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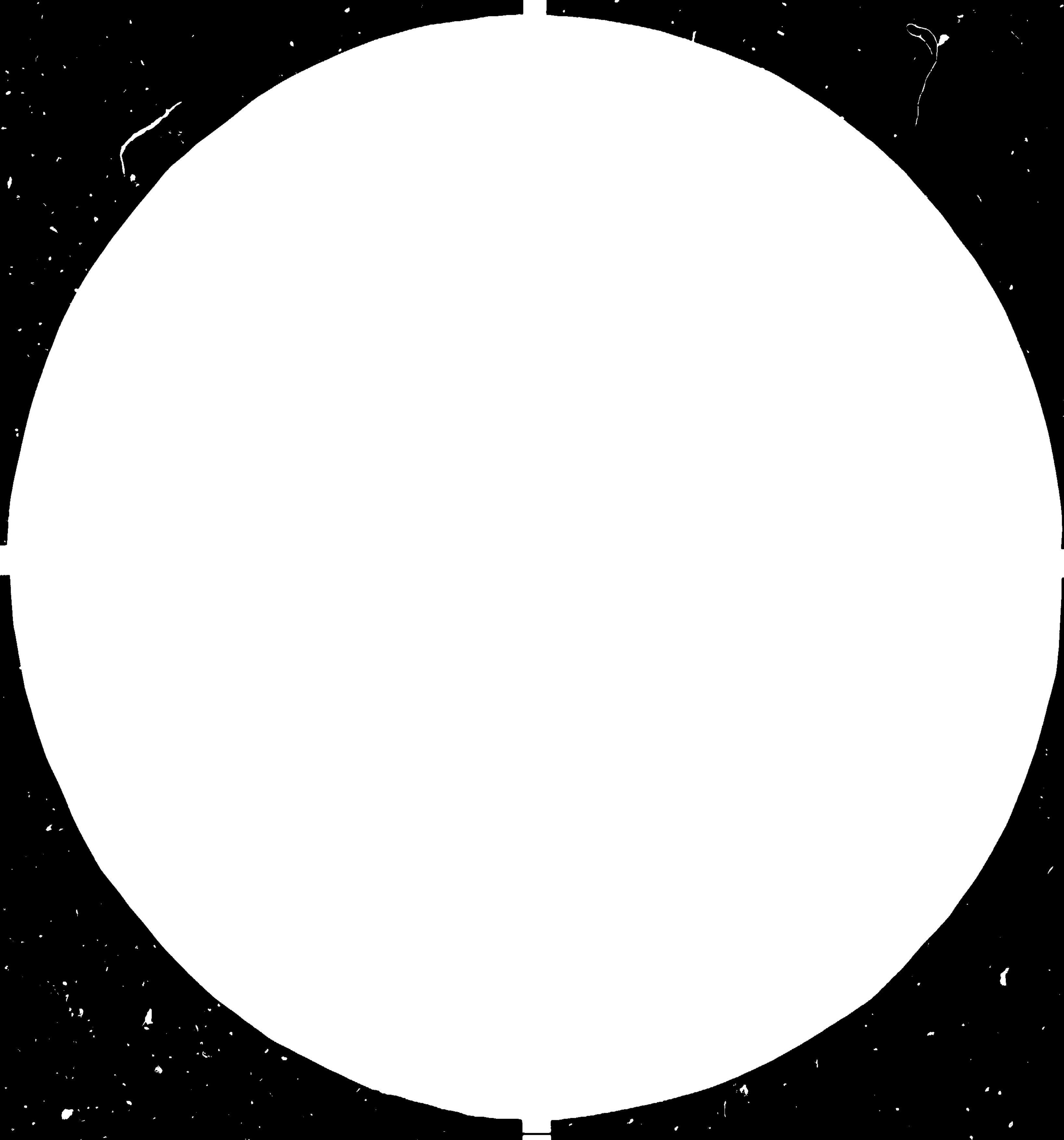

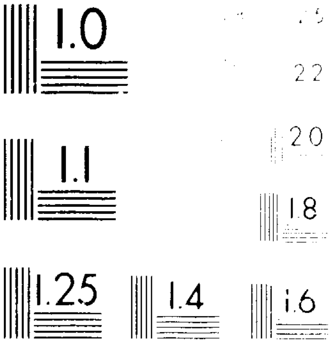
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INDUSTRIAL PROMOTION
AND
THE ROLE OF NATIONAL DEVELOPMENT FINANCE INSTITUTIONS.

(Organization of the Islamic Conference)

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I. INTRODUCTION

This paper is aimed at analysing the objectives, functions and the problems of the National Development Finance Institutions (NDFI) in the member countries of the Organization of the Islamic Conference (OIC). After the identification of the objectives and problems of these institutions, some recommendations and possible solutions have been put forward for their better operation.

The Organization of the Islamic Conference consist of 45 member countries of varying geographical and population sizes, at different stages of development. However, all the NDFIs operating in different economic environments of the member countries have one common objective, that is, the economic development and industrial promotion, which is aimed at increasing the living standarts of their people.

The basic reason for the establishment of NDFIs in the member countries is to have institutions as effective instruments for the industrialization and economic development. Some of these institutions have carried out successful performances in this field, whereas the operations of the others have been rather limited

If NDFIs are expected to play a significant role in industrialization and economic development of their respective countries, a special care should be given to their healthy development.

In the early years of their establishment, NDFIs are considered as financial institutions providing only long and medium term credits to industry with reasonable terms. However, by the time, there has been changes in this understanding. Today NDFIs all around the world are recognized as institutions providing medium and long term credits together with very comprehensive extension services to their clients for the rapid industrialization of their countries.

In some countries of the world where the importance of these institutions were recognized well in advance, NDFIs have grown in size, expanded their operations and now, with their very dimensional functions they are playing very influential role in the economic order and contributing a lot to the industrialization and economic development of their respective countries.

Every developing country has set forth some targets for the development of the economy. These goals are mostly expressed in the development plans and programmes of the countries and are called as development objectives. The ultimate aim of all these objectives is to increase the economic and social welfare in the country. Investmens are the efficient instruments for the realization of these objectives. However, due to the scarcity of resources, the investable funds in the developing countries are limited. Therefore, the limited resources of the countries should be used in a most efficient manner in order to promote the industrialization and economic development.

NDFIs are established as institutions providing financial and non-financial assistance for the investment projects. These institutions should keep in mind two basic objectives in their operations. First one relates to the financial objective, that is, extending credits to financially profitable projects. The second one is of developmental or socio-economic nature, that is, providing assistance to those investment projects which will contribute to the development objectives of the country. In their operations, NDFIs are expected to establish a good balance between these two objectives. It will only be possible for those NDFIs to survive and be beneficial for the industrial promotion of their countries which are able to establish and maintain such a sensitive balance.

The existing NDFIs in the OIC member countries presently operating in different economic environments, have faced with serious problems and deficiencies in carrying out their activities. Some NDFIs have tried to find solutions to their problems and started to be influential in the industrial promotion of their respective countries, but the others are still in serious difficulties. Although the NDFIs in member countries are operating in different environments, many of them have common problems.

The basic purpose of this paper is to identify the importance of NDFIs, to point out their effective role in the accelaration of industrialization in the member countries, to enumerate their problems, bottlenecks and deficiencies and to make some recommendations for their better operation.

In many countries of the world, NDFIs have been used as effective instruments in the economic development of their countries and now they have been indispensable institutions in the economic order.

Therefore, it is believed that NDFIs in the member countries, if they are transformed into efficient institutions, can play a substantial role in the industrial promotion of the Islamic countries.

II. PRESENT ECONOMIC CONDITIONS OF THE OIC MEMBER COUNTRIES

Since almost 30-40 years, economic development has become a major consideration in many countries. Because of ever increasing gap in per capita income between developed and developing parts of the world, many low income countries have felt the necessity of developing their economies. For this, they have formulated plans and programmes and adopted a systematic approach to the industrialization and economic development of their countries.

Today, the Organization of Islamic Conference is composed of 45 member states. These members can be classified as low income countries, middle income and oil exporting countries. Of these member states, about 22 are called as low income, 11 as middle income and the remaining 12 as oil exporting countries.

Despite the fact that economic structure of the member states has shown some changes since 1960, many of them are still within the group of low income countries where a major portion of GDP comes from agriculture. In fact, in these countries agricultural sector is a predominant sector in the economy, but still some of these countries have a serious food shortage. Industrial development in the low income countries is very limited and the low level of exports consist of primary agricultural products.

Middle income member countries are those which have already started industrial development and have been able, during the last two decades, to realize a transformation in their economic structure. In fact, the the share of industrial sector in GDP has been raised in these countries while the portion of agricultural sector has been decreased. It is not possible to assume that these countries have completed their economic development. Many of them are still at the stage of implementing their industrial development programmes with a variety of difficulties. Lack of capital, scarcity of foreign exchange, lack of qualified personnel, unemployment problem, inflation, low level of exports, heavily dependence on imported raw materials and industrial products and a slow rate of economic growth due to the deflationary measures are the basic constraints in these countries.

In the oil exporting countries, the oil sector is the main sector having a great share in the gross domestic product of these countries. However, the economies of these countries are very vulnerable to the changes in the oil market. Any decrease in the oil revenues results in budget deficits, contraction of expenditures and a real deterioration in the growth rate.

In general, it should be mentioned that the OIC member countries, as a group, are composed of those countries which are at the stage of industrial development with differences in levels.

As the magnitude and the factor endowment in the member countries are considered, it shall be seen that Islamic countries have great potentials in the world economy for the future. However, due to the low level of technology and development, these countries are very sensitive to the developments in the outside world. Because, a large number of the member countries depend largely on the imported manufactured goods and food whereas their exports are mainly composed of primary goods and raw materials.

Due to the fact that the level of industrialization and economic development are not well advanced, the member countries, at present, largely depend on trade with the industrial countries in order to implement their economic development programmes and to meet the ever increasing requirements of their population. This linkage makes the economies of the member countries very vulnerable to the problems, developments and policy changes observed in the industrialized countries. It is obvious that the more the industrial promotion is increased in the member countries and the more the size and scope of the trade and cooperation among the members are realized, the less shall be the dependence.

OIC member states like other developing countries have set forth some targets for the improvement of their economies and modernization of their countries. The targets which are aimed at realizing the industrial progress and economic development in the developing countries are defined as "development objectives".

Development objectives of a country can be summarized as follows: First objective can be described as increasing the standard of living in the country. The main indicator of this objective is a high level of income which will enable the citizens of the country to live under conditions compatible with human dignity. The ultimate aim of development is the ensure an improvement in the living conditions and for this, the economic development and industrialization is essential.

The second objective is concerned with decreasing the dependence of a country on external sources. The main indicator showing such a dependence of a country is the foreign trade deficit. In order to achieve this objective, a country taking into account its comparative advantage position should increase its exports, do export diversification by increasing the share of industrial goods in exports and undertake import substitution activities. Also, the industrialization should be formulated in such a way that the country, in the long run, should have an economic structure producing its own technology instead of importing it. Because, if a country continues to import the modern inputs and technology from abroad, it will continue to be called as a country depending on external sources. However, this objective should not be considered as the one decreasing the volume of world trade. On the contrary, the ultimate target is, within the principle of comparative advantages, to reach an equilibrium in the balance of payments of the a country with a high level of exports and imports.

The third development objective deals with the employment. What is meant by this objective is that the country should reach a position to be able to provide jobs for its population at working age. Therefore for the realization of this objective, the level of employment should be increased and unemployment and disguished employment in the economy should be diminished.

The fourth objective is related to a balanced regional development. This objective is aimed at eliminating the important differences in the level of development among the various regions of a country.

The fifth objective is concerned with improving the income distribution. Development objectives of a country are not only concerned with increasing the level of national income via a high rate of growth in GNP, but the real aim is, through a better income distribution by individuals and by regions, to promote the overall welfare in the country.

The sixth development objective is industrialization. Since industrialization is regarded as a most efficient way of development, industrialization itself in many countries has been regarded as a seperate objective. Industrialization contributes to the realization of other objectives. This objective is intended to ensure a structural change in the economy and to increase the share of industrial sector in GDP. Industrial sector can be divided as: Consumer goods producing, intermediate goods producing and capital goods producing industries. Industrialization is not only realized by increasing the share of industrial sector in GDP, but also it is essential that the share of intermediate and capital goods producing industries in the total industrial output should be increased.

The above mentioned development objectives which have been explained briefly, are almost the common development objectives for the OIC member countries.

Mobilization of resources and their rational allocation for the realization of these objectives have been the major concern of the OIC member countries.

III. NATIONAL DEVELOPMENT FINANCE INSTITUTIONS(NDFI)

1. The Place and Role of the NDFIs in Economic Development and Industrialization

Every developing country with a desire of economic development, tries to mobilize and intensify all of its efforts for the realization of development objectives. As will be known, investments play a very important role in achieving these development targets. In fact, investment considered as a very efficient tool, because of its direct influence to the realization of the objectives.

Acceleration of economic development and increasing the growth rate require high level of savings and investment. Financing of economic development necessitates an increase in total savings and their channeling into the productive investments which are aimed at realizing the development objectives of the country.

Developing countries are generally characterized by vicious circles such as low income-low savings-low investment which will again result in low level of income. During the development process, such a vicious circle should be broken. However, this will only be possible with a substantial amount of domestic savings and foreign contributions. Mobilization of external sources by the developing countries has not been an easy task. A slow growth rate observed in the developed countries has also slowed down the flow of external sources to developing countries. Besides, the slow recovery of the industrialized countries from the economic crises has caused uncertainties on the volume and stable flow of external sources. Due to the fact that financial contributions from abroad are limited and may not be a continious one for the future, developing countries must largely rely on mobilizing domestic resources. Therefore mobilization of domestic resources has been a very significiant part of economic development and industrialization process.

In developing countries, due to the low level of income, the level of domestic savings is also low and existing financial institutions are not successful enough to mobilize and productively channel these savings.

Economic development is accelerated by the development of a proper financial system. It is essential to have an integrated and well functioning financial system in order to mobilize domestic resources and to use them in financing the investment projects which will bring about a structural change in the economy.

In order to analyse the financial system, the economy can be divided into two parts as surplus sectors and deficit sectors. Surplus sectors are composed of household and external sector and the deficit sectors include government and business sector.

Government and business sector are generally defined as deficit sectors because their own savings do not meet their financial resource requirements. Therefore, deficit of these sectors are financed by household savings, foreign loans and foreign capital from external sector. Since the financial contributions to be obtained from abroad are limited and cannot be considered as a permanent guarantee for the future, developing countries should basicly depend on mobilizing the domestic resources from the household sector. The savings of the household sector are partly invested in physical assets and partly invested in the form of financial assets. Only those part of the household savings which are in the form of financial assets can be used in meeting the resource requirements of the deficit sectors.

In order to have an integrated, efficient and well functioning financial market, it is necessary to encourage the savings of household sector to hold a major part of its savings in the form of financial assets.

Savings of the household sector which are in the form of financial assets can be analysed in two ways as direct financial savings and indirect financial savings. Direct financial savings of the household sector are in the form of purchase of government bonds, corporate bonds and shares. Indirect financial savings are the savings of the household sector kept in the financial intermediaries such as the banks, saving and loan associations, life insurance companies and pension funds etc.

As the country develops, the savings of the household sector in the form of financial assets will increase and borrowings of the deficit sectors from the financial institutions shall also grow in size.

If a careful study of the household savings in the form of financial assets is performed in the developing countries, it will be seen that direct financial savings via securities market constitute only a small portion of the total of financial assets whereas a larger portion of financial assets is mobilized by the financial institutions.

In order to ensure efficient and rational mobilization of savings and channelling of these funds for the financing of the investment programs consistent with the development objectives, financial institutions play a very important role, because they act as intermediaries between surplus and deficit sectors in the country. Due to their significant role in resource mobilization, financial institutions, that is, the banking system and the social security institutions will have a influence on resource allocation in the country and their policies and decisions for the resource allocation shall dominate the channelling of the funds.

Here, the importance and the necessity of development banks should be recognized. By historical reasons, the existing banking system, the commercial banks in developing countries are oriented to finance urban trade and partly the industrial activities having a prompt return. Usually they are not furnished with necessary mechanism to provide medium or long term credits to finance the industrial projects or enterprises. These financial institutions generally provide short term working capital to the existing companies which are known by them and where the risk in credit extension is minimum. As a result of such a performance, some sectors in the economy have been favoured while the others been discouraged.

Economic development necessitates the implementation of large scale investment projects which will bring about a structural transformation in the economy. The projects to be undertaken in the industrial and agricultural sectors and also the infrastructural type of projects are characterized as the projects having a long gestation period where the return is extended in a long period of time. For economic development, it is also essential to provide financing for the new entrepreneurs in the small and medium scale industries. Therefore, in the financial system of the developing countries, there has been a gap in respect to providing medium and long term finance for the promotion of development oriented projects. The establishment of development banks is aimed at filling this gap.

However, there has always been an argument that such a function of a development bank can also be performed by the commercial banks. In fact, some commercial banks through equity participation and/or renewal of their short term loans have been able to extend long term credits to some enterprises. It is alleged that the commercial banks which are established with private capital are under the control of some large holdings or banks. Therefore a major portion of their funds may only be extended to specific enterprises which might result in a discrimination in resource allocation. Such a discrimination in resource allocation may be inconsistent with development priorities. Besides, involvement in medium and long term financing by the commercial banks may create serious problems in the future. Financing of non-profitable projects by the commercial banks may cause losses and misallocation of the scarce resources since they are not equipped with technical staff having the full knowledge on feasibility studies and project appraisal. Today the development banks, with their ever increasing functions and contributions to the economic development, have been indispensable financial institutions within the overall financial system of the developing countries.

2. Objectives and Functions of NDFIs

There exist various types of development finance institutions in the OIC member countries. From their ownership point of view, development finance institutions are owned by private sector or by the state, or they may be with mixed ownership or with the foreign participation. While some of these institutions are established to serve only one sector of the economy, operations of the others cover several sectors in the country. Also, some development finance institutions finance only private investments or the public investments whereas the others are organized to extend credit both the public and private sector projects. From geographical coverage point of view, we may see development finance institutions operating at national or regional level.

Although the types of development finance institutions differ from each other, today the objectives and functions of these institutions have become almost similar. When the statutes of various national development finance institutions are examined, such a similarity in the functions may be observed. However, the effectiveness in the implementation of these functions shows great differences. Some national development finance institutions in the OIC member countries are indeed implementing modern development banking activities and therefore they have become effective in the industrialization process. However, there are other institutions with limited functions and expertise which are still unable to play a significant role in the economic development of the member countries.

By the time, there has been several changes in the idea of development finance institutions. During 1950's, these institutions are regarded as establishments mainly responsible for promoting the profitable investment opportunities and financing the viable investment projects.

During 1960's, development banks are considered as institutions emerging from the inefficient functioning or the lack of well organized capital markets. Therefore, in these years, development finance institutions are expected to operate mainly on commercial basis mobilizing financial resources from the market and providing medium and long term finance to the profitable projects. However, after 1970's, a new dimension has been brought to the objectives of the development finance institutions. These institutions are not only expected to operate on private profitability basis, but they have also been considered as institutions contributing to the economic development and industrialization of the country. Particularly in the countries where the existing market forces and the capacities of the private sector are not adequate enough to initiate and speed-up the industrialization process, there has been a need, as a government policy, to establish national development finance institutions in order to promote economic development and industrialization. Accordingly, development finance institutions started to finance the projects having a high economic rate of return together with the private profitibility.

At present, national development finance institutions have a large variety of functions contributing to the economic development and industrial policy of their countries. Here, an attempt has been made to formulate the objectives and functions of these institutions. As was mentioned, in some OIC member countries the existing development finance institutions do not have such a wide range of activities. However, through the development of the member countries and by the better appreciation of the importance of these institutions, it is expected that many of them shall be equipped in the future with these functions.

The activities of the national development financing institutions have been summarized below;

(a) NDFIs mobilize domestic and foreign resources. For this, they use government sources, issue bonds and securities in the domestic and international markets and secure credits from international financial institutions.

(b) NDFIs extend medium and long term credits for the financing of investment projects in conformity with the general economic development and industrial policy of the country. In addition to the medium and long term credits, these institutions, in recent years, have started to meet the working capital requirements of the investment projects.

(c) NDFIs mainly operate on project basis. Before granting any loan, investment projects have to be appraised by the NDFIs staff composed of economists, financial analysts and engineers. Financial and economic viability of the projects, have to be assesed through the appraisal of the projects from technical, managerial, financial and economical points of view.

(d) During the appraisal and review of an investment project submitted for financing, NDFIs analyse the project in detail and if necessary suggest modifications in order to make the financial and economic profitability of the project better-off.

(e) NDFIs control the implementation of the projects financed by them, identify the bottleneck areas and try to provide solutions to the specific problems in order to ensure the proper implementation of the investment projects.

(f) In addition to the medium and long term investment credits, NDFIs provide equity participation to some projects. These institutions subscribe directly to equity shares of some companies and take an active role in the implementation and operation of the projects.

(g) These institutions undertake research and prepare industrial surveys in order to identify the most attractive areas where the funds should be allocated, even prepare feasibility studies for specific projects and make these available to the potential entrepreneurs.

(h) When the own sources of the enterprises and the investment loans are not sufficient, NDFIs assist in finding additional funds for large scale projects by attracting other private investors and by undertaking loan syndication activities with other financial institutions.

(i) NDFIs contribute to the development of capital market. They sell their own bonds and securities to the public and provide guarantee for the bonds and securities of the enterprises financed by them. In cases where they have equity participation in some projects, NDFIs sell the shares in the market after the projects are fully implemented and properly operated. Besides, NDFIs have started to undertake a leading position in promoting new types of financial institutions such as money-market finance companies, mutual funds, mortgage banks, stock exchange and leasing companies etc.

(j) NDFIs provide technical assistance to their clients either the existing enterprises or the new enterpreneurs, on the subjects of formulating, evaluating and operating their investment projects, on the choice of technology, financial planning, management and business administration techniques, accounting systems, marketing techniques, existing incentive measures, government policy and strategies related to their activities.

(k) NDFIs also extend their services to the rural areas. In addition to their financing the large and medium scale industries, they also provide loans and technical assistance for the small scale industries, rural and cooperative institutions thus helping the development of backward regions of the country.

(l) The objectives and functions of NDFIs should be consistent with the government policy for industrialization and economic development. They have to follow closely the development and industrial policy in the country. Also, they have to supply information to the government policy makers, identify existing problems, bottlenecks and the deficiencies and make necessary recommendations and even take an active part in the preparation, formulation and implementation of development plans, investment and industrial programs.

3. Present Position and the Existing Problems of NDFIs

Although the NDFIs have started to play an effective role in the economic development and industrialization of the OIC member countries, many of these institutions have serious problems in fulfilling their functions properly. These problems may be characterised as the internal and external problems. Depending on the economic structure of the OIC member countries, the size, scope, priority and the weight of these problems show differences in the NDFIs. Some NDFIs in OIC member countries have been able to find partial solutions to the existing problems. However, many others are still under the pressure of these deficiencies which, in fact, hampers the proper functioning of these institutions within the framework of economic development and industrialization. Here, an attempt has been made to identify these problems where the ranking has no relevance to their priorities.

(a) Resource mobilization is one of the serious problems that NDFIs face today. In most of the member countries either the capital of the existing NDFIs or the resources they have mobilized from conventional or non-conventional sources are not adequate to meet their funding requirements.

Sources of NDFIs may be analysed in two parts as domestic and foreign sources. Domestic sources of NDFIs mainly include the funds obtained by share capital and borrowings from government, issue of bonds to the public saving institutions, issue of bonds and shares to the household sector, term credits from commercial banks and deposits. Foreign sources of NDFIs include the funds obtained from abroad in the form of equity participation and foreign borrowings.

Inflationary conditions observed in many member countries have eroded the equity of NDFIs and aggravated the already difficult conditions of borrowings. Due to the low level of income in developing countries, domestic saving potentials to be mobilized by NDFIs are limited. Besides, these institutions face competition for resource mobilization from commercial banks, and other financial intermediaries. NDFIs, in many of the member countries, have only a small portion within the total resource mobilization network of their respective countries. Due to the lack of adequate resources, many of the NDFIs presently have limited contributions to the economic development and industrialization.

In case of state-owned NDFIs, influence on industrial promotion has been somewhat greater compared to some privately owned small NDFIs. If these institutions are expected to play a more significant role in the overall industrialization process, a permenant solution has to be found for their resource problem.

(b) Another important problem of NDFIs in the OIC member countries is concerned with the technical and professional staff they need to fulfill their obligations. These institutions have to employ qualified managers and specialized personnel in the fields of project preparation, appraisal and follow-up. Also, they are in need of qualified staff for providing consultancy and extension services to their clients. Present level of salaries paid by NDFIs particularly by the state-owned ones, are not adequate to attract professional personnel to these institutions. There seems a need for increasing the availability of expertise in quantitative and qualitative terms for development banking activities.

(c) Many of the projects submitted to NDFIs for financing are poor in quality. This is because of the fact that the majority of the clients do not have adequate knowledge in project preparation even many of them are not aware of the importance and benefits of well prepared feasibility studies. Poor project formulation by the clients increasesthe amount of work to be undertaken by the NDFIs and prolongs the time period for extending loan to their clients. Besides, poor project preperation also results in problems during implementation, supervision and operation of the projects. Furthermore, it should be mentioned that even some NDFIs in the member countries suffer from the scarcity of projects for financing due to the lack of adequate number of entrepreneurs to identify sound projects.

(d) Many of the NDFIs in the member countries face with the problem of time and cost overruns in the projects financed by them. Delays in the implementation of the projects and the cost overruns effect the profitibility of the projects and eventually make the clients unable to repay the loan on time. Such an occurence puts the NDFIs in a difficult position which are already facing with serious resource problem.

(e) Many of NDFIs in the member countries only provide medium and long term finance for the investment projects. Working capital requirements of the project are usually met with high costs from the commercial banks. Sometimes enterprises are encountered with difficulties in obtaining short term loans for the working capital requirements which is necessary for the operation of their plants. Lack of an effective cooperation between NDFIs and the commercial banks causes delays and cost increases in the projects financed by NDFIs.

(f) Some of the NDFIs in the member countries are established basically to provide medium and long term finance for the industry. They are not organized or equipped to provide promotional type of development banking services to their clients.

Lack of adequate counselling and guidance services to be made available to the clients at all stages of the project cycle results in project failures and also difficulties in NDFIs.

(g) In some NDFIs, interest rates play an important role in their operations. Interest rate policy determines the type of sources from which the NDFIs can mobilize their necessary funds and also the areas where these funds shall be allocated. In most cases, many NDFIs do not have much influence on the interest rates since the interest rates are fixed, either by the governments or by the central banks in the light of their monetary policy. The interest rates applied in some member countries aggravated the resource mobilization difficulties of NDFIs. High interest rates on credits charged by NDFIs adversely effected the financing of projects contributing to the industrialization by increasing the cost of funds for industry, while low interest rates required subsidy and sometimes resulted in irrational allocation of the resources.

(h) Inflation has been a very crucial problem for the NDFIs of some member countries. Domestic and international inflation while eroded the equity, increased the cost of capital and reduced the lending margins of NDFIs. Inflation also changed the viability of the projects, caused increases in the project cost and in the amount of credit requirements, aggravated the repayment problem and raised the risk and uncertainities.

(i) Some NDFIs in member countries have limited or no access to the external markets. It is obvious that such an opening is very essential for resource mobilization from external markets and from international financial institutions. It also provides opportunities for joint ventures and co-financing. Lack of experienced and foreign language speaking personnel, inefficiency in the communication system, foreign currency controls, complexity and ever-changing foreign exchange policy, credit worthiness of the country and limitations and restrictions of the foreign countries have been the major reasons of their failures in the external markets.

(j) Due to lack of a well-established and an efficient resource mobilization policy, secondary capital market (individual bankers system) is developed in some member countries.

Insufficiency of the funds of NDFIs, long formalities and time consuming procedures in their lending operations made some enterprises to obtain high interest rate credits from secondary capital market in order to meet the financing requirements of their investment projects. Attractiveness resulting from the quick availability of the funds from the secondary capital markets, caused some entrepreneurs to underestimate and ignore the high costs involved in it and therefore resulted in project failures and losses which has adversely effected the industrial promotion in the country.

(k) Most of the NDFIs in the member countries offered credits to their clients both in local and foreign currency. In case of foreign currency loans, exchange risk has been a problem in their operations. It has been a standart practice for many of these institution to make their clients bear the exchange risk. Heavy devaluation observed in some member countries made it difficult for some clients to repay the foreign loans to NDFIs. A higher amount of local currency requirement for the repayment of foreign loans which has resulted from devaluation suddenly brought some enterprises to the edge of bankruptcy or necessitated additional borrowings with high interest rates. It is argued that some NDFIs in the member countries could better inform the enterprises using foreign loans on the probable difficulties that they would face in the future.

(l) OIC member countries have a variety of NDFIs operating in different economic conditions. Some of them have been able to bring about solutions to the problems faced presently by others. Since the stage of development are different in member countries, the problems encountered by NDFIs also has a differing nature by the time. Some problems are not considered, anymore, as a problem by the others in the OIC member countries.

However, we can hardly talk about any close and effective cooperation among the NDFIs in the member countries. Due to the lack of such a cooperation, NDFIs are unable to benefit from the knowledge and experiences of each others.

(m) Some NDFIs in the member countries are established with limited functions. If their statutes are examined, it may be seen that some of these institutions are not fully equipped with the contemporary development banking functions. Some of these institutions have only been responsible for channelling the government funds to the investment projects and scope of their functions has been confined only to medium and long term credit activities. They are hardly allowed to take an active part or a direct involvement in external and domestic resource mobilization. Also promotional activities that these institutions should carry out have not been foreseen in their statutes. Limitations and restrictions imposed on NDFIs by their statutes and legislation resulted in some institutions to remain small and to exercise a limited function in the overall industrialization of the member countries.

IV. CONCLUSION AND RECOMMENDATIONS

NDFIs have been established with the idea of speeding up economic development and accelerating industrial promotion. These institutions in fulfilling such an important task have faced with serious problems. Here, an attempt has been made to formulate some recommendations to the present problems of NDFIs in the OIC member countries. Since many of the OIC member countries enjoys different economic conditions and have different legislations, recommendations put forward for the NDFIs may not be applicable to all of them, or some of the recommendations may not be valid any more since the problems have already been solved.

Some NDFIs have substantially been able to solve the problems and have become powerful and influential financial institutions. Others which are still under the pressure of these problems are in need of recovery or even survive. Serious problems NDFIs today face need urgent solutions. Some solutions require administrative actions whereas the others involve financial costs. Because of this monetary element that, some problems of NDFIs still remained unsolved. In order to bring about a solution to the problems of NDFIs it will be necessary to make a comparison between the cost involved in the solution of the problems and the benefits incurred from the proper operation of a NDFI. It will be seen that contributions of the NDFIs to the economic development and industrialization of their respective countries shall be far beyond the financial assistance to be provided for them.

Recognizing the leading role of NDFIs in the industrial promotion, actions to be taken for the solution of their problems should be given priority.

(a) If NDFIs in the member countries are expected to play a significant role in the industrialization of their respective countries, there is a need to increase their resources for lending. No matter how well these institutions are established, their contributions to industrial promotion shall be inadequate with limited resources. Due to the structural deficiencies in capital markets, many of the NDFIs in the past have depended more on official sources. Since the official sources from government were limited, lending operations of these NDFIs have also been limited. Today, there is an urgent need to increase the domestic and external sources of the NDFIs. It is recommended that government should provide necessary funds in the beginning to these institutions. Government support is also necessary for an effective resource mobilization activity of NDFIs from domestic and external sources.

In order to be effective in resource mobilization, it is essential that NDFIs should have a sound financial structure and portfolio which will enable them to be successful in their activities. Followings are recommended for increasing the sources of NDFIs:

(i) In case of fully and partially state-owned NDFIs, the share capital of these institutions has to be increased in order to make them financially sound and raise their chance of success in domestic and foreign borrowings.

(ii) NDFIs in the member countries should be given necessary priviliges to compete in domestic market for resource mobilization.

Cash guarantee and also a guarantee for the repayment of the principle to be provided by the government shall increase the attractiveness of the bonds issued by NDFIs. Another type of government assistance to the NDFIs might be the provision of tax exemptions or tax incentives. Tax structure might be so formulated that bonds of NDFIs are either exempted from taxes or lower income tax rates are applied to the bonds having long maturity. Such a special treatment for the bonds of NDFIs shall, in the long run, cause a gradual development of the capital market and consequently a decrease in the dependence of NDFIs on the government sources.

(iii) In addition to the funds to be provided by the government in the form of share capital, NDFIs should also be furnished by the borrowings from the government or other government entities with soft terms. Experiences of several NDFIs in some OIC member countries having substantial loans from the government have justified the benefits of such an operation.

(iv) Rediscounting facilities may also be important for increasing the lending operations of NDFIs. Rediscounting facilities to be provided by the government for the loans of NDFIs, shall enable these institutions to generate new liquidity from their portfolios.

(v) In order to channel some funds from commercial banks for long term lending by NDFIs, these institutions may issue bonds with the guarantee of the central bank or the government for being subscribed by commercial banks, private or public insurance companies, investment institutions etc.

(b) NDFIs in the OIC member countries should be made more active in securing funds from abroad. The loans which will be extended by NDFIs in the form of foreign currency shall not only meet the credit requirements of the enterprises, but also meet the foreign exchange components of the industrial projects. For this, NDFIs should cooperate more with international financial institutions by securing lines of credit from them. NDFIs, after a technical understanding to be established with the international financial institutions, may channel the direct loans from these institutions to the specific industrial projects and exercise a control over the proper implementation of the projects. Such a cooperation with the international institutions shall also facilitate the activities of NDFIs securing foreign loans from the capital markets and the commercial banks abroad in the form of bond issue or syndicated bank loans. In fact, there seems great potentials for many NDFIs in the member countries to benefit from this type of external funds that have not been so far utilized.

However, financial and administrative structure of the NDFIs should be well improved to benefit from these sources. Government guarantee and the overall credit worthiness of the country are also the essential factors for their successful operation in the external markets.

(c) Many of the NDFIs are in need of well qualified staff. Professional personnel are necessary for NDFIs to carry out their functions concerning with project preparation, appraisal, follow up and with the extension services.

To bring a solution to this problem, followings are recommended:

(i) NDFIs in the member countries should initiate regular programmes of recruiting young university graduates so that a continuous flow of personnel to NDFIs be assured.

(ii) NDFIs are recommended to prepare suitable in-house training programmes on a permanent basis. Training programmes to upgrade the skills and to improve the capabilities of the personnel should be so formulated as to ensure them acquire the right attitude for developmental work to handle various responsibilities.

(iii) In order to increase the number of development banking professionals and also to establish a new career on development banking, it is suggested that the number of courses on development banking should be increased leading to a diploma or certificate in this field.

(iv) Some NDFIs in the OIC member countries are in an advanced level in organizing and implementing sophisticated training programmes and they have special training units for this purpose. The activities of these institutions can easily be enlarged to meet the training requirements of other NDFIs in the region. Cost of such training programmes can be met by the NDFIs concerned or by the technical assistance to be secured from regional or international institutions. Activities of the Islamic Development Bank and of the SESRTCIC on this field have shown satisfactory results.

(v) To upgrade the skills and increase the capabilities of the personnel, it is recommended that the NDFIs in the member countries should initiate a regular personnel exchange programme to benefit from operations and management practices of each others.

(vi) Finally, there is a need especially for state-owned NDFIs to review their wage and salary policy. It is recommended that the salary system or the personnel payment policy should be readjusted in order to make it suitable for attracting young graduates and to keep the qualified and trained personnel in the NDFIs.

(d) At present many of the NDFIs only provide term financing to their client enterprises. It is observed in many member countries that due to the shortage and high costs of short term financing industrial projects have either failed or faced with serious difficulties in securing working capital. Particularly inflationary conditions and tight money policy have aggravated this difficulty. Therefore, it is recommended that NDFIs should be modified into universal banking institutions which will provide both long term and short term financing for their clients. Such a procedure will bring about a single window delivery system providing all necessary loans for the enterprises. However, it is suggested that provision of short term financing for working capital by the NDFIs should only be confined to those industrial projects to which the NDFIs have already extended long term investment credits. Otherwise, a wider application of short term financing by NDFIs may cause them to deviate from their fundemental objective of long term development financing.

(e) At present, there exist a little or no cooperation between NDFIs and commercial banks in financing the industrial projects. While some commercial banks via equity participation or by the renewal of short term loans were extending long term credits, some NDFIs have started to collect deposits to meet their lending requirements. Deposit collecting by NDFIs may be reconciled with their short term lending operations but it is only recommended for those NDFIs which has a large branch network.

However, deposit collecting by NDFIs and long term financing by the commercial banks have some disadvantages. Competition between NDFIs and commercial banks for deposit collecting is a factor causing an increase in the cost of money in the light of limited domestic savings. Long term credit operations undertaken by the commercial banks without any expertise on projects may result in financing non-profitable industrial projects. Hiring of professional staff by commercial banks shall be costly and increase the cost of long term credits. Therefore, there is a great advantage for the commercial banks and NDFIs to establish a close cooperation in financing the industrial projects.

Such a cooperation shall decrease the administrative cost of these institutions and shall provide a facility for the enterprises to secure long and short term credits for their industrial projects. Therefore an organic link between NDFIs and commercial banks is very necessary. Furthermore a regular flow and exchange of information between commercial banks and NDFIs on the client enterprises will decrease the number of risky operations of both sides. It seems necessary that a quickly operating system should be established so that an industrial project which has been financed by a NDFI should get an automatic short term loan for its local capital requirements from the commercial banks with the green light or the guarantee of the NDFI concerned. Such a procedure will ensure the best use of total domestic funds and accelerate the industrial development.

(f) Inflationary conditions observed in some OIC member countries call for a different approach in the borrowings and lending operations of the NDFIs. These institutions should be cautious in their long term borrowings with the prevailing high interest rates during inflationary periods. Long term borrowings by NDFIs with high interest rates will unnecessarily impose high costs on their clients until the repayment of the loan. Therefore, under inflationary conditions, it is suggested to go short or medium term borrowings instead of their traditional long term borrowings and apply variable interest rates on loans to their client enterprises in accordance with the cost of their borrowings. However, the managers of NDFIs should be very careful in exercising such a system and should always keep in mind the sensitive balance between their borrowing terms and the maturity of loans extended.

(g) There seems a great need for NDFIs to provide development banking services to their client enterprises at project preparation, project appraisal and implementation stages. Such a service shall, to a great extent, avoid the probable deficiencies which might prevail in the future. It should be emphasized that technical assistance and guidance to be provided for their clients must be considered as an important function of NDFIs at all stages of the project cycle.Today, the role of NDFIs in the member countries should not be considered as a passive one to wait the well prepared projects to come for financing and accept or reject the project. On the contrary, an active approach is needed for NDFIs to initiate the activities and to improve the quality of work.

Involvement of NDFIs in the projects should start from an early stage. Market surveys, sector studies, identification of potential investment opportunities, information on technology, publications on the government strategy and policy for industry, incentive measures, management development, research on input potentials to be carried out by NDFIs shall be of great value for entrepreneurs.

Collaboration in preparation of feasibility studies or revisions and adjustments to be made on the project proposals by NDFIs shall improve the financial and economic profitability of the projects and ensure a sound industrial development in the country.

Such extension services providing improvements in the client enterprises shall also enable the NDFIs to maintain profitability and a healthy portfolio, ensure the rational use of scarce resources and thus accelerate the industrial development in the country.

However, provision of such extension services by NDFIs is a costly activity. Therefore, NDFIs should seek a balance between their directly profitable operations and their non-financial type of extension services. In some member countries, these services are either carried out by NDFIs or by their subsidiaries. Also in some cases, the cost involved in such developmental activities are either born by NDFIs or they are passed to the clients or shared. Since the small clients of NDFIs are not financially capable of paying fully the total cost of these services, some NDFIs take the burden of these activities and finance them through their own budgets. In such cases, NDFIs should explore the possibilities of obtaining concessional funds from regional or international institutions or from their governments to subsidize the cost of these activities.

(h) In addition to the extension services, NDFIs should also work on formulating some special schemes for industrial promotion.

NDFIs may extend soft loans in order to provide assistance to various sub-sectors of industry which deserve such an assistance. Such a programme shall particularly be beneficial for the promotion of those industries involved in export promotion, import substitution, and modernization of existing technology.

Some NDFIs in the OIC member countries may be authorized to accept, discount or rediscount the bills of industrial nature. With such an arrangement, for instance, domestic manufacturers of capital goods may increase their production and sales by offering instalment payment facilities to the users since they will be able to get the payment by discounting the bills. This system shall contribute to the development of capital goods industry and also provide a facility for the new entrepreneur or existing enterprises to set up, expand and modernize their industrial plants, consequently contributing to the industrial development of the country.

Small industry has an important place in the industrial structure of the OIC member countries. Development of small industries has therefore to be given priority in the industrial development programmes of the member countries. NDFIs may be effective in providing assistance to small industries by direct loans or through a refinance scheme.

NDFIs may also be influencial in securing a balanced regional development. In conformity with the government policy towards a balanced regional development, NDFIs may provide assistance on concessional terms to the entrepreneurs to set up new industrial units in the backward areas of the country. Such a operation by NDFIs shall attract industrial investments in the backward areas, decrease the risk of entrepreneurs and thus contribute to the acceleration of the industry.

(i) Many of the NDFIs in the OIC member countries face serious problems concerned with project failures. Especially, the recent economic conditions of the member countries have aggravated this problem. Basic reasons for project failures may be mentioned as poor quality of feasibility studies, long delays in the project implementation, substantial increases observed in project costs vis-a-vis original estimates, lack of timely availability of short term finance and poor management etc.

Project failures do not only hamper industrial promotion, but they are also very crucial for the NDFI itself. The performance and efficiency of NDFIs depend largely on the successful operation of their clients.

It is therefore recommended that in order to cope with the problem of project failures, the NDFIs in the OIC member countries should develop an early warning system to identify the areas of failures.

Most common areas from where the early warning signals shall be received are the time and cost overruns, operational expenditures, sales revenues, unforeseen market competition, decreases in profit margins, increases in inventories etc. In order to decrease the number of project failures, it is suggested that NDFI in the member countries should give more importance to their project appraisal studies.

What is recommended is that, NDFIs should carry out both ex nte and ex-post evaluation for the projects they financed, incorporating risk and sensitivity analysis into their appraisal work, that is, a project appraisal when the project is submitted to the NDFI for financing and an ex-post evaluation after the industrial project has been completed. Such a double appraisal including risk and sensitivity analysis shall be a technical study indicating the vulnerable areas of the projects financed by NDFIs. It will help the NDFIs and their client enterprises to take necessary measures to overcome the probable difficulties. Also the use of critical path method(CPM) during project implementation shall indicate the sensitive areas of project failure. At this point, it should be mentioned that a close cooperation to be established between NDFIs and commercial banks shall also contribute to receiving early warning signals for project failures. In case of project failures, it is recommended that NDFIs should designate some of their officers to deal specifically with these projects. Some

NDFIs even have specific units as a part of their organization responsible for handling the problem projects. It is also an observed practice to hire an outside consultant to deal with these projects.

(j) It is suggested that the operations of NDFIs in the form of equity participation should be increased. Such operations of NDFIs shall improve and strenghten the financial structure of the companies which have inadequate sources of their own.

Also, in cases when the project is a new one employing a modern technology and brings about substantial benefits to the economy an equity participation by the NDFI shall decrease the risk of enterpreneurs and speed-up the execution of the project.

Furthermore, equity participation by the NDFIs shall give a right to them to take an active part in the administration and to control the management of the enterprises. It will also secure the repayment of already extended credits. This is important particularly when NDFIs have serious doubt about the capabilities of the managers to implement and operate the projects properly.

The equity participation by the NDFIs shall provide a guarantee and security for the third persons who would like to buy a share or extend private credit to the enterprises, thus contribute to the development of capital market in the OIC member countries.

(k) In the recent years, OIC member countries have started to feel the need and recognize the importance of economic cooperation for the promotion of their industrial development. Within this context, joint ventures among the OIC member countries may be considered as an effective instrument.

Economic cooperation in the form of joint ventures furnish the capital-scarce member countries with the necessary investment funds and foreign exchange also provide relatively profitable and safe outlets for the funds of capital-surplus countries of the OIC.

Besides the flow of capital and foreign exchange among the member countries, joint ventures shall also provide other benefits. Transfer of technology and know-how, uniting administrative, managerial and technical skills and capabilities of the member countries, setting up large-scale modern and competitive industrial plants, benefiting from the economies of scale and sharing the risk of the projects are among the benefits that will accrue to the OIC member countries.

NDFIs in the OIC member countries can play a very important role for the establishment and promotion of joint ventures. These institutions can carry out detailed studies and identify sectors, activities and projects for possible joint undertakings within the member countries. They can also study the laws, regulations, rules and procedures concerning with joint ventures and furnish the parties involved with these information.

It is also recommended that NDFIs in the OIC member countries with a close cooperation to be established among themselves and with the commercial banks should formulate co-financing schemes and intensify their operational activities by providing co-financing for the industrial projects.

(l) The repayment problem of some client enterprises arising from devaluation and foreign exchange risk has been the major concern of a number of NDFIs in the OIC member countries. It is well known that difficulties and shortcomings of the clients shall also make an adverse effect on the portfolios and the operations of the NDFIs.

Although the currency pooling system has provided some relief for the borrowers, the problem is still serious for many client enterprises. Therefore it is suggested that NDFIs should be more cautious in the allocation of foreign loans to their clients. They have to warn their clients on the possible exchange risk burden which may come up in the future.

The investment project should be more carefully appraised, cash-flow tables should be reformulated in the light of possible exchange rate fluctuations and the repayment capacity of the project should be reassessed. Only those projects which shall have enough benefits to compensate the probable exchange risk should be provided with foreign credits.

No matter whether the exchange risk is born by the clients, by the government or by the NDFI, it should be the basic task of the NDFIs to carry out such a test and make the necessary recommendations.

(m) At present the cooperation among the NDFIs of the OIC member countries is negligible. It is observed that some of these institutions are advanced in their operations while others have little experience in development banking activities. Some NDFIs, by the time, have been able to transform their structure in order to better help their clients and accelerate industrial promotion.

There seems an urgent need for their close cooperation. In recent years, on the occasion of the Annual Meetings of the Board of Governors of the Islamic Development Bank, special meetings have also been organised by the IDB bringing together the NDFIs of the member countries and discussing the topics of mutual interest. These meetings of the IDB have indeed provided a proper basis for the close cooperation of NDFIs in the future. It is recommended that NDFIs in the OIC member countries should establish a close cooperation among themselves. Such a cooperation shall enable NDFIs to benefit from their operational experiences and business practices. A close cooperation among NDFIs shall provide opportunities for the exchange of personnel, organization of joint seminars on projects and development banking, exchange of relevant publication of technical nature. Furthermore, a close cooperation among NDFIs, with the combination of their capacities, shall ensure these institutions to undertake new activities such as joint ventures and co-financing.

It is also recommended that NDFIs in the OIC member countries should establish close links with the institutions and subsidiary organs of the OIC. Such a cooperation shall enable the NDFIs to better help the industrial development of their countries within the objectives and principles of the Organization of the Islamic Conference.

(n) Some NDFIs in the member countries are in need of reorganizing their structure. This is necessary if the NDFIs are expected to carry out properly their ever increasing functions and to play a significant role in the industrial promotion.

NDFIs are recommended to institutionalize some of their activities and establish separate departments in their organizations. The followings may be regarded as the new units in the organizational chart of the NDFIs in addition to their traditional service departments.

- Research and Training Unit
- Technology Evaluation and Promotion Group
- Equity Participation Department
- Extension and Promotional Services Unit
- Problem Projects Unit etc.

It is suggested that NDFIs should incorporate the CPM techniques to their operations. Introduction of an effective management information system (MIS) in their operations should be considered as essential and indispensible for the efficient decision making procedures and sound operations of the NDFIs. Some of these institutions have started to use computers in their operations and have been successful increasing efficiency and control in their overall activities. It is recommended that a wider use of computers should be made by the NDFIs by training and increasing the number of computer experts in the member countries.

(o) In order to increase the capabilities and the efficiency of their activities, NDFIs in the OIC member countries should make contacts and establish long term and regular cooperation with the international and regional institutions abroad.

Technical assistance and services provided by these institutions shall be of great value for the operations of NDFIs. Many of these services are not fully known or benefited by all the NDFIs in the member countries. Therefore, it is recommended that NDFIs should be more familiar and benefit from these studies on promotion of industrial projects, transfer of technology, joint ventures, technology promotion, management information systems, computer systems, etc. Furthermore, courses and seminars organized by the international institutions and technical assistance in the form of consultants and fellowships provided by them shall be of great benefit to increase the capabilities of NDFI personnel in the OIC member countries.

(p) NDFIs in the member countries should establish close links with the government authorities. It is essential that the objectives and operations of NDFIs should be in harmony with the governments industrialization and development policy. Establishment and maintenance of a permenant dialog between government and NDFIs shall be very beneficial for both sides.

Since NDFIs deal with individual projects and firms, they operate at micro level, whereas government decision makers are responsible for the formulation of macro policy. Accumulation of knowledge and experience from micro studies and the existing problems and constraints should be made available to the government authorities in order to ensure them to better formulate industrial policies and to take necessary corrective measures for the acceleration of industrial promotion.

NDFIs should always keep in mind that they should maintain good relations with the government authorities. These institutions can not alone find solutions to many problems they face presently. Government support, assistance and guidance in various forms and degrees is essential for the effective operations of the NDFIs.