D.O., reference can be made by member banks to obtain informed views on equipment, raw materials, etc.

If the Network is to be of practical value, it has to provide information at the micro level in terms of the evaluation of the various constituents of specific projects. Therefore, the following factors are relevant:-

- Member banks and development institutions in industrialised countries would submit detailed information on the volume required and cost per unit, of the various agents of production in a number of particular industries - thus for instance the number of power units used per so many items of an article produced.

- Similar information would be given on plant machinery and equipment, its description, makers, date of manufacture, value, and where applicable on site preparation requirements.

- This information, it is admitted, would entail painstaking work to extract from figures relating to complete projects, but the scope is to cover all aspects of the production process, and thereby provide "a model" - with which comparison can be made by an assessing-bank - in as-wide-as-possible a spectrum of products.

- A continuous flow of this information will need to be maintained, not only by submission of data on new projects but also by up-dating existing details.

- The service of engineers and other technicians should be available to advise on the value, capacity, capability and up-to-dateness, in terms of developing technology, of plant machinery and equipment. U.N.I.D.O. could co-ordinate the needs of developing countries in this area and the availability of the relevant expertise in technical institutions and information banks.

- A similar service could be developed, from information flowing in from contributors to the Network, regarding the procurement of raw materials, their availability and prices

- There should finally be an exchange of personnel between the member countries, at the financing institutions level, to enable an easier dissemination and exchange of experiences - which can be co-ordinated by a central point.

(5) Other suggestions to comply with and support the needs of project evaluation and technology choice, and on how IDFI's could contribute to strengthening the technological capabilities and capacities in the country.

(a) The possibility of setting up organisations to give technical advice could be explored by development banks, on a regional basis. These would effectively be able to advise on choice of technology, assessing and monitoring projects.

(b) Another possibility is for development banks, on a regional basis and with the co-operation of industrialised countries, could form under the direction of U.N.I.D.O. a Unit to develop industrial activity in developing countries. Its principal aim would be to help such countries use their own skills and materials to best advantage. An Operational Section of the Unit would carry out field studies and advise on ways how to expand production by using existing capacity more fully, and diversifying into new products which would attract new markets. Such Unit would advise on operational details, and help in the transfer of technologies to upgrade existing industries.

(c) Within the parameters set by Government policies on the type of industry it would be desirable to promote, development banks could involve themselves in promoting projects in conjunction with technical know-how from industrialised countries. This could be achieved in such cases where escalating production costs, industrial unrest which is disrupting production, or for any other reason, an enterprise ceases to operate profitably in its country but could find a new lease of life in a developing country where costs are lower. In this way, technology would find its way to developing countries. But this requires a clearing house where the needs of the industrial project can be matched as much as possible with the incentives which a developing country could offer it.

Conclusion

The knowledge required in institutions providing loan financing for industrial projects must be over wide areas - legal, taxation, to determine what is the proper gearing, and also that of a non-financial nature, i.e., to determine at the outset the viability of a project, and subsequently its profitable implementation. It is from experience, in an investment bank in a small developing country, that I maintain that all these qualities together are virtually impossible to harness in a developing country where industry is still in a stage of initial development. And the problem becomes more acute as the spectrum widens from the relatively simple, labour-intensive projects to the more complex technologies.

An interchange of experiences, in financing different industrial activities, between countries might be a start in making project evaluation less of a risky exercise in developing countries.