SECURITIZED TRADE FINANCE

RAM DIS TIÇARET, A.S. (TURKEY)

PRE PROJECT NUMBER 940-0002.56

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EXECUTIVE SUMMARY
SECURITIZED TRADE FINANCE (TURKEY)

Project Purpose

The Securitized Trade Finance (STF) Project (PRE Project No. 940-0002.56) was designed to help companies move away from short-term, variable rate loans by giving a major trade finance company initial access to U.S. capital markets. The project had two major purposes. (1) To implement an innovative new strategy for mobilizing foreign exchange credit for small and medium-scale enterprises (SMSEs) that export; (2) to help expand SMSE trade financing through private sector involvement. Turkey was chosen because it had an international standing midway between OECD and Less Developed Countries. This fact permitted a testing of the format with less concern for country risk.

A.I.D./PRE provided a $2 million co-guarantee to facilitate the borrowing of $10 million from the U.S. capital market by Ram Dis Tiçaret A.S., a wholly owned subsidiary of Koç Holding, A.S. Four million dollars of the borrowing was to be used to finance trade transactions for SMSEs (net fixed assets, excluding land, of no more than $1 million) and Ram agreed to use its best efforts to assure that not less than 50% of the remaining $6 million of the proceeds would also be used for the benefit of SMSEs. The borrowing was to be secured by trade receivables, the full faith and credit of Koç, and an additional $8 million guarantee by a consortium of international banks.

Evaluation Purpose and Methodology Used

Data for the STF case was collected in November 1988. This evaluation is one of fourteen studies of PRE Revolving Fund investment projects conducted for the PRE Office of Development Planning. The purpose of this effort is to discover lessons learned about the effectiveness of PRE investment project models. These lessons are presented in a separate volume. A standardized data collection guide was used to make data comparable. The process included: (1) review of project documentation and interviews with PRE Investment Officers; (2) site visits to a representative sample of beneficiaries; and (3) interviews and document reviews in participating IFIs.

Findings and Conclusions

1. The STF facility assisted Koç in its plan to obtain long term fixed rate foreign currency credit in the U.S. capital market and possibly influenced the successful negotiation of a subsequent borrowing, but did not create an new capital market mechanism for Turkey.

The A.I.D. co-guarantee expedited gaining access to offshore fixed term capital markets and reduced the Koç Group's dependence on short-term, variable rate commercial bank Eurocurrency financing, but it was not a significant factor in permitting Koç to get an AAA rating from Standard and Poor's. According to both Koç and Ram management, Koç could have received this rating with the support of Postipankki (the lead bank).

The experience with the STF facilitated the company's negotiations for the German DM30 million Morgan Guaranty/IFC private placement. However, the successful negotiation of this note placement may have resulted from <u>both</u> the STF and Koç's international reputation. The greatest impact of the A.I.D. participation was in obtaining the participation of the other members of the consortium of guarantors without which Postipankki would not have provided the full $10 million guarantee.

The STF facility did not create a new capital markets mechanism for Turkey as was intended (Investment Proposal-IP, Sec. 1.08). First, the STF loan was to be guaranteed by existing trade receivables, but there was no evidence that Ram's trade receivables were used as security. Second, there were no Turkish institutions involved in guaranteeing Ram's notes nor any observable impact on other Turkish financial institutions. Although anticipated that other Turkish borrowers would use the STF as an alternative funding source, there were no follow-on projects carried out to test the STF model through a smaller company.

2. <u>The amount of trade financing provided to SMSEs probably increased as a result of the project, but credit terms to SMSEs did not become more favorable.</u>

Some qualifying borrowers were benefitted. Out of a sample of 14 borrowers [1] representing Ram's whole trade finance portfolio, 50% were within the target group currently, but the amount lent to qualifying borrowers represented only 13% of total credit available to the sample. As of November 30, 1988, average net fixed assets of the enterprises in the sample was $2.3 million.

The benefits of the fixed rate, medium term financing obtained by Ram were not passed on to SMSEs as originally intended. In the sample, except for one credit, all loans went to clients with pre-existing lines of credit from Ram, and most of the loans were renewals of previous credits, again in contrast to original project design. The project had little, if any, incremental effect on the size of credit lines extended.

3. <u>Measurement of borrower impact was impossible because funds were commingled and required sub-borrower reports were not submitted to PRE.</u>

The STF funds were commingled with other credits and no disbursement/repayment accounts are kept on a source of funds basis. As a result semi-annual reports submitted by Ram cannot specifically identify STF borrowers. In addition, Ram does not keep records concerning sub-borrowers' assets, loan terms, purpose of finance, dollar volume of exports and imports, employment, or production as was required by the Project Agreement. It is therefore impossible to determine the level of compliance from monitoring reports.

4. <u>The STF project did not encourage Ram to change its policies and procedures for SMSEs</u>.

As far as could be determined from records submitted by Ram, the project had no significant impact on the type or terms of credit provided to SMSEs. In addition, there was no significant change in the composition of Ram's trade portfolio. Ram continues to lend to companies that are either subsidiaries of

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[1] See p. 19 of report regarding selection of sample.

Ram or have long trading relationships with Ram. There was virtually no marketing effort associated with the project to attract new small enterprises.

5. <u>This is not a securitized trade finance facility in the strict sense</u>.

According to original design (IP, Sec. 4.02), this project involved collateralization of the STF loan with Ram's trade receivables. As implemented, the bank consortium guarantee backing the Koç guarantee served as collateral rather than trade receivables. Therefore, the securitized trade finance model for SMSEs finance has not been tested by this project, and more complete tests will be necessary to determine the viability of the STF mechanism.

6. <u>Staff in the implementing divisions of Ram did not know about or understand the terms and requirements of the PRE/Ram project agreement.</u>

Despite the major role played by the sales and finance departments in Ram's trade finance operations, they were only superficially informed of the provisions of the A.I.D./STF Agreement. For example, Ram's finance staff were not told to segregate the STF loans under the facility into separate accounts. As a result, compliance with the terms and objectives of the project was mixed.

<u>Recommendations for Successor Activities</u>

1. Testing the STF model could usefully be carried out with companies smaller than Koç to determine whether PRE's credit enhancement mechanism can provide new access to long-term fixed rate capital on a replicable basis and thus create a new capital markets mechanism. Koç is not at all representative of typical trade finance companies in developing countries.

2. In addition, if the STF mechanism is to promote the use of trade receivables as collateral for international loans, then projects must require that receivables be included as collateral.

3. In order to assure that SMSEs receive the benefits of financing terms obtained by the IFI, parameters for the terms of the sub-loans linked to the IFI loan should be established as a specific requirement for project implementation.

4. PRE should either (A) actively enforce periodic reporting and sub-borrower lending requirements or (B) drop sub-borrower reporting and lending requirements.

5. In order to monitor sub-borrowers, it may be necessary for IFIs to establish a separate account for PRE project loan proceeds. In addition, the establishment of a system to periodically record required information on sub-borrowers should be a condition precedent to disbursement of funds. Without such a system impacts on borrowers and compliance with sub-borrower requirements cannot be determined.

6. In order to encourage the IFI to expand the number of SMSEs receiving loans, a guarantee fund should be established for the sub-loans.

7. IFI operational staff responsible for the project should be informed of the project terms and requirements from the outset. This would significantly enhance achievement of project objectives.

ANNEXES

1. Transactional Steps and Institutional Inter-relationships
2. Ram Organization Chart
3. Matrix of Ram Sub-Borrowers Interviewed
4. Representative Sample of Companies Borrowing from Ram
5. Government of Turkey Sponsored Export Incentive Credit Facilities
6. General Economic Environment and Financial Markets Overview

ACRONYMS

ADC	Advanced Developing Country
A.I.D.	The United States Agency for International Development
CMB	Capital Markets Board
COMECON	Council for Mutual Economic Assistance
DESIYAB	Devlet Sanayive Isci Yatirim Bankasi
DYB	Devlet Yatirim Bankasi (The State Investment Bank)
EEC	European Economic Community
Eximbank	Export Import Bank of Turkey
GOT	The Government of Turkey
Koç	KOÇ Holding, A.S.
IFC	International Finance Corporation
ISE	Istanbul Stock Exchange
LDC	Less Developed Country
LIBOR	London Inter-Bank Offer Rate
PRE	Bureau for Private Enterprise
Ram	Ram Dis Tiçaret, A.S.
SMSE	Small and Medium Scale Enterprises
STF	Securitized Trade Finance
SYKB	Sinai Yatirim ve Kredi Bankasi
TSKB	Türkiye Sinai Kalkinma Bankasi (The Industrial Development Bank)

SECURITIZED TRADE FINANCE

RAM DIS TIÇARET A.S. (TURKEY)

I. ECONOMIC AND FINANCIAL OVERVIEW

A. Economic

Despite the strong export growth that Turkey experienced over the past several years, access to credit continues to be a constraint for both exporters and importers. High inflation, the 1979 debt rescheduling, persistently high levels of foreign currency debt and a scarcity of fixed rate, long-term funding from the Eurodollar market have required exporters and importers to rely on short-term, variable rate financing.[1] As a result, companies often mismatch their financing patterns by using short-term revolving lines to finance long- and medium-term capital investments and raw materials purchases.

The Securitized Trade Finance (STF) Project was designed to help companies in Turkey move away from short-term, variable rate loans by giving a major Turkish trade finance company initial access to U.S. capital markets. By assisting the borrower, Ram Dis Tiçaret, to gain access to international markets, it was expected that Ram would then provide more long-term, fixed rate funding for local small and medium scale enterprises (SMSEs). As stated in the Investment Proposal "... the price and tenor benefits of borrowing from U.S. capital markets will be passed on to the smaller scale business sector producing products for export."[2]

In anticipation of full membership in the European Economic Community (EEC), Turkey recently adopted economic measures to liberalize the economy and encourage business competition. The impact of these policies, combined with the rapid expansion of public-sector investment, resulted in an overheated economy and rampant inflation in 1988. Nevertheless, for the past four years, Turkey has experienced a high rate of economic growth. The average annual rate of GNP growth was 6.7% from 1984 to 1987, 8.1% in 1986, and 7.4% in 1987.

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[1] Legally recognized trading companies (equity greater than TL 500 million) are permitted to obtain credit in other foreign currencies (besides Eurodollars) as well.

[2] Investment Proposal for Revolving Fund Loan Guarantee in a Securitized Trade Finance Facility ..., p. 4.

Although imports grew less quickly than exports in 1987, the trade deficit still grew at 9% per year from 1986 to 1988.

B. Financial

The banking sector includes a great diversity of banks, ranging from multi-branched state banks to small finance houses operating according to Islamic banking practices. At the beginning of 1987, the Turkish banking system included 75 banks: 51 deposit banks, 4 investment and development banks, and 20 foreign banks. Recent years have seen a rapid expansion in the number of foreign banks operating in Turkey, including joint ventures with Turkish institutions.

Two of the goals of the Central Bank's credit policy are to increase the share of private sector credit by decreasing public credit availability and to increase the availability of export and investment credits to the private sector.

In 1987 and 1988, the latter goal could not be met due to heavy public sector investment and high inflation. During this period, the share of private sector credit in total Central Bank credits increased only marginally.

There are 30 private deposit banks in Turkey, including four joint venture banks with foreign shareholdings. There are also 14 branches of foreign banks operating in Turkey. Private banks hold 58% of the nation's deposits, and provide 45% of credit. Among the private banks, 88% of deposits and 83% of private sector credit are held by the 6 largest banks. The rest of the credit is provided by commercial state-owned banks and by development and investment banks (public sector and semi-financial institutions). Companies also raise capital through the Istanbul Stock Exchange.

Although commercial bank credits increased by 60% in 1987, this was less than the previous year (77%). The increase of 57% for the 12-month period ending June 1988 was much lower than the 85% rate of inflation. Nevertheless, commercial banks credits continued to be the main source of expansion for the economy's credit stock. The share in total credit of investment and development banks declined from 10% in 1986 to 9% in 1987.

The interest rate policy of the Central Bank is based on two principles:

- Keep lending interest rates low enough to maintain economic growth;

- Establish and encourage positive real rates of interest on savings to make financial savings more attractive to the public.

Such goals are difficult to meet in an economy plagued with an inflation rate of 85%. To protect the small investor, the Central Bank has maintained fixed rates for deposits with maturities of one year or less, but has authorized banks to set interest rates on deposit accounts with maturities of one-year or longer and on certificates of deposits over 10 million Turkish Lira, regardless of maturity.

The introduction of open market operations by the Central Bank in February 1987 also affected interest rates. Although the purpose of open market operations is to implement monetary policy, a by-product was the development of a secondary market for government bonds and market determination of interest rates. Fixed interest rates on short term deposits are also affected by market rates due to periodic adjustments by the Central Bank.

As mentioned above, a constraint for Turkish importers and exporters continues to be the inability of private Turkish companies to borrow fixed rate, medium- and long-term credit for investment. Commercial banks typically lend to Turkish borrowers at relatively high variable interest rates and short maturities. For long-term funding from banks, support is required from a government export agency (Devlet Yatirim Bankasi, or DYB), or programs financed by the World Bank and International Finance Corporation (IFC). Further, long-term funding often requires GOT guarantees before private financial institutions are willing to lend to Turkish borrowers. An additional constraint is that the trade credit programs carried out by the Central Bank and DYB are oriented toward larger companies and are usually limited to businesses that have existing relationships with commercial banks and trading companies. This has left substantial unmet demand for commercial credit from smaller export producers.

The STF Project was designed to address these constraints by facilitating the provision of medium-term, fixed rate credit to one of the largest and most successful trading companies in Turkey, **Ram Dis Tiçaret**. The objective was that the benefits of such financing be passed on to SMSEs that were current exporters or that intended to enter the export market, but lacked access to credit.

More detailed information on the economic and financial environment can be found in Annex 7.

II. THE LOAN AND PROJECT AGREEMENTS

A. Project Rationale

According to the Investment Proposal, this project is foremost a capital markets project using a securitized trade finance (STF) arrangement. The STF arrangement is basically a bond facility that entails the sale of securities to institutional investors in the U.S. capital markets. The A.I.D. Bureau for Private Enterprise (PRE) provided a $2 million guarantee for a borrowing of $10 million from the U.S. capital market (from non-bank sources) by **Ram Dis Tiçaret, A.S.**, a wholly owned subsidiary of **KOÇ Holding, A.S.** in Turkey.[3] Not less than $4 million of the borrowing was to be used to finance trade and pre-export transactions of small and medium scale private enterprises with net fixed assets, excluding land, of no more than $1 million.[4] The borrowing was to be secured by trade receivables, Koç, and an additional $8 million guarantee by a consortium of international banks.

As stated in the Project Authorization, the project had two major purposes:

- To implement an innovative new strategy for mobilizing foreign exchange credit for small- and medium-scale exporting enterprises; and

- To help expand SMSE trade financing through private sector involvement.

In the Investment Proposal (p.4) it was anticipated that "... once (the STF was) demonstrated as a viable and competitive funding strategy, a number of commercial Turkish borrowers will try to use STF as an alternative funding source." In addition, Turkey, an advanced developing country (ADC), "is trying to establish more links with offshore capital markets and offers a case study of how A.I.D. might support such linkages between LDCs and developed countries." [5]

Thus, the project is a prototype instrument to be developed for later replication in LDCs.[6] It was argued that "given the highly innovative nature

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[3] Hereafter referred to as Ram and Koç, respectively.

[4] In addition, Ram agreed to use its best efforts to assure that not less than 50% ($3 million) of the remainder of the proceeds would also be used for the benefit of SMSEs.

[5] Memorandum to Sean Walsh from Compton Chase-Landsdale, March 21, 1985.

[6] Investment Proposal, p. 5.

of this project, PRE elected to experiment first in a less risky credit market." [7] PRE planned to then test this financing strategy in Indonesia and Thailand.

The co guarantee by A.I.D. was a "credit enhancement mechanism" meant to act as a catalyst to strengthen the Turkish capital market. This mechanism enabled the sale of securitized trade paper as an alternative to traditional short-term loans from international banks. The STF also made it possible for a Turkish company to borrow directly in U.S. capital markets on advantageous terms and familiarized non-bank lenders with an effective method of undertaking LDC credit risk. The result was to be assistance to the target beneficiary group, i.e., small and medium sized exporters, in obtaining favorable export credit facilities.

Ram finances Koç's import and export activities. The funding source for Ram's past foreign exchange requirements has been commercial banks. Ram relies on facilities organized by Eurodollar money center banks, typifying borrowing strategies of the Turkish private sector. At the time the project was designed fixed rate, long-term funding from the Eurodollar market was scarce, resulting in a dependence on variable rate and short-term credit to meet medium-and long-term investment and trade finance requirements of exporting companies.

The project was designed as a case study in the use of "credit enhancement" for building access to the U.S. capital markets for private companies. Ram's credit rating was enhanced because A.I.D. and several other international guarantors provided guarantees for Ram's borrowing.

Ram sold its fixed rate, long-term guaranteed notes to institutional investors in the U.S. at terms that were better for Ram than those then available in Eurodollar markets. Not only was the project intended to help Ram, but it was also designed to demonstrate the STF mechanism to guarantors.

The Project Agreement (Section 2.10) stated that twice the amount of PRE's guarantee (i.e., a total of $4 million) would be used for "Qualifying Subloans" (loans to SMSEs). This was judged feasible because Ram already supplied credit to numerous smaller manufacturers. It was assumed that price and tenor benefits (i.e., fixed rate, medium-term) resulting from the STF facility would be passed on to small export manufacturers. PRE's Investment Proposal stated that the project had a "clear focus on small- and medium-scale exporting enterprises as a beneficiary group." This objective, however, was not included as a

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[7] Memo to the Files, Compton Chase-Landsdale, February 6, 1987, p. 2.

requirement in the Project Agreement, the document that established the terms of the project for Ram and Koç. The Investment Proposal, on which the Project Authorization is based, specifically defines eligible sub-borrowers as small- and medium-sized exporting enterprises. Thus a focus on SMSE exporters was another project objective.

The credit risk of Ram's borrowing from the investors was borne in part by Koç through its guarantee of Ram to Postipankki. Additional risk reduction to A.I.D. was provided by the co-financing leverage of $8 million provided by international banks. Each of these banks agreed to take the commercial risk of Koç on a pari passu basis with A.I.D. Through this risk sharing arrangement, A.I.D. accessed the risk assessment capabilities of established international commercial institution.

Although there are several agreements relating to the project, the most important for this evaluation are the Project Agreement (Sponsors/A.I.D.), Loan Agreement (Issuing Bank/A.I.D.) and Note Purchase Agreement (Sponsors/Purchaser).[8] Relevant portions of each is described below, and to encourage understanding of relationships among the various organizations, a chart and description of the STF transaction is presented in Annex 1.

B. Project Agreement Between Koç Holding, Ram Dis Tiçaret and A.I.D.

The Project Agreement was signed on January 5, 1987 by A.I.D., Koç, and Ram. The Sponsors, with Ram as borrower and Koç as guarantor, were to arrange a $10 million loan. In practice, A.I.D. acted as a catalyst to bring the various parties together. Contitrade Services Corporation, a trade finance subsidiary of Continental Grain, was to manage the offering. The loan was to come from non-bank sources in the U.S. who would purchase Ram's promissory notes. The proceeds were to be used "to finance certain trade transactions and pre-export transactions to benefit small- and medium-scale private enterprises in (Turkey)" and the borrowing would be "secured by Koç and bank guaranties and trade receivables."[9] Although this project was primarily intended to support

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[8] The "Sponsors" are Koç Holding and Ram Dis Tiçaret; the "Issuing Bank" is Rainier; and the "Purchaser" is Contitrade Services Corporation.

[9] This statement was in the "Recitals" section, which is not legally binding on the signatories.

export transactions, this was not stated in the Project Agreement. The Investment Proposal (1.06, p.3) stated that there would be "a clear focus on small- and medium-scale **exporting** enterprises as a beneficiary group."

A.I.D. agreed to facilitate this borrowing by joining as co-guarantor with Postipankki Bank of Finland (the triple A rated bank that provided a standby letter of credit for Koç) and a consortium of guarantor banks.[10] A.I.D. would guarantee $2 million of the $10 million borrowing.[11] The promissory notes were to be amortized over a three year period and would bear interest at a rate comparable to similar instruments in the U.S. capital markets. A.I.D. had the right to approve the terms and conditions and all related agreements of the $10 million borrowing. A.I.D. approval was deemed given upon execution of an agreement between A.I.D. and the issuing bank.

The Project Agreement defined the following terms of sub-borrower eligibility:

- Qualifying Sub-borrower - an individual or company that is a national of Turkey, 100% owned and controlled by Turkish citizens with its principal place of business in Turkey and with net fixed assets excluding land of no more than the equivalent of $1 million;

- Qualifying Subloan - a loan to a qualifying sub-borrower for financing a lawful trade transaction or pre-export transaction supporting production of products for export. The loan was to be additional to previous credit and not a renewal or extension of an existing loan.

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[10] The following banks (in addition to A.I.D.) issued counter guarantees to Postipankki's standby letter of credit for $10 million:

Bank	Nationality	Branch Location	Amount
Banque Indosuez	French	Oslo	$ 3 million
Standard Chartered	British	Istanbul	$ 3 million
Paris Bas	French	Geneva	$ 1 million
Postipankki	Finnish	Helsinki	$ 1 million
			$ 8 million

[11] Actually, USAID was not a guarantor; it deposited $2.4 million in Rainier Bank (Seattle). In turn, Rainier (the actual guarantor) issued a standby letter of credit in favor of Postipankki Bank (Helsinki), which consolidated all guarantees and issued a letter of credit to Contitrade. The additional $400,000 covered the estimated interest to be paid by Ram to the U.S. trustee bank.

The Sponsors agreed to make $4 million of Qualifying Subloans with proceeds from the $10 million within one year after the borrowing. They also agreed to use their "best efforts" to assure that not less than 50% of the remainder (i.e., $3 million) would also be used for Qualifying Subloans.

The sponsors also agreed to maintain "books and records ... adequate to show ... the purpose for which the Subloans were made and the size and type of business of the Sub-borrowers ... until five years after the termination of the STF" and to submit semi-annual reports to PRE including the following information for each Qualifying Subloan:

- name and location of each sub-borrower
- date, principal amount, and terms
- purpose
- dollar volume of anticipated exports or imports and destination of the exports or imports
- impact of each subloan on employment and productive of each sub-borrower

Default by Ram would be triggered by payment default, breach of warranty, breach of covenant, insolvency and lack of attainment of project purposes.

C. Loan Agreement Between Rainier National Bank and A.I.D.

The Loan Agreement was signed on January 14, 1987 and amended in June 1987. The purpose of the Agreement was: (a) "to set forth the obligations and understandings ... with respect to the establishment of the Standby Facility and the issuance of the Standby Letter of Credit" as relates to A.I.D.'s guaranteed portion of the $10 million borrowing; and (b) "to induce Rainier National Bank to issue the Standby Letter of Credit in favor of Postipankki in consideration of a loan from A.I.D. of $2.4 million."[12] Loan proceeds were to be disbursed to Rainier (the "borrower") in one lump sum after which Rainier would issue the Letter of Credit.

The annual interest rate on the STF loan was to be 0.375% above the yield on six month U.S. Treasury Bills and paid semi-annually on the outstanding

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[12] To guarantee $2 million of principal and $400,000 of interest. However, the actual amount of the letter of credit was only $2,310,817, since the interest was less than originally estimated.

principal balance. Principal was to be repaid in one lump sum two business days after March 3, 1990.[13]

The amount of principal to be repaid would be reduced by any amounts paid by Rainier to Postipankki due to defaults under the Standby Letter of Credit. In the event of a default, or if A.I.D. were to declare the remaining principal and interest immediately payable, then 4% annual interest would be paid above the regular interest rate. Rainier was permitted to charge A.I.D. 0.2% per year on the outstanding balance of the letter of credit. The amount of the letter of credit was to be reduced proportionately as the promissory notes were paid off by Ram.

Events of default by Rainier to A.I.D. included payment default, breach of warranty, breach of covenant, insolvency and adverse events to attainment of project purpose.

D. Note Purchase Agreement Among Ram, Koç, and Contitrade

The Note Purchase Agreement was signed on January 9, 1987 by the seller (Ram), the guarantor (Koç) and the purchaser (Contitrade). The purchaser agreed to buy nine promissory notes from the seller, in the aggregate amount of $10 million plus interest due. The interest rate was slightly different for each principal note.[14] The notes could be assigned, transferred or pledged without Ram's consent.[15] There were three notes covering the principal of $10,000,000 plus six notes totalling $1,554,083 reflecting semi-annual interest as follows:

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[13] This repayment provision was part of the amendment to the Loan Agreement (dated June, 1987). Originally there were to be three principal repayments of $880,000, $785,000, and $735,000 to be made successively on the last business day of the 13th, 25th and 37th month after the initial disbursement.

[14] The interest rate on the these three notes was fixed. However, if there was a default on any of the notes, a variable rate termed the "Post Maturity Rate" would apply. The "Post Maturity Rate" is equal to 2% in excess of the prime rate "to change when and as such prime commercial lending rate changes."

[15] Contitrade did, in fact, assign the notes to a U.S. trustee bank, Chase Manhattan, where a grantor trust was established.

Amount	Maturity Date	Term	APR
1) $3,333,333	1/25/88	one year	7.798
2) $3,333,333	1/23/89	two years	7.735
3) $3,333,334	1/23/90	three yrs.	7.756
4) $384,625			
5) $395,250			
6) $257,833			
7) $257,833			
8) $128,917			
9) $129,625			

$11,554,083			

The purchaser was to receive a letter of credit issued by the lead guarantor bank (Postipankki) insuring payment of the notes. In addition, Koç unconditionally guaranteed the repayment of each note to the purchaser. This was a guarantee of payment and not of collection; that is, Koç waived all requirements as to diligence, presentation, demand for payment, protest and notice and submitted to the jurisdiction of any New York state court for any claim or proceeding related to the guarantee. If a payment were missed for <u>any</u> reason, the purchaser had a right to demand immediate payment from Koç, rather than going through legal proceedings.

E. <u>Transaction Steps under the STF</u>

The procedure developed for accessing the U.S. capital market in this project is extremely complicated. A brief description of this process follows below. A more detailed description and chart illustrating institutional relationships is presented in Annex 1.

Basically, the borrower (Ram) obtains a letter of credit from an international bank (Postipankki) as a vehicle for raising funds from the U.S. capital market.[16] This letter of credit guarantees payment of principal and interest to the purchaser (Contitrade). Ram's parent company, Koç, guarantees that Postipankki will be repaid. Contitrade then buys the promissory notes from Ram in the amount of $10 million and an additional $1.554 million to cover interest due.

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[16] The Postipanki letter of credit is backed by the letter of credits from four other banks, one of which is Rainier, whose letter of credit is backed by a $2 million loan from A.I.D.

Contitrade then sells these notes to a large institutional investor. Funds from this sale are deposited in an escrow account in a trustee bank (Chase Manhattan). After Ram submits proper documentation to Chase Manhattan the full $10 million is disbursed to Ram. At the maturity of each note, Ram repays Chase Manhattan, which in turn repays the institutional investor.

If Ram misses any payment, Chase Manhattan advises Postipankki, which immediately remits funds to Chase Manhattan for repayment to the investor. Postipankki then seeks to recover these repayments from Koç and Ram.

III. RAM DIS TIÇARET ORGANIZATION AND OPERATION

A. Organization of Koç and Ram

After World War II, Koç underwent exponential growth forming joint ventures with General Electric, Siemens, CPC International, Fiat, Ford, American Express and Goodyear. Today the Koç Group is the leading private manufacturer, food processor and distributor in Turkey and a major company in the Middle East.

Since the holding company structure was established in 1963, the Koç Group has stressed innovation and modernization, forming Turkey's first long range planning department, decentralizing management, and setting up a well regarded in-house management studies center that stresses the importance of Koç's entrepreneurial origins. Koç has developed a corporate culture stressing state of the art management and manufacturing techniques, high growth and rapid change. This orientation results in a bias against corporate connections with all but the ablest of medium- and small-sized entrepreneurs in Turkey.

The company currently consists of over 100 subsidiaries and affiliates, and is the oldest and largest privately owned conglomerate in Turkey. With U.S. $4.8 billion in sales and $1.6 billion in assets in 1987, it is one of the 200 largest private industrial enterprises in the world. The Group's principal product lines and businesses are automobiles, trucks, tractors, automotive parts, durable goods, food processing and distribution, construction contracting and materials, international trading, and industrial gas distribution. Koç has two major operational divisions: the Automotive Companies and the Industrial, Commercial and Energy Companies. Koç's strategic policy emphasizes decentralization of its numerous subsidiaries. Accordingly, Koç Holding's Managing Board and corporate staff provide general strategies and policies and set long range investment targets, while leaving daily operating decisions to lower level managers.

Ram Diş Tiçaret is the principal trading subsidiary of the Koç Group and is responsible for over 90% of Koç's foreign trade. Ram was organized in the early 1970's to centralize the Group's exports of durables (household appliances, construction materials), foodstuffs, chemicals and automotive parts, and imports of raw materials, steel and iron, machine tools and livestock from over 50 countries. Two thirds of Ram's revenues come from exports and imports for divisions of Koç or exports of Koç affiliates. The remaining one third comes from trade services provided to approximately 200 Turkish industrial and construction companies.

Ram is organized into five departments that combine both functional and geographic responsibilities. (See Annex 2) Group managers are given a large measure of authority and autonomy within Ram. Administration and Finance Division is responsible for providing financing and corporate support services.

The Division's Finance Department, which administers the STF program, is directed by a Group Manager responsible for foreign currency and Turkish Lira loans, and non-accounting corporate services. He reports to Ram's General Manager and Managing Director on matters related to foreign currency and subsidiary financing.

Ram's Managing Director, Mr. Evren Artam, said that the company is flexible in its organization and marketing strategy. Although Ram handles roughly 2.5% of Turkey's exports, Ram would like to substantially increase that percentage over the next three years and is currently changing its Ram's lending strategies. Ram's management identified the following recent market trends:

- The end of the Gulf War and the financial problems of many Middle Eastern nations have lowered demand for Turkish products in this region.

- The EEC offered prospects for increased sales of Turkish goods because Ram's sales force has made progress in penetrating this market, especially Germany and France.

- The integration of European markets in 1992 promises to stimulate demand.

Sales divisions have begun to concentrate on doing business with industrial leaders rather than building a broad client base. This strategy tends to eliminate most small companies as clients, with the exception of entrepreneurs identified as being exceptionally talented. Also, there is intense competition for medium-sized clients from other Turkish trading companies. At present only Ram's textile clients include a large proportion of small companies. As textile companies grow larger they develop their own extensive foreign connections and no longer need Ram's trading services. This leaves only the smaller companies which need to sell their textiles through Ram to tap the export market.

In 1987, both Koç and Ram experienced strong growth in revenue and profitability. Koç Holding and its subsidiaries' revenues increased 29% from $3.1 billion to $4 billion and operating income rose 42%. Correspondingly, Ram's revenues -- including affiliates in Germany, Switzerland and the U.S. -- rose 86%, from $192 million to $357 million; operating income rose by over 300%. The net positive effect of this increase was substantially reduced as Ram's trade receivables increased by over 317% because of liquidity and foreign exchange problems among Middle Eastern and North African clients. (The majority of these receivables were not covered by confirmed letters of credit.) However, Ram's controller believes these problems have been resolved with the collection of one third of overdue receivables in early 1988, and restructured repayment of the balance through September 1989.

Ram's controller projects another substantial increase in revenues for 1988, with net sales rising to $733 million. However, due to lower exports to the Middle East and North Africa, less income from imports, and greater expense from carrying overdue trade receivables, operating income will see a more modest increase of only 42% over 1987.

Although Ram's financial performance has been excellent, Ram and Koç's management hope that there will be improvements in the Turkish economy, so as to prevent the resumption of high inflation and the deterioration of international terms of trade.

Ram has a unique position within Koç because of its function as the Group's chief trading entity. Equally important is Ram's legal status as the Group's only division that is allowed by the Central Bank to borrow in foreign currencies besides Eurodollars. Mr. Tevfik Altinok, in his capacity as the Koç Group's Executive Vice-President of Finance, assumes the responsibility for all corporate borrowings. He negotiated the A.I.D./STF Agreement with the participation of Evren Artam, the Managing Director of Ram, and without involvement of Ram's Finance Department. They stated that their first priority was to broaden Koç's access to international capital markets. They were willing to accept the conditions of the Agreement provided that these did not impede Ram's normal business operations or place undue administrative burden on the Finance Department's staff.

Once the A.I.D. Agreement was signed, Ram, as an autonomous member of the Group, was given full responsibility for administration of the loan and determination of specific sub-borrowers. Neither Sales nor Finance Departments were fully informed of the background or requirements of the Agreement, and A.I.D./STF proceeds were merely added to the trade financing pool without further follow-up by either Mr. Altinok or Mr. Artam.

B. Operations/Project Management

1. Loan Origination, Analysis and Collateral Requirements

Ram's trade financing funds come from a commingled pool of short- and medium-term commercial bank loans, the A.I.D./STF facility, and (recently) three officially sponsored export promotion credit lines through the Central Bank, the commercial banking system, and the Eximbank of Turkey. No disbursement and repayment accounts are kept on a source of funds basis, and therefore it is impossible to identify any single credit line funded by a particular funds source, including the A.I.D./STF facility. One exception is a $2 million loan from the STF to Tat, a Koç food processing subsidiary.

The management of Ram's trade finance pool is divided between the Administration and Finance Division and the four sales divisions. Financing proposals for working capital advances and cash lines of credit are initiated by the sales groups. If an initial credit proposal comes from outside the Koç Group, Ram's engineers and sales managers analyze the applicant's technical capabilities and reputation, potential trading relationship with Ram, and proposed credit terms. Ram's sales and financial management pointed out, however, that they generally do not carry out a detailed financial analysis. As a trading company, very few staff members have the skills or time to carry out a satisfactory commercial banking analysis. Ram prefers to rely instead on certifications and guarantees of reputable commercial banks. Moreover, the sales managers believed that an enterprise's reputation is much more important in the Middle East than a financial analysis because of the common tendency for all but the largest companies, such as Koç, to hide real financial conditions.

Processed loan proposals are forwarded to the Finance Department where the Group Finance Manager can approve an outside credit application on its own merits if it fits two criteria:

- Ram will finance up to 75% of a pro-forma invoice of any Turkish manufacturing or processing enterprise with three to four years of exporting or importing experience with the company.

- Since Ram's staff does not carry out a credit analysis, it requires an irrevocable commercial bank standby letter of credit (or occasionally mortgages) from all enterprises that do not have a well established working relationship with Ram/Koç.

There is no minimum loan size, although there are currently no loans below $4,000. Furthermore, the extension of credits below $10,000-15,000 is discouraged. The maximum loan size depends on Ram's market judgement of the applicant.

Loans are extended on a revolving line of credit basis, have no prepayment penalties and can be replenished according to the company's credit standing and the nature of the transaction.[17] For example, export credits are usually repaid in exportable goods on which Ram collects the receipts from the foreign buyer. Ram then forwards the net proceeds to the borrower after loan repayment. Import credits are repaid by Ram acting as a wholesaler and deducting a portion of the sales proceeds, or by a regular loan amortization schedule.

Exceptions to these procedures are reviewed by the weekly Managing Committee consisting of the General Manager, Assistant General Managers and Group Managers. The Committee's credit policy requires bank letters of credit as collateral for loans to most companies that are not Koç subsidiaries or are new clients. Ram's management believes that the company must excel in understanding commercial risk and the provision of trade services. However, the company does not have a financial services division to analyze credit risk in the same manner as a commercial bank. The Group Finance Manager said that Ram is more advanced than some companies and lending institutions because it only requires between 125 and 140% collateral compared to the usual 200% or more required by commercial banks. There are instances where small companies such as Arat Textiles have graduated into an open trading account with Ram as they have grown. Nevertheless, Ram is not prepared to modify its requirement for a

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[17] One exception is the TAT loan which was arranged as a pass-through loan with terms to fit identically the repayment terms of the STF facility.

commercial bank standby letter of credit from most borrowers even with the A.I.D./STF facility, especially with its recent credit problems in the Middle East and North Africa.

2. Funding, Interest and Fees

As discussed above, Rams's trade financing is funded by a commingled pool including the STF funds. This makes it impossible to distinguish the recipients of any particular line of credit from the pool, with the possible exception of the Tat loan. Ram's controller said that the Accounting Department never received instruction from the Finance Department, Sales Divisions or Koç Holding concerning use of the STF facility. In particular, they were not told to segregate STF loans under the facility into separate accounts, nor would the company have been inclined to do so, even for internal records, because Koç/Ram receives better tax treatment by presenting a consolidated loan portfolio to fiscal authorities.[18]

The majority of Ram's loans are 3-4 month raw material or semi-finished inventory advances having an average built-in price of approximately 6% per month or 72% per year during the first nine months of 1988 (7.5% per year in interest, an average devaluation rate of 5% per month and a 4% per year service fee). These figures compared favorably with local commercial bank rates averaging 80-85% per year. Moreover, Ram was able to maintain competitive financing rates throughout 1988 because of a major shift in the currency composition of its loan portfolio from 85% in foreign currency loans and bank facilities as of January, 1988 to 26% as of December, 1988.

The mechanics of the GOT sponsored credit lines are complicated and detailed elsewhere in this report (Annex 5). The essential components are three local currency credit lines that total TL37 billion ($26 million), or 74% of Ram's trade finance credit pool. The first of the three lines is equal to 5% of a company's past export performance, if a company has positive export

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[18] Ram's controller asserted that Ram does not keep separate accounts for tax reasons. For example, it would be disadvantageous to keep separate accounts for different sources of funding because then losses or gains could only be applied to that specific program. Even though such records are necessary to keep track of borrowers under the STF facility, the controller stated that Ram is not be willing to change its procedures now.

revenues. This credit is offered directly by the Turkish Eximbank at 36% per year. The second is also provided by Eximbank. It is a post-shipment credit accessed through the commercial banks for 20% of the value of an individual export sale, offered at 30% interest. The third is a Central Bank rediscount facility also offered through the commercial banks at 37% per year, financing 50% of pre-shipments backed by letters of credit.

All three of these local currency credit lines are currently cheaper than foreign currency loans, especially U.S. dollar loans, because they eliminate foreign exchange risk. Accordingly, Ram is replacing its dollar debt, including the A.I.D./STF facility net balance of $3.6 million, with a DM 30 million (TL 24 billion), three year private note placement. The financing will be underwritten by Morgan Guaranty of Frankfurt and the International Finance Corporation, backed only with Koç's good faith and credit guaranty.[19] For this borrowing Ram's officers believe they can negotiate at least a 5% per year advantage over U.S. dollar financing on similar terms.

3. Operational Management of Ram's Credit Facilities

The functions of the Finance Department in loan management are to handle disbursements, monitor loan repayments, share responsibility with sales departments for delinquent credit workouts, and initiate legal proceedings in cases of default. The Group Finance Manager is assisted by a Finance Manager who acts as his operating deputy, supervising two sections: Foreign Currency and Turkish currency credits.

The Foreign Currency section is responsible for daily management of the A.I.D./STF facility. It employs eight people and is headed by an Assistant Manager of Finance. She delegates the administration of all international credits to a coordinator who prepares reports for PRE and monitors disbursements and repayments from and to the trade finance pool.

The Assistant Manager and the International Coordinator said that they had never seen the A.I.D. Loan Agreement and were only slightly aware of its provisions. This is a major reason for the inconsistencies and incomplete state

[19] That is, the IFC is not providing a credit enhancement by means of a counter guarantee. It should also be noted that Morgan does not have a triple A rating (only AA).

of the regularly submitted sub-borrower reports. Furthermore, these officers explained that with the exception of the Tat loan and a few advances made within the first months of the signing of the Agreement, all loans cited in the reports came from Ram's general trade portfolio. Loans that fit the requirements of the Agreement as they understood it were presented in PRE reports as the recipients of A.I.D./STF funds. These officers said that Ram's client base was not expanded, and no new companies were targeted because of the STF.

Lack of communication between divisions responsible for administering loans is a weakness in Ram's management of the A.I.D./STF facility. The key to the success of the A.I.D. project lies in the Finance Department, because it has responsibility for overall loan management. In practice, however, the Department's responsibility under existing credit lines is limited to oversight because of the pivotal role sales departments play in Ram. While the Finance Department advises the Managing Committee on loan agreements, letter of credit requirements, and conditions of default, the sales departments establish many basic loan agreement terms and **often do not communicate the specifics to the Finance Department**. For example, the Finance staff was unable to specify the advance interest and fee costs added to loans. In addition, although sales managers are responsible for all field visits and technical oversight, and share in determination of workout terms for delinquent credits, they often restructure loans without consulting the Finance Department.

Despite the major role played by sales departments in Ram's trade finance operations, they were only superficially informed of the provisions of the A.I.D./STF Agreement. Although Ram's Managing Director stated that assistant and group sales managers made an initial effort to comply with Loan Agreement Article 7.7.1 -- which specifies requirements for subloans under the project -- an analysis of Ram's second and third semi-annual reports demonstrate that compliance is mixed, with many loan disbursements made to large companies. Aside from a lack of understanding of the goals and terms of the A.I.D. Project Agreement, sales department personnel were required to meet ambitious sales goals that biased them in favor of large loans.

Finally, the Foreign Currency section closely monitors overdue loans, notifying the sales managers within two business days of a missed loan repayment. Nevertheless, the sales departments lead in loan negotiations, and in most cases extend repayment terms if a customer can supply a valid reason for delinquency. Occasionally, if a customer's financial position seems to be deteriorating, the Finance Department will request more collateral and an increase in the rate of interest. In this regard, the Finance Manager pointed out that Ram has only been obliged to call 5% of the standby guarantees covering both foreign currency and local currency loans. In spite of problems with overseas creditors, Ram's controller estimated that the allowance for doubtful receivables will be no higher than 1.1% of accounts outstanding (compared to 1% in 1987 and 1986).

IV. SUB-LOAN DISBURSEMENTS AND IMPACT ON SUB-BORROWERS

As mentioned above, Ram puts all of its trade credit funds into a common pool, and lends to its portfolio of trade finance clients from this pool. Therefore, Ram's Finance Department was unable to identify particular clients that had received funds under the A.I.D./STF facility. To evaluate the impact of A.I.D./STF funds on SMSEs, therefore, it is necessary to examine the impact of Ram's portfolio as a whole.

To examine the portfolio, Ram's staff was asked to provide a list of all trade credit recipients so that the evaluation team could select a random sample. When they failed to provide this list (for unknown reasons), the team requested that Ram's staff select a sample of companies representative of Ram's trade finance portfolio in terms of industry, company size, credit background and location. This sample would then serve as a basis for assessing the types of clients that had benefitted from the STF facility, and for examining the impacts of loans on these clients.

Ram's Finance Department selected a sample of 14 clients for visits. This sample came from a list of 24 trade finance clients (Annex 4) that, according to Ram finance staff, is representative of Ram's portfolio as a whole.

Visits were made to all 14 clients, and interviews with each were guided by a standard data collection guide to ensure consistency in the data obtained. During each client visit, a tour was made of the facilities and an attempt was made to interview company staff and employees. Information from these visits is presented in Chapter VI (Borrower Profiles). Statistical information from the sample is presented in Annex 3.[20]

Not all borrowers were willing to provide information about their operations, and some of the data had to be estimated by the team and Ram staff. In addition, because Ram does not keep updated data on the financial condition of its clients, it was difficult to make **before-after** comparisons. There were no ongoing records kept on sales, earnings, production or employment by clients, and regular sub-borrower reports submitted to A.I.D. did not contain anything other than borrowers' names, product, outstanding loan amount and location.

According to Ram staff, there were no significant changes made in the terms or sizes of lines of credit given to clients in implementing the STF facility. It was impossible to verify that there have been no changes because client records submitted by Ram did not include loan terms or previous loan amounts. The only information concerning Ram's credits included in these reports was the original loan size and amount currently outstanding to the 14 clients.

Despite all of the difficulties in collecting meaningful data about Ram's clients there are several notable findings. As far as could be determined from the records submitted by Ram, the project had no significant impact on the type or terms of credit provided to SMSEs. Because there was no direct link between the $10 million borrowing and credit provided to Ram's clients, Ram made no operational changes in its SMSE credit program.

In addition, there appeared to be no significant change in the composition of Ram's trade portfolio. Ram continues to lend to companies that are either subsidiaries of Ram or have long trading relationships with Ram. Ram added almost no new clients to its portfolio as a result of receiving funds from the STF borrowing. As illustrated in Annex 3A, all of the companies visited for this study had received previous credit from Ram prior to 1987 when STF funds became available. Also, three companies were either actual or <u>de facto</u> subsidiaries of Koç and the rest were previous clients (see Annex 3A). There was virtually no effort made by Ram to develop new SMSE business.

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[20] The data in Annex 3 are tentative because all figures, particularly asset size, are estimates. In addition, the conversion from TL to U.S. dollars is affected by monthly changes in exchange rates. It was unknown when many clients received their first loans from Ram. Therefore, when available, the average exchange rate for the year was used; otherwise the end of year rate was used. For 1988 the 8/88 rate was used.

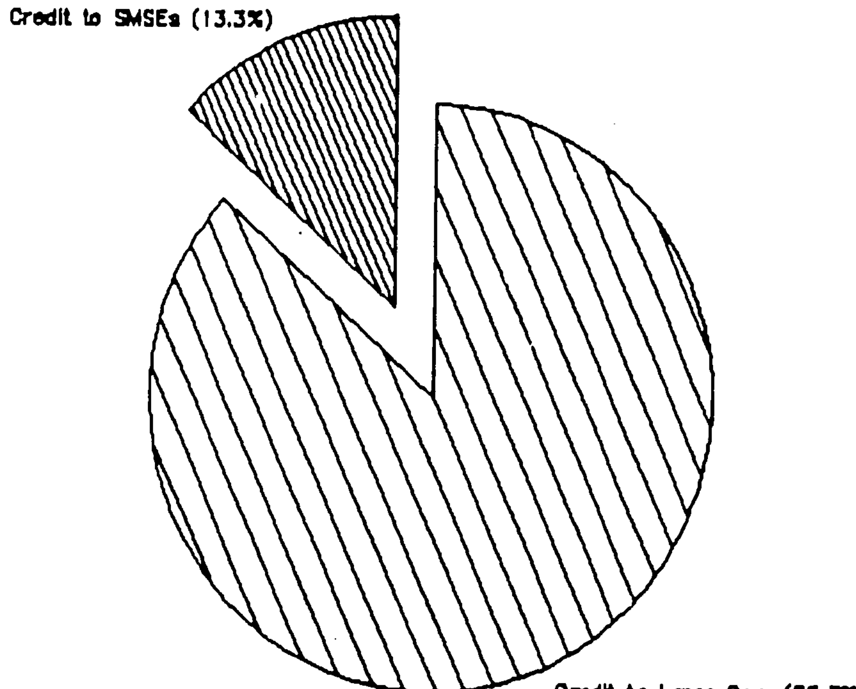
As of November 30, 1988, average net fixed assets of enterprises in the sample was $2.3 million. Only 13% of the total credit provided went to businesses with net fixed assets less than $1 million (see Figure 1). If this is representative of Ram's total portfolio and if we can assume that STF funds were distributed proportionately to all clients since funds were commingled with outside sources, then it can also be assumed that STF funds were lent to large and small businesses in the same proportion as the portfolio as a whole. To be in compliance with the Project Agreement, at least 40% of the STF amount should have been lent to SMSEs, and Ram should have made a best effort to lend an additional 30% to SMSEs, for a total of 70% going to SMSEs. One might argue that at the time they received the first STF credit from Ram (which could not have been before 1987), some of the seven companies that now have net fixed assets above $1 million may have had net fixed assets below that figure. In fact, 11 of the 13 companies that reported assets figures in the interviews estimated that they had net fixed assets below $1 million at the time of their first Ram credit. However, at the time of this evaluation only 6 of 13 were Qualified Borrowers. Since the average loan term is three months with a maximum of six months (except for the Tat loan), and unless dramatic growth had occurred recently, the majority of these companies were out of compliance with respect to their most recent loan.

Another objective of the project was to pass on to SMSEs the advantages of borrowing on the U.S. market (i.e., fixed rate and medium- to long-term). However, Ram did not provide medium- or long-term credit to SMSEs. The average loan in the sample (excluding loans to Tat and Maret) was a three month revolving loan for $484,000. Including all companies, the average loan was $756,000. The smallest loan was $29,000 to ER-KA, a clothing manufacturer in Istanbul. The largest loans were for $2 million to Tat, a Koç food processing subsidiary with operations in the Bursa Valley, $1.8 million to Ilhanar, a food processor near Izmir, and $4.3 million to Maret, a meat processing subsidiary of Koç. There have been no defaults among the clients on Ram's list.

Some clients in the sample did show significant increases in net fixed assets, sales and employees from the time they first became Ram's clients to the present. The production of food processing and textile exporting companies increased by nearly five times. This growth was led by Tat, with export sales

FIG. 1: Ram Credit to Large vs. SMSEs

Among Sub-Borrowers Interviewed



rising from $1.8 million in 1986 to a projected $32 million in 1988. Sales by importers (generally firms in more mature industries such as sawmills and meat packing) increased by a more modest 34%. This reflects Ram's selection of businesses that have above average sales and earnings performance.[21] Some of the more dramatic increases can be attributed to the purchase of a building (Ilhanar) and the establishment of joint ventures (Tat).

Although funding through the Ram trade finance pool has been largely for trade receivables or production advances, with an average term of three months, Ram's loans have encouraged increased investment in fixed assets such as new plant and equipment. Export industries increased their net investment by approximately 200%, and this increase was mainly in more sophisticated equipment. At the same time, traditional import firms increased their net fixed investments by around 34%, principally in new plant and power equipment.

Over five times more credit was extended to exporters than to importers. Exporters in the sample had an average of $3.9 million in net fixed assets, compared to the importers' average of $473,000. Only one enterprise in the export-oriented group could be considered small- or medium-sized under the terms of the Loan Agreement. Figure 2 shows graphically the net fixed asset size of importers and exporters. This reflects the fact that there are now few small exporters in Turkey.

As stated in the Investment Proposal, one objective of this project was to provide export finance primarily to SMSEs (Qualified Borrowers). An associated implied objective was to make it possible for SMSEs not currently exporting to gain access to this market through finance and marketing from Ram. It appears, however, that Ram made no special efforts to bring additional SMSEs into the export market.

According to the Loan Agreement, credits under the STF facility were supposed to be additional to credit outstanding before the facility, and not renewals or extensions of pre-existing loans. In the sample of 14 clients, except for one credit, all loans went to clients with pre-existing lines of credit with Ram, and most of the loans were renewals of previous credits. Therefore, the project resulted in little, if any, additionality, that is, credit to borrowers that otherwise would not have received loans.

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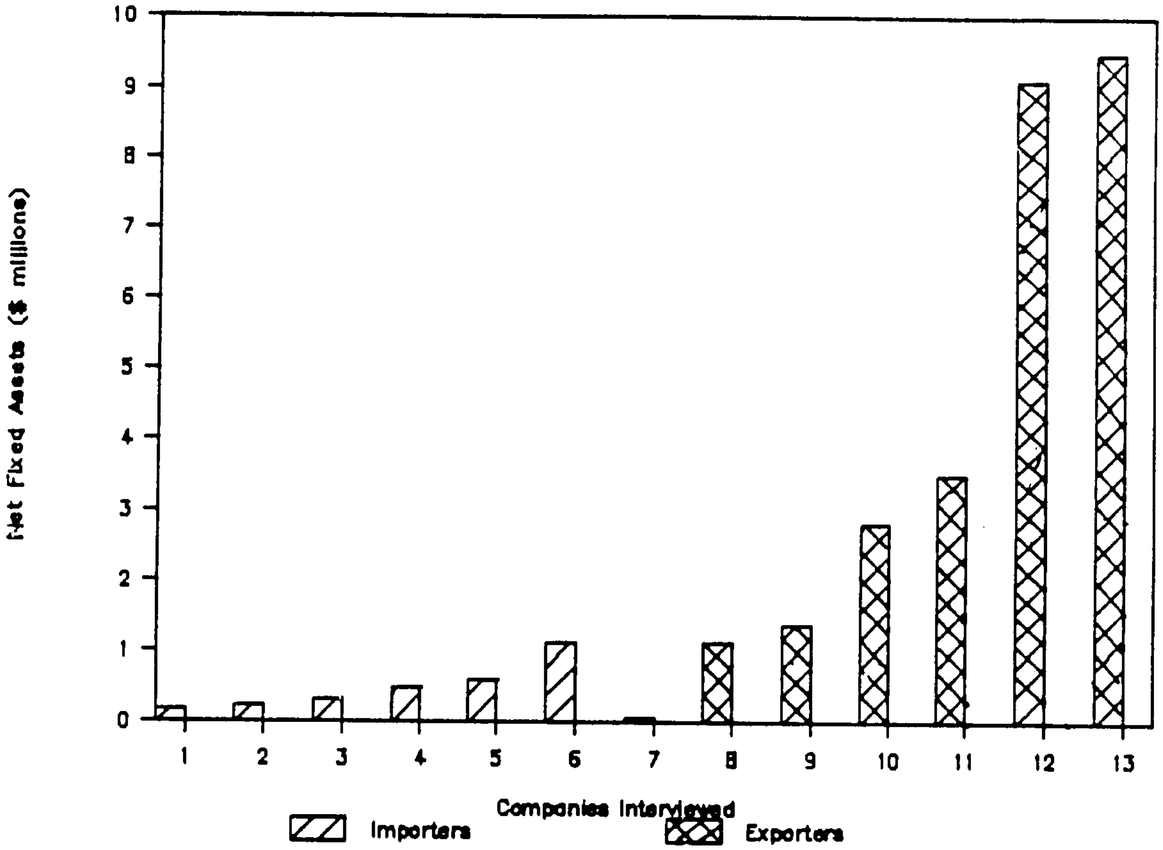
[21] It is difficult to compare these increases because these companies obtained there first loan from Ram in different years.

Figure 2: Net Fixed Assets of Importers Versus Exporters
(Subborrowers Interviewed)



Finally, women benefited from the increase in semi-skilled employment within the export-oriented industries of the sample because they represent approximately 60% of workforce in these companies. Conversely, few of the proprietors believed that there were any managerial opportunities for women.

A.I.D. Project Monitoring

Since this was an experimental project in a country without a USAID Mission, it probably required greater monitoring than other PRE projects. Since the project began in January 1987, there has been only one visit to Ram by a PRE Investment Officer (June 1988). In addition, the three semi-annual reports submitted by Ram to date do not include sufficient information about borrowers, and compliance with terms in the loan agreement cannot be determined.

Ram does not keep records on asset size, date, terms, purpose of finance, dollar volume of exports and imports, destination of exports or imports, impact on employment generation, and productive capacity of the sub-borrowers as was required by the Project Agreement. This lack of data, along with the fact that STF funds are commingled with other sources of financing, has made it impossible to measure borrower impact accurately. The lack of adequate record keeping and monitoring of borrowers by Ram can in part be attributed to the fact that members of the Finance Department responsible for implementing the project were not included in negotiations for the STF project until they had been finalized. Ram's Managing Director stated that the objectives of Ram/Koç were primarily to gain access to the U.S. capital market. There is no evidence that Ram had any intention of expanding financing of SMSEs under the project.

V. INSTITUTIONAL IMPACT OF PROJECT

A. Impact on Koç and Ram Dis Ticaret

The A.I.D./STF facility did not have a measurable operational or institutional impact on Ram or Koç. The facility did not change Koç/Ram's lending operations for SMSEs. It did, however, assist Koç in its plan to obtain long-term fixed rate foreign currency in the U.S. capital market and influenced the successful negotiation of a subsequent DM30 million note placement. This chapter examines reasons for the gap between project objectives and actual impacts.

1. Types of Clients

The Project Agreement, Section 7.1, specifies that 40% of the $10 million in loan proceeds, or $4 million, should be lent to small- and medium-sized enterprises, and Ram was to attempt, on a best efforts basis, to extend no less than an additional $3 million to SMSEs. An SMSE was defined as an enterprise with less than $1 million in net fixed assets (excluding land).

Although Ram's management claims that these stipulations were faithfully followed during the first disbursements (including the $2 million loan to Tat), it is difficult to verify this assertion because loans came from a mixed pool of funds. The reasons why the STF funds were not kept in a separate account were discussed in Chapter III. The only loan that clearly came from STF proceeds, the Tat loan, did not fit within the asset size limits because Tat had $1.1 million in net fixed assets at disbursement (January 1987). Ram has not fully complied with reporting requirements under Section 7.2. It did not provide information regarding: a) the date, amount of principal and terms of loans; b) purposes of the loans; c) anticipated export-import production of sub-borrowers; and d) employment generation of each subloan. Loan amounts shown in regular reports submitted to PRE represent amounts outstanding as of the reporting date rather than the original principal, and information on loan purpose and employment generation is cited for only a few sub-borrowers (i.e., those with loans of six months or longer terms).

The Finance Department did not have information on the net fixed assets of any companies in the loan portfolio because management believed that spending time collecting this information was not cost-effective. Ram's credit policy states that a commercial bank letter of credit suffices as a guarantee for most clients. In the case of firms with open accounts, it is more important (and feasible) to know their commercial reputation than their asset size. According to the Finance Department, it is difficult to obtain an accurate picture of a firm's assets in the Middle East.

The Finance Department's staff informed the team that there were relatively few companies in the loan portfolio, excluding textile factories, with net fixed assets less than $1 million. Furthermore, there are no companies in the loan portfolio that fall within the Halkbank's definition of small (gross assets of up to $59,000) and medium-sized (gross assets of up to $147,000) firms. The Halkbank, a parastatal, is Turkey's largest savings bank and primarily serves medium-sized enterprises. It also has a sizable World Bank-funded portfolio of small enterprise loans.

2. Credit Products

The A.I.D./STF facility was developed as a prototype capital market instrument to be tested in an ADC for later application in LDCs. PRE's $2 million leveraging of a $10 million STF facility accelerated the diversification of Koç's sources of international capital that was already planned. As a capital market instrument, Ram/Koç senior managers, Kutsan Celebiçan, Vice President of Finance of Koç Holding and Evrem Artam, Managing Director of Ram, agreed that the A.I.D. facility assisted Ram in gaining access to offshore fixed term capital markets and reduced the Group's dependence on short-term, variable rate Eurocurrency financing. They qualified their comments, however, by stating that Ram/Koç had been negotiating a guarantee with Postipankki before they were approached by PRE, and the STF offer only sped up this guaranteed offering by several months. They complained about the complexity of the loan mechanism and the guarantees, as well as the higher interest and fee expenses compared to short-term commercial bank Eurocurrency financing. They nevertheless conceded that Ram/Koç's successful negotiation of the Morgan/IFC DM30 million note placement was assisted by the success of the STF facility, though they contend that the major factor was Koç's excellent international reputation. This facility only requires Koç's general faith and credit guarantee as backing for the Morgan Guarantee Trust and IFC placement three year DM notes for Koç with German financial institutions. It should be noted that Morgan does not have a triple A rating and that the IFC is not providing credit enhancement by means of a counter guarantee. However, it is too soon to determine whether this project resulted in any changes in Koç's long-term position in international capital markets, or any changes in perceptions of Turkish borrowers in these markets. Nevertheless, the recent DM 30 million note placement indicates Koç's ability to obtain this type of financing has improved. What is not clear is whether this was priamrily a result of the STF experience, changes in financial market conditions or Koç's international reputation.

PRE's participation seems to have encouraged participation by the other members of the consortium of guarantors. A senior securities officer in New York said that the co-guarantor banks in the consortium would probably not have guaranteed a medium-term borrowing were it not for the Rainier Bank's letter of credit backed by an A.I.D. deposit. Recent negative experiences with long term loans to Latin American clients have left international banks skeptical of non-government backed loans for more than one year. Borrowings of one year, particularly those related to trade, are considered less risky.

3. Credit Operations

Ram's financial staff admitted that the STF facility was not treated differently than the other funding lines, with the exceptions of the preparation of the semi-annual report for PRE, and visits by a PRE officer in July 1988 and the evaluation team in November 1988. They believed the domination of the sales departments in negotiating advances and cash loans and the paucity of small credits in the portfolio were topics that needed more attention. They also believed that there might have been a clearer understanding of project objectives if PRE staff had worked with them when the facility was installed and if Ram and Koç's senior staff had communicated project goals to them. They informed the team that they had not realized that there was a gap between A.I.D.'s requirements and Ram's implementation of the STF facility until the PRE officer's visit. However, they had not taken time to focus on this gap and make major improvements because they felt they would be too disruptive for a facility that was not a major component of their credit program. Moreover, the facility would be two-thirds repaid by January 1989 and completely repaid by January 1990.

Although Ram reorganized its sales and finance departments subsequent to the STF, these changes were a result of changing market conditions rather than requirements in the PRE Project Agreement. Ram's management mentioned during the evaluation team's visit that its credit and technical assistance were drifting away from small enterprises but there was no explicit policy to do so. They did not believe this trend would be reversed since it would require a major reevaluation of Koç and Ram's marketing and corporate growth strategy.

B. Impact on IFIs and Financial Markets

The facility had no observable impact on the capital market. The securitized trade mechanism as implemented under the Turkey PRE project has not created a new capital markets mechanism. The project involved using a European bank's letter of credit to secure a fixed rate, medium-term borrowing. This means of facilitating borrowing from capital markets is not new in Turkey. There were also no Turkish institutions involved in guaranteeing Ram's notes. For these reasons, there was also no observable impact on Turkish financial institutions as a result of the project.

As indicated in Chapter III, the borrowings were also to be guaranteed by existing trade receivables as envisioned in the original project design. However, there was no binding requirement in the loan agreement for Ram or Koç to secure its guarantee with trade receivables. The use of such trade documents as security could provide an important source of credit to finance Turkey's exports. In this case, however, there was no evidence that trade receivables were used to secure the borrowings. Ram's import and export finance activities played no direct role in Ram's obtaining credit in international markets and Ram did not secure its notes with trade receivables or other trade paper. Although the Investment Proposal (p.4) anticipated that other Turkish borrowers would use the STF as an alternative funding source, there was no follow-on A.I.D. projects contemplated in Turkey to allow testing of the STF model by a smaller company without backing of a large company like Koç.

C. Impact on the Government of Turkey

The Government of Turkey (GOT) already has export promotion programs created in response to a need for the financing of exports. These programs complement the STF project, but there is no indication that officials in the GOT were aware of the STF facility. Thus there was no visible impact on the GOT from this project.

VI. BORROWER PROFILES

The following pages provide brief descriptions of a sample of fourteen sub-borrowers visited. These borrowers represents Ram's trade finance portfolio. The procedure for selecting these borrowers was described in Chapter IV. As stated above, it is impossible to determine which companies received STF funding (except for Tat) since these funds were commingled with Ram's other resources. Thus, it was assumed that a representative sample of Ram's total portfolio would be a representative sample of borrowers included under the STF project and the type of borrowers included on the semi-annual reports submitted to PRE.[22]

[22] These reports do not include net asset size so it is impossible to determine if they are eligible borrowers.

These descriptions are intended to capture some of the flavor of the individuals involved and their unique business situations. Statistical information on these enterprises is presented in Annex 3.

APIKOGLU SUCUKLARI

Alibeykoy-Istanbul

Meat Packer

Description of the Company

Apikoglu, Turkey's oldest commercial spiced sausage and salami processor, was founded in 1903 by the Armenian family that still owns the firm. Apikoglu also produces such products as fat, blood flour, organ meat, intestines, bones and leather. It has an automatic separator that cuts meat from the bone, thereby eliminating most hand work. Other than this one modern feature, the team noticed that the plant, dating from 1935, was rather antiquated.

The firm's management admitted that the plant was outdated and plans to replace it with a new one using its own savings. This will increase current production of 2,500 metric tons by 50%.

Dirtal Agça, the production manager and family spokesman, mentioned that they also own a small stainless steel plant that has no connection with the sausage company.

Operations

In 1987 sales totaled $4.8 million, of which 70% was sales to wholesalers in the Istanbul area. Management estimates that the market value of net fixed assets (excluding land) is $1.1 million; current assets total $1.1 million; and shareholders' equity is around $600,000. The firm had approximately $900,000 in net fixed assets in 1986 before the relationship with Ram because it had not yet acquired the automatic meat separator and some delivery vehicles.

Mr. Agça stated that there are 150 full-time employees, only six of which are women. He added that he believed the company's operations were medium-scale in Turkish terms, with nine other firms of approximately the same size in the industry and four larger companies. There were approximately 86 smaller sausage firms around the country specializing in one or two local products.

Relationship with Ram

Apikoglu's relationship with Ram dates from the time of the first STF disbursement in 1987. It is limited to import financing consisting of live cattle advances totaling $900,000 in 1987. Advances amounted to only $300,000 in the first nine months of 1988 because of a sharp fall of the Turkish Lira. Advances are provided on a three month revolving basis against a commercial bank's standby letter of credit, and their total cost to Apikoglu was 73.50% per year.

The firm's management says it borrows from Ram solely because Ram's advances are cheaper than commercial bank financing.

Summary

Apikoglu Sucuklari is a conservative, family-run business typical of the Middle East. The firm minimizes expenses by keeping overheads low and self-financing its operations. However, rising competition, modernization of the Turkish meat industry and consumer demand for higher quality products will put pressure on Apikoglu.

ARAT TEKSTIL SAN VE TIC A.S.

Istanbul

Clothing Manufacturer

Description of the Company

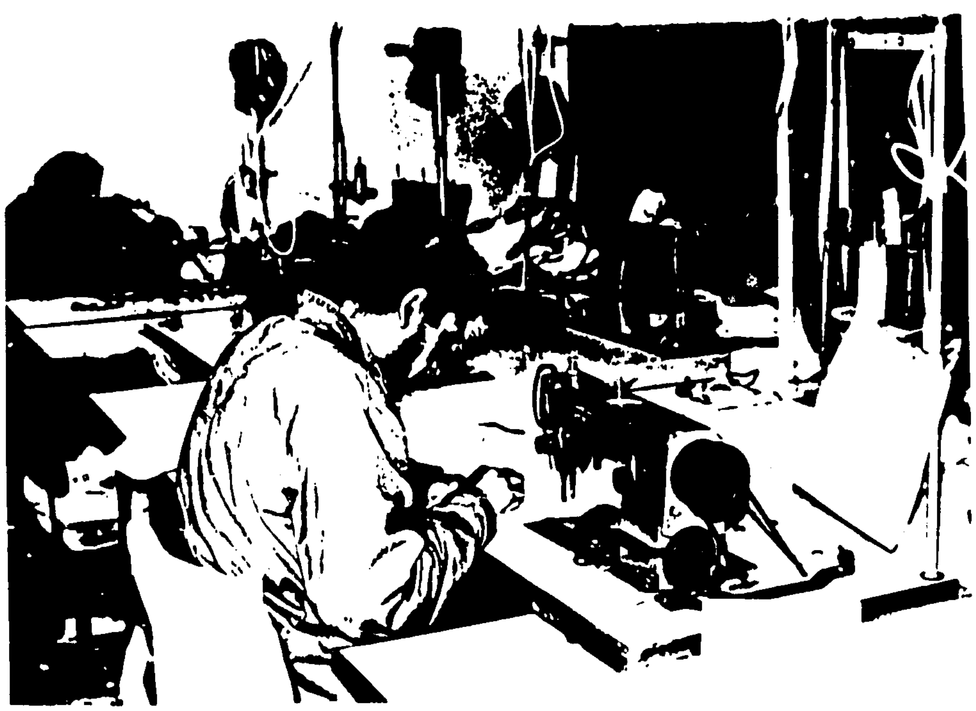
Arat Tekstil was founded in 1983 as a manufacturer of women's dresses and men's jackets for the boutique market in Western Europe and Hungary. The firm is owned in equal shares by the three Arat brothers, all in their middle to late thirties. The eldest brother, Hasan Arat, is the chief executive and marketing director; the other brothers concentrate on purchasing textiles and operations. Hasan, a former national basketball star, began selling textiles while playing basketball and studying for his B.S. in Economics. He is the firm's principal strategist.

Arat Tekstil's growth of sales has exceeded 200% per year between 1983 and 1987. Mr. Hasan has consolidated the company's gains in 1988 through long-term investments in new finishing equipment for the company's Istanbul workshop, an investment in a local wholesaler, and a 50% investment share in a knitwear manufacturer/wholesaler in Austria. Arat Tekstil provides for the welfare of the 140 full-time employees (35 of whom are women), by providing a small, modern medical dispensary, a clean lunchroom, air conditioning during the summer, excellent lighting and adequate fire protection.

Operations

Arat Tekstil procures its textiles with loans from Ram. It subcontracts the stitching work, creating between 1,000 to 1,500 temporary jobs in 30 locations around Istanbul. Then it finishes garments in its workshops. Exporting 97% of its garments, the firm is competitive with European and even Asian firms because it can promptly deliver a finished garment at 40% less cost than its foreign competition. Because of this advantage the company's sales rose from $275,000 during its first year of operations to an estimated $6 million in 1988.

The company currently has $2.3 million in net fixed assets of which approximately 55% represent its office/workshop.



Sewing clothing

Relationship with Ram

Arat Tekstil has worked with Ram since the beginning of 1986 when Arat had $700,000 in sales and possessed only $500,000 in net fixed assets.

The company's capital consists of Mr. Arat's athletic earnings and reinvested profits. Mr. Arat was initially obliged to borrow from commercial banks and from Ram under a standby bank guarantee. Currently, with the exception of the building's mortgage, its $117,000 quarterly revolving line and $3 million short term bank lines are on open account.

Summary

Although the Ram relationship pre-dates the PRE facility, Ram's credit lines have played a key role in assisting the firm to increase its revenues from $2 million in 1986 to $4.5 million in 1988.

Ram considers the Arat brothers to be prime examples of the type of entrepreneurs they want as clients. Ram management pointed out the flexibility in their guarantee requirements in the case of a company like Arat. In fact, the company is as much a sales partner as a client of Ram because increasingly the two companies split Arat's export sales profits instead of entering into a financing agreement.

AYVACILAR KERESTE SANAYI VE TIÇARET AND AYCAM AHSAP URUNLERI SANAYI

Civizli

Construction Materials

Description of the Company

These two medium-sized enterprises, located about 40 miles from Istanbul, are owned by two sons of a family that has had ties to the Koç family for three generations. The older brother, Salem Aynaci, runs Kereste, the original family firm founded by his grandfather. He limits his sales of cut lumber to small construction firms in the Istanbul area. Mr. Aynaci, an engineer by training, estimated that his firm would have $660,000 in sales in 1988, $300,000 in net fixed assets, and would continue to employ 20 people (no women).

The younger brother, Izzet Aynaci, an economist by training, owns Aycam, roughly the same size ($625,000 in sales, $400,000 in net fixed assets and 34 male employees). He produces prefabricated window and door frames for middle income apartments in which he is often an investing partner.

Operations

Kereste's office and mill take up two acres. Here the entire work force cuts raw logs into lumber according to customer specifications and delivers the orders to construction sites on a rented truck. All equipment is of Turkish origin and modern. Work areas are poorly laid out, and there is a great deal of wasted space.

Aycam,-located approximately 2 miles from Kereste, is housed in a series of workshops situated on 1 1/2 acres. Each workshop is responsible for a specialized assembly line function, has foreign equipment, much of it more modern than Kereste, and the plant is well laid out, with greater regard to worker safety. Izzet Aynaci explained that Aycam's manufacturing process is modeled on American "just in time" inventory techniques, where frames are manufactured and picked up by customers in coordination with construction schedules.

Relationship with Ram

Kereste's relationship with the Koç Group dates back to the 1920s when Koç helped the Kereste family make their fortune as a small building material supplier and construction company. Based on this long-term relationship, in 1984 Ram waived the requirement for a standby commercial bank guarantee for its $110,000 revolving advance line to import logs from Finland, the USSR and the U.S. The company has cut back on this line of credit in the past several months due to unfavorable foreign exchange terms and has begun to self-finance the purchase of local logs from a parastatal.

Similarly, in 1987, Aycam opened a $367,000 revolving line of credit with Ram. Aycam has lowered its credit exposure in anticipation of an economic slowdown. Nonetheless, it continues to import foreign logs that are of superior quality to the Turkish ones because it services a wealthier housing market than Kereste.

Summary

While Ram will continue to provide short-term financing to Kereste, the trading company has identified Aycam as a preferred customer. Consequently, Ram has provided assistance in everything from the procurement of foreign equipment to obtaining a commercial bank line without guarantee requirements.

BIRLESIK AMBALAJ

Packaging

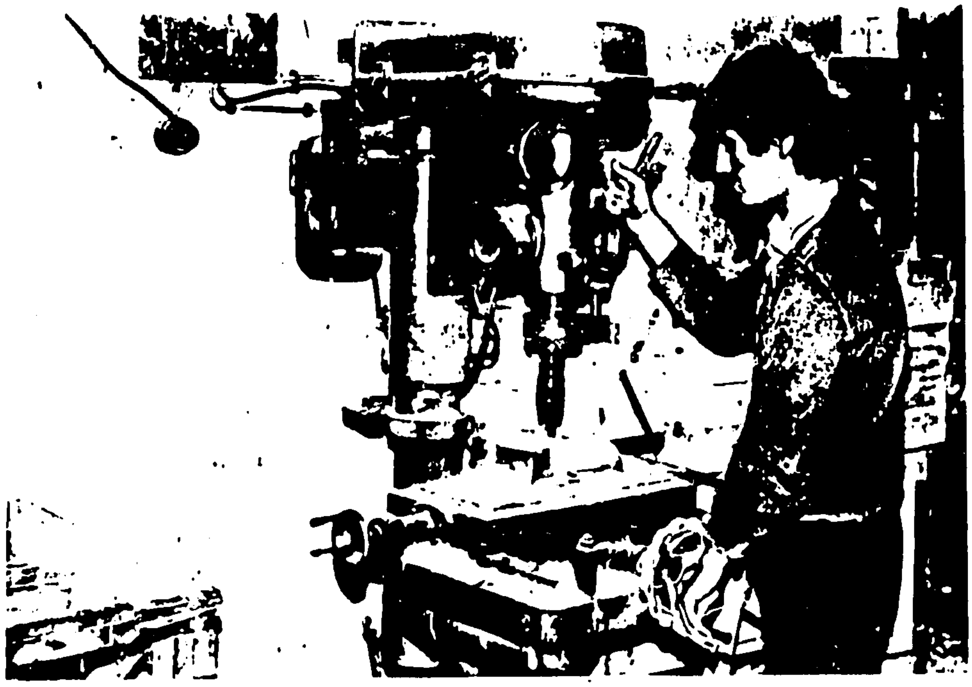
Istanbul

Description of the Company

This medium-sized company produces wooden crates, paper cartons and packaging material such as styrofoam. According to the owner, it is the second largest company in Turkey for packaging materials. Raw materials are lumber, polystrel (oil based) and paper pulp. It uses a capital intensive production process and has 35 employees. Mr. Mehmet Ates is manager and a majority owner along with five other investors. The company was established in 1943 by Mr. Ates' father. Mr. Ates began working with the company as an apprentice and has a bachelor's degree in business administration and economics.

Operations

Mr. Ates would not give total sales or asset figures. The production of wooden pallets (the only good financed by Ram) in 1987 was 250,000 with approximate sales of $300,000. The company has approximately 2,000 competitors, all but one of which are smaller. Eighty percent of the firm's production is sold through Koç to domestic manufacturing companies. Most buyers are established customers, some with whom Mr. Ates' company has had a relationship for over 40 years. Current demand for their products is in excess of their production.



Drilling wood pieces

Relationship with Ram

This company started dealing with Koç in 1963 and with Ram in 1986. They supply the Arçelik Appliance Company (a Koç subsidiary) with wooden crates. One advantage of this long-term business relationship is that checks received as payment from Koç subsidiaries can be signed over to Ram to pay for wood. In general, they have had a very favorable relationship with Ram. They do have access to bank credit, but the interest rate on commercial bank loans is in excess of 100% per year.

Making wood crates

BIRLIK KERESTE

Sawmill

Istanbul

Description of the Company

Birlik is a small sawmill that buys imported logs and cuts them into boards to buyers' specifications. There are four full-time employees (all men), and part-time workers are hired as necessary. Three months before the interview, demand was greater so there were seven employees. The company was formed in 1973 and is owned by three equal partners. Mr. Ekrem Yildiz, the manager and one of the partners, owned a small furniture company before this. Another partner was a box maker and the third owned another sawmill. All three of these companies were sold to obtain capital for the formation of Birlik. Mr. Yildiz learned the trade from experience as a sawmill apprentice before owning his previous company.

Operations

Birlik buys approximately 150 cubic meters of logs per month and produces 120 cubic meters of boards. Of this, 90-100 cubic meters is sold immediately and the balance -- used for joining furniture -- must be dried for three months. Sales for 1987 were $70,000. The company must pay a value added tax of 12% on gross sales. The land is rented. The net value of plant and equipment is $170,000.

Competitors are 15,000 sawmills throughout Istanbul, 80% of which are the same size; 10% are larger. There are only about five companies that can produce more than 100 cubic meters per month. Demand has decreased, so many have closed and the number may be reduced to 5,000. One of the primary reasons for falling demand is that the government is not paying the construction companies (main clients of sawmills) in a timely fashion. Birlik's sales are currently to wholesalers (75%) and individuals, all within the domestic market. Mr. Yildiz sells by visiting companies to establish contracts for purchases, but sales have decreased and so have profits.

Relationship with Ram

Birlik got its first loan from Ram in 1986. Ram requires a letter of credit bank guarantee, which may be less than the amount of the loan. The difference is made up by an open check. The first contract required payment within one month and the logs were delivered within the same period. For each subsequent shipment Birlik had longer to pay.

Birlik heard of Ram from another company and buying from this trading company was attractive because Ram sold logs more cheaply than other companies. Birlik also has confidence that Ram will deliver the amount of logs ordered (and paid for), which is often not true with other companies.

COSKUN NAMLITÜRK SUCUGU

Meat Processor/ Packer

Istanbul

Description of the Company

Coskun is one of the largest meat companies in Turkey. It is a family owned company founded in 1975. In 1987, 20% of the firm's livestock were imported, some of which came through Ram from Comecon countries. The rest came from domestic sources. By the end of 1988, all animals came from domestic sources. The company slaughters the animals and processes them into spiced sausage and salami. Some by-products also sold are fat, blood flour, organ meat, intestines, bones and leather.

Mr. Kemal Coskun began in this business as an apprentice when he was 12 years old. He now owns the majority of the company and is its President. The company is proud of its modern equipment and processing techniques. Sanitation is high and the plant is spotless. The company has 150 full-time employees, 50 of whom are women.

Operations

In 1987 the company had sales of $1.5 million and in 1988 has net fixed assets of $596,000. The largest volume items produced were spiced sausage (22%) and salami (14%). There was also a large volume of organ meat (34%) as a by-product. A little bit of this production (0.5%) was exported to Cyprus and Iran. They cannot export to the EEC because the products are not up to the standards required.

Competition in Istanbul comes from nine other similar companies, 80% of which are the same size. In addition, there are 60-70 similar companies in the rest of Turkey and the government has its own meat packing plant.

Some of Coskun's products are sold directly to the public from one store in the plant and two more in other cities. The company also owns a store that sells only to wholesalers and supermarkets. Of total sales, 70% are in Istanbul, 15% in Ankara, and 5% in the rest of the country.

The financial needs of the company are for long-term capital for equipment and working capital. Since this company's exports are minimal, it must rely on Turkish lira financing, for which it pays 85-90% per year.

Relationship with Ram

Although Coskun has no loans from Ram at the moment, Ram has in the past imported livestock for the company. Livestock advances are usually repaid in three months. Ram has also provided advances to hire 50 additional employees and has extended credit for imported machinery purchases.

DOG TEKSTIL VE NAKIS TIC KOLL STI

Izmir

Clothing Manufacturer and Food Processor

Description of the Company

Dogu Tekstil is a conglomerate involved in the manufacture of men's and women's mid-priced apparel and tie-dyed denims, and raisin processing for the European and Middle Eastern markets. Since the Ram relationship is limited to the clothing division, the Managing Director, Mr. Gursel Yildim, declined to give specific details on other operations. He informed the team that the clothing manufacture will have $4 million in sales in 1988, $1.3 million in net fixed assets (minus land) and 260 permanent workers, of which 70% are women. The apparel division of Dogu Tekstil shows some direct links between growth of the company and the Ram credit pool. Mr. Yildim said the real growth witnin the Dogu Group came from the apparel division, which had only $850,000 in net fixed assets at the end of 1986.

Mr. Yildim, 38, has university training in business administration, and said that he took over leadership of the company from his father, the founder, about eight years before. He and his brother had branched out into the tie-dyed denim and raisin processing subdivisions.

Operations

Mr. Gursel described the apparel operations as capital intensive. These operations are based on designs that are sent by the customers - mainly large wholesalers or popular retail houses in West Germany. He believed that Dogu Tekstil is a medium-sized enterprise, but admitted that there are probably no more than four or five larger Turkish clothing manufacturers. Mr. Gursel believes that the market demands economies of scale, credibility in quality control and short delivery times in order to be competitve. He emphasized that capital and quality requirements -- and reaction time needed to compete in the international market -- are increasing every year. The company's biggest problems are maintaining careful management to meet these exacting standards and buying quality textiles in Turkey (a complaint echoed by the Arats).

Making clothing

Relationship with Ram

The relationship with Ram dates from 1985, but Ram did not extend financing until 1987. Financing now consists of a $210,000 two month revolving advance credit line and a $90,000 two year loan for plant modernization backed by a commercial bank standby letter of credit. In addition, the company has a $1 million secured commercial line of credit priced at the three month London Inter-Bank Offer Rate (LIBOR) plus 2.5% per year. Mr. Yildim mentioned that Ram provided assistance in accessing export markets and obtaining equipment and financing on a competitive basis. Export sales have risen from $1.7 million in 1986 (providing employment for 100 permanent employees) to current sales of $4 million (providing employment to the mentioned 260 permanent employees).

ER-KA TEKSTIL

Textiles

Istanbul

Description of the Company

Er-Ka is a small company that makes women's clothing and dresses for export to Austria, Germany, Holland and Switzerland. Er-Ka buys textiles domestically, mostly from Bursa. Dresses are cut, sewn and finished by hand by 25-30 employees, nine of whom are women. All work together in cramped quarters. The owner, Mr. Dafer Dirim, was a tailor until 1962, when he went to Germany and founded a textile company exporting dresses to the U.S. He returned to Turkey in 1977 and established the current business. In 1983 he formed a 50/50 partnership. Sales for 1987 were $530,000. The value of net fixed assets is $70,000.

Relationship with Ram

In 1983-84 Er-Ka exported dresses through Ram to Iran and Iraq without a line of credit. In 1986 Er-Ka borrowed $60,000 from Ram to buy textiles. Their fixed assets, estimated at $150,000, were mortgaged to Ram as a guarantee. Er-Ka claims that Ram denied them a credit of $29,000 because Ram said they did not have sufficient funds available. If Ram had given this credit, Er-Ka says they could have expanded their operation. Later it was learned from Ram that this company did, in fact, receive a credit of approximately $29,000. His denial may have been due to a misunderstanding resulting from translation problems.

ILHANLAR A.S

Izmir

Raisin Processor

Description of the Company

Ilhanlar is a raisin processor founded in 1979 by Mustafa Ilhan, owner of 25% of the firm. Mr. Ilhan, a 58 year old self-taught businessman with an elementary school education, is a cultivator of citrus, cotton, and grapes His two sons (who have high school educations) run the plant, while Mr. Ilhan takes care of the farms. His sons own the other 75% of the company.

Operations

One of Mr. Ilhan's sons buys high quality dried grapes in the Izmir market and transports them to the plant for processing. One hundred fifty workers, including 90 women, separate stems and dirt from the raisins, wash, inspect and pack them for export under the Ilhanlar and Ram labels. 60% of the plant's processing is mechanized and 40% is manual.

Mr. Ilhan estimated that the firm has 50 competitors nation-wide, some of which are government owned. He described Ilhanlar as a medium-sized company with approximately $1.1 million in net fixed assets (excluding land) and $10 million in sales.

Sorting raisins, removing stems and other imperfections

Relationship with Ram

Although Ram did not begin financing the firm until 1986, it has a long established relationship with Mr Ilhan. Currently, Ram's open account to finance operations during the off season is $733,000, and $2.9 million during the harvest season to cover inventory and operations. Ram exports raisins to

Europe at a guaranteed price to Ilhanlar and pays the company a percentage above this price if the European wholesale price is higher then the guaranteed price.

The firm has other commercial bank lines to finance capital purchases. It uses Ram exclusively for trade finance because the banks demand up to 200% in collateral and charge up to 15% more per annum than Ram.

Ilhanlar fits the profile of SMSE under the A.I.D./STF Agreement. The company receives technical and financial assistance from Ram, and in 1985, before its first loan from Ram, sales were $500,000 per year and the company employed 50 people. Presently, the firm expects its business to improve because of growing demand for raisins in Europe and Ram's plans to diversify into other markets.

Final packaging

KARTAL MARKARNA

Food Processor

Izmir

<u>Description of the Company</u>

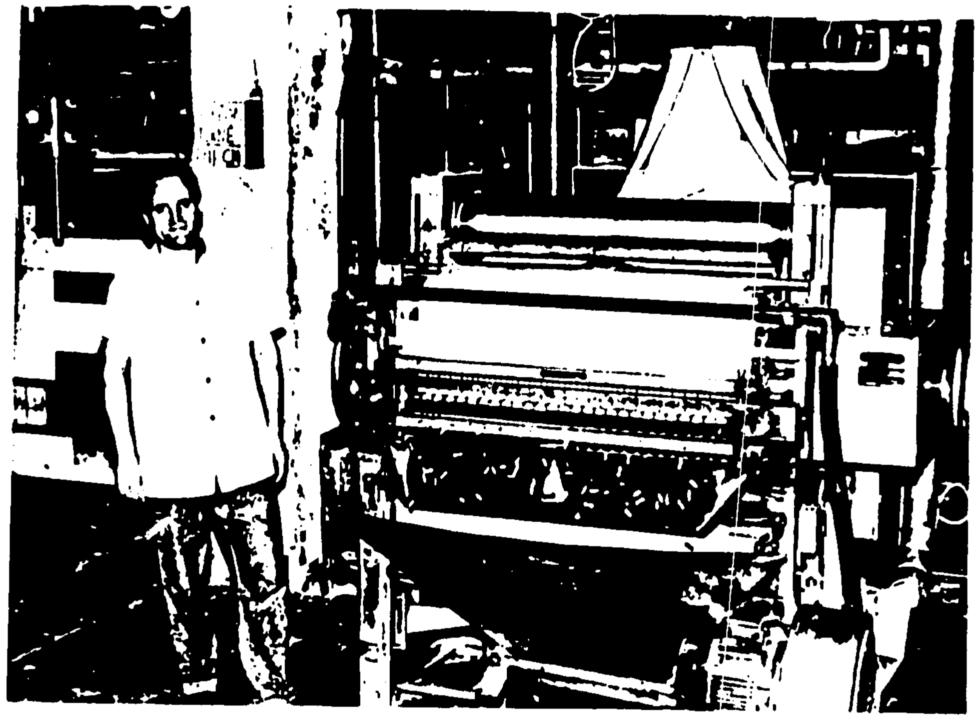
Kartal Makarna is the second largest Turkish processor of macaroni, semolina and flour by-products. Founded in 1928, the firm's shares are concentrated with seven members of one family. The largest shareholder is Ali Gencer Ulukartal, the founder's son and an agricultural engineer by training. He concentrates on production problems and quality control and delegates administrative and financial matters to Bahaettin Besikcioglu, the president. However, Mr. Ulukartal is the de facto board chairman and has ultimate decision-making power, but he prefers to run the firm by team work.

Operations

The company operates at 80% capacity, processing 60,000 metric tons (MT) of durham wheat into 26,000 MT of macaroni, 12,000 MT of semolina and 11,000 MT of byproduct flour. Kartal has modern manufacturing processes, with most of its machinery installed within the past six years, but it does not use state of the art technology such as Italian mixers to blend durham and soft wheat.

Kartal's sales in 1987 totaled $10 million and net fixed assets excluding land were $9.1 million. In addition, the company had 140 permanent employees, including 20 women in semi-skilled positions, making Kartal the second largest Turkish macaroni producer. Kartal's macaroni products are half the price of quality Italian macaroni.

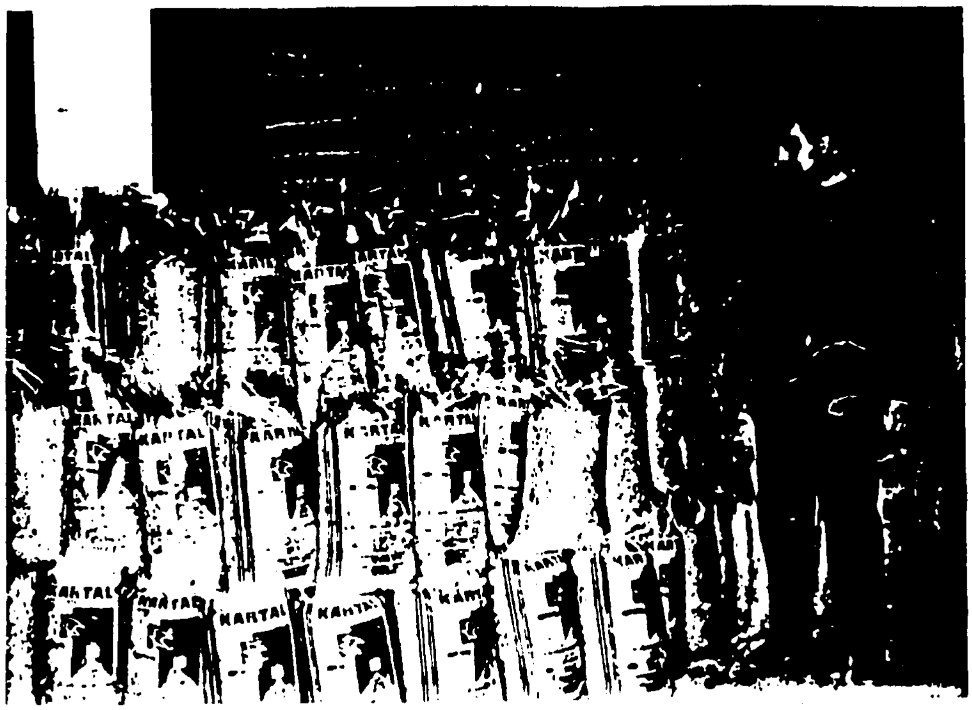
Current exports of approximately $2 million are principally semolina to the Middle East and macaroni to Europe. However, export sales are down 43% from 1984 due to lower demand in the Middle East.



Cut macaroni coming out of processing machine
Semolina "dough" enters from the top

Relationship with Ram

The relationship with Ram dates from 1982 when the company had $8 million in sales, $3 million in exports and 120 employees. Since then, total sales have increased by 25% and net fixed assets have doubled. Exports are lower because of lower sales in the Middle East, but 20 new permanent positions have been created. Kartal fits Ram's profile of a growing, dynamic company, and so Ram has assisted the food processor in selecting its export markets. Kartal buys local wheat through a $450,000 three month non-collateralized line of credit from Ram. These funds are provided at 6.5% per month plus a 4% transaction and devaluation risk fee, with the total price of the line coming to about 70% per year. This compares favorably to the commercial bank rate of 90% per year for the same transaction. Kartal currently has $450,000 in commercial bank trade finance lines of credit, but the firm prefers to finance exports through Ram because of its more competitive price and the trading company's flexibility and marketing assistance.



Packaged macaroni

MARET MARMARA BESICILIK VE ET SANAYI VE TIÇARET A.S.

Tepeoren Koyu Pendik

Meat Processor and Packer

<u>Description of Company</u>

Maret, a subsidiary of Koç that opened in 1987, is a state of the art, integrated slaughter and meat processing plant. The plant employs 450 full-time workers (65 women) and uses the latest technology in each step of slaughtering, offal (tripe) processing, deboning, lunch meat processing and packaging, and rendring, according to EEC standards and Islamic Law. Ram is proud of this facility and requested that the team visit the facility because it would provide a contrast to the smaller meat processing firms.

<u>Operation</u>

Mr. F. Bulend Ozaydinh, Maret's Executive Vice President, was educated at American University in Beirut on an A.I.D. scholarship and rose through the Koç supermarket chain, Micros. He explained that he was on a committee that encouraged the development of plants in a peri-urban area 50 miles from metropolitan Istanbul in order to avoid congestion and promote agribusiness in an economically disadvantaged area. Mr. Ozaydinh stated that Maret was now the only company in the Koç Group to incur operating losses even though the company had gross revenues of $10 million and $9.5 million in net fixed assets (less land) in 1987. These losses were principally due to higher than anticipated start-up costs and disappointing results from initial sales of packaged processed meat products (sausages, salamis, traditional "sucuk" spiced meats and mutton "kavurma" cubes).

Maret has captured an estimated 12% of Istanbul's market for raw meat, against a projected 15%. The company has only been able to attain 5% of the processed product market against an overly optimistic projection of 20%. This is a market with a high profit margin. The major impediment is that even affluent Turkish consumers are not receptive to paying higher prices for Maret's hygenically packaged products.

Export possibilities are more optimistic, and Maret has developed a viable, growing market for its product lines in Saudi Arabia, Turkish communities in Western Europe, and Hungary. Currently 40% of Maret's volume, or 25 tons per week, is exported. As a result the company projects it will break even in 1988, and hopes to expand exports to 40 tons per week by mid 1989.

Relationship with Ram

Although Ram claims that Maret is not a participant in the trade finance pool because of its size, the commingling of STF funds with other Ram resources makes this unverifiable. Maret does not fall within the A.I.D./STF Agreement target group, and the average net capital investment per job is $21,000, comparable to a similar job in Western Europe.

A principal source of funding for Maret is Euro-Dollar debt, including $4.3 million in revolving short-term credit lines, guaranteed by Koç. The dollar lines helped Maret import cattle in 1987. However, the company has begun to obtain local cattle because of the unfavorable dollar terms of trade.

TAT CONSERVE SANAYII A.S.

Istanbul

Food Processing

Description of the Firm

Tat is Turkey's largest processor of tomato paste and canned vegetables. The firm, established in 1987 as a joint venture of Ram and a parastatal, the Turkish Sugar Factories (TSF), merged with Bettas, a smaller, modernized tomato paste processor. This merger substantially increased Tat's net fixed assets. In February 1987, Tat had $1.1 million in net fixed assets; in contrast, net fixed assets at the end of calendar year are projected to be $2.8 million. Currently, Tat's shareholders are Koç, 67%, TSF, 22%, Japanese foodstuff importers 7%, and private Turkish investors 4%.

Operations

Tat has two 40,000 Metric Ton (MT) capacity plants in the fertile Bursa Valley and processes approximately 40,000 MT of tomato paste and 8,000 MT of canned vegetables yearly. The firm estimates that 1988 sales will total $32 million, an 18% increase over $27 million in 1987.

Two thirds of revenues are from exports to Japan, Canada, the EEC, Sweden, Switzerland, Austria, the U.S. and Malaysia. Japan is the largest consumer of tomato paste (10,000 MT). Consequently, Japanese importers have taken an equity stake in the firm. Tat has also increased its exports of peas, okra and beans to the United Kingdom and Scandinavia. In contrast, the Turkish market for processed tomato paste and canned vegetables is stagnant, although Tat's products represent 25-30% of local demand.

Relationship with Ram

Shortly after Tat's merger with Bettas, Ram began the A.I.D./STF facility. Part of the STF funds were passed directly to Tat in a $2 million three year loan on the same terms and conditions as the $10 million STF facility. The company also currently has $4 million in credit lines from Bank of Tokyo and is negotiating a $2-3 million revolving line with Koç-Amerikan Bank.

Tat's deputy general marketing manager, Ahmet Toygar, stated that Tat, like Ram, did not ask for the STF facility, and viewed it as less flexible and more expensive than commercial bank lines of credit. The STF loan is priced at 7.65% plus 1.5% per year (guarantee fee of 1.35 plus service fee of .15%), or

9.15% per year. On the other hand, the average cost of the Bank of Tokyo revolving line through September 1988 was 7.5 to 8% per year, plus a management spread of 1.2 per year, or 8.7 to 9.2% per year. The revolving line also has the advantage of a drawdown-payback feature that allows Tat to tailor credits to its cyclical working capital requirements for procuring tinplate, steel drums and other materials, and financing individual farmer suppliers during the seven month cultivation and harvest period of April through October.

The team's interview with Tat brought out three important points: (1) Tat's management was unhappy with the STF loan because it was not tailored to seasonal trade transactions like revolving lines of credit and could not be prepaid, making it 60% more expensive than the Bank of Tokyo line of credit during 1987 and 1988; (2) Tat's staff was unaware that the six month LIBOR had risen to 9.5% per year by late November, and the price of commercial bank financing had risen to 10.7%, while the price of the STF loan remained at 9.15% per year; and (3) The STF loan assisted small producers through Tat's supplier loans. In fact, Tat's suppliers increased from less than 1,000 in January 1987, to approximately 3,500 at the end of 1988.

TOPSAN KERESTECILIK

Sawmill

Istanbul

Description of the Firm

This small sawmill buys imported logs, cuts them into boards and sells them on the domestic market. Its labor intensive production line has seven full-time employees, including Mr. Mustafa Topçu and his two sons. They also hire part-time employees as the work requires. Mr. Topçu is 100% owner and manager. He came to Istanbul 25 years ago from Kastamonu, where he was an apprentice since the age of 12. In Istanbul he began work in another sawmill, and started Topsan in 1973 with help from entrepreneurs from Kastamonu living in Istanbul.

Operations

Topsan produces 350 cubic meters of cut boards per month. The yearly sales for 1987 were $75,000. Net fixed assets are $212,000. When there are profits, they are reinvested in the business. In 1988, however, profit was minimal and often Mr. Topcu says he has "only had enough money for a cup of soup." Mr. Topçu has another business that makes wooden boxes and crates using the waste from cutting the boards. Other wastes are sold for burning in home stoves.

There are approximately 15 competitors in the immediate area, half of which are larger and half smaller or the same size. All sales are made in Istanbul, 30% to large construction companies and 70% to consumers, especially families building their own homes. Mr. Topçu does not advertise, other than by placing the company's sign in front of the factory.

Relationship with Ram

Topsan has bought imported logs through Ram since 1986. They must provide Ram with a two month post dated check for 60% of the value and a cash deposit for the other 40%. In addition, they must give Ram a bank letter of credit for 70% of the value of the purchase. So far they have not needed to borrow from a bank. To date the experience with Ram has been positive. They would like to have longer-term credit, but the term Ram extends depends on the supply and demand for logs.

Cutting logs into boards

TRANSACTIONAL STEPS AND INSTITUTIONAL INTER-RELATIONSHIPS

Transactional steps and institutional inter-relationships are described below and illustrated in the accompanying chart:

1) Ram (borrower) obtains triple-A rated standby letter of credit (unconditional, irrevocable, and transferrable) from Postipankki which guarantees timely payment of 100% of principal and interest due under the Ram's promissory notes. This letter of credit is issued in favor of the U.S. trade finance company (Contitrade), the purchaser.

2) Ram sells its own medium-term, US$ denominated promissory notes, with no prepayment provision without recourse to Contitrade. Payment of each note is guaranteed by Koç.

3) Contitrade assigns to U.S. trustee bank (Chase Manhattan) in a grantor trust the promissory notes and transferable guarantee (from Koç) as collateral for its own matching obligations (triple-A rated U.S. corporate securities).

4) Contitrade sells its triple-A rated securities to large institutional investors.

5) Institutional investors deposit funds in escrow account with Chase Manhattan.

6) Ram requests disbursements of funds from Chase.[1]

7) Chase disburses funds to Ram.

8) Ram repays Contitrade via Chase as per maturity dates of the promissory notes.

9) Chase repays the institutional investors as scheduled in the matching securities of Contitrade.

In the event that Ram misses payment:

1) Chase advises Postipankki via Contitrade.

2) Postipankki remits funds immediately to Chase for timely repayment to institutional investors.

3) Postipankki seeks recourse from Koç and/or Ram, per prior letter of credit agreement.

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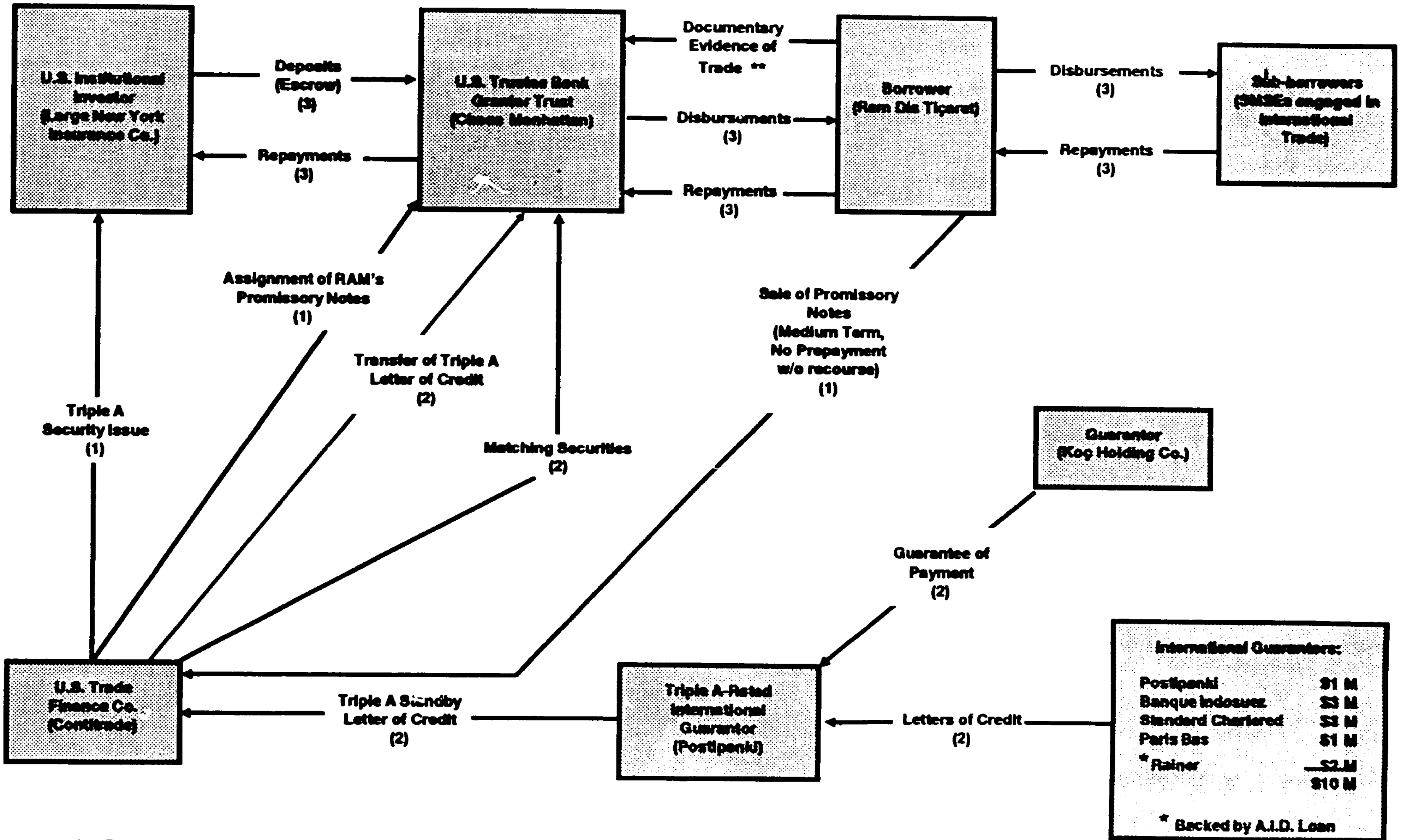
[1] In addition, Ram was to submit documentary evidence of some form of present, recent past, or near future international trade, e.g. its own import invoices, promissory notes from foreign importers, evidence of pre-export finance, etc.

ANNEX 2: CHART OF TRANSACTIONAL STEPS AND INSTITUTIONAL INTER-RELATIONSHIPS SECURITIZED TRADE FINANCE (TURKEY)



(1) Documents
(2) Guarantee
(3) Flow of Funds

** This documentary evidence was required to have been provided by RAM to Contitrade However, there is no evidence that this was done.

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ANNEX 2

ANNEX 3A: Matrix of Ram Sub-Borrowers Interviewed

COMPANY NAME	(1) Exp/ Imp	(2) Rel with Ram	Year of First Credit fr Ram	Net Fixed Assets ($'000s) As of First Credit	Net Fixed Assets ($'000s) At Present	Sales ($'000s) As of First Credit	Sales ($'000s) At Present	Employees As of First Credit	Employees At Present	Amt of Line of Credit ($'000s)
Birlesik Ambalaj (Packaging)	Imp	PC	86	(3)	(3)	391	301 (4)	25	35	200
Er-Ka Tekstil (Textiles)	Exp	PC	86	50	70	450	530	20	30	29
Birlik Kerestecilik (Sawmill)	Imp	PC	86	50	170	60	70	4	7	200
Topsan Kerestecilik (Sawmill)	Imp	PC	86	150	212	50	75	?	6	200
Ayvacilar Kerestecilik (Sawmill)	Imp	PC	82	250	300	600	660	20	20	110
Aycam Ahsap (Sawmill)	Imp	PC	82	200	460	450	625	25	34	367
Coskun at Mamulleri (Meat)	Imp	PC	85	450	596	1,000	1,487	100	150	306
Apikoglu Sucuklari (Meat)	Imp	NC	87	900	1,100	3,800	4,800	120	150	300
Ilhaner (Raisins)	Exp	DFS	85	775	1,100	500	10,000	50	150	1,800
Dog Tekstil (Textiles)	Exp	PC	86	850	1,360	1,700	4,000	100	260	210
Arat Tekstil (Textiles)	Exp	PC	86	500	2,800	700	6,000	50	140	117
Tat-Beytas (Food)	Exp	S	86	1,100	3,500	1,800	32,000	1,000	3,000	2,000
Kartal Markana (Pasta)	Exp	PC	82	4,550	9,100	8,000	10,000	120	140	450
Marat (Meat)	Exp	S	87	(5) 0	9,500	(5) 0	10,000	(5) 0	450	4,300
Total				9,825	30,268	19,501	80,548	1,634	4,572	10,589
Average					1,598		5,753		327	756

Export Companies

Sales ($'000s) As of First Credit	Sales ($'000s) At Present	Net Fixed Assets ($'000s) As of First Credit	Net Fixed Assets ($'000s) At Present
13,150	72,530	7,825	27,430

Import Companies

Sales ($'000s) As of First Credit	Sales ($'000s) At Present	Net Fixed Assets ($'000s) As of First Credit	Net Fixed Assets ($'000s) At Present
6,351	8,018	2,000	2,838

Funding ($'000s)

Imports	%	Exports	%	Total
1,683	19%	8,906	84%	10,589

Notes: (1) Exp = primarily exporter of finished products; Imp = primarily importer of raw materials.
(2) PC = Previous client; DFS = De facto subsidiary; S = subsidiary; NC = New client
(3) Could not estimate value of net fixed assets, but is probably < $1 million.
(4) This decrease was due to fact estimated sales were the same in TL in 1986 as present. Therefore, devaluation caused decrease in $ value.
(5) Start-up.

ANNEX 3B: Matrix of Ram Sub-Borrowers Interviewed
(Sorted by Importers vs. Exporters)

COMPANY NAME	(1) Exp/ Imp	(2) Rel with Ram	Year of First Credit fr Ram	Net Fixed Assets ($'000s) As of First Credit	Net Fixed Assets ($'000s) At Present	Sales ($'000s) As of First Credit	Sales ($'000s) At Present	Employees As of First Credit	Employees At Present	Amt of Line of Credit ($'000s)
Birlesik Ambalaj (Packaging)	Imp	PC	86	(3)	(3)	391	301 (4)	25	35	200
Birlik Kerestecilik (Sawmill)	Imp	PC	86	50	170	60	70	4	7	200
Topsan Kerestecilik (Sawmill)	Imp	PC	86	150	212	50	75	?	6	200
Ayvacilar Kerestecilik (Sawmll)	Imp	PC	86	250	300	600	660	20	20	110
Aycam Ahsap (Sawmill)	Imp	PC	82	200	460	450	625	25	34	367
Coskun et Mamulleri (Meat)	Imp	PC	82	450	596	1,000	1,487	100	150	306
Apikoglu Sucuklari (Meat)	Imp	PC	85	900	1,100	3,800	4,800	120	150	300
Er-Ka Tekstil (Textiles)	Exp	PC	87	50	70	450	530	20	30	29
Ilhanar (Raisins)	Exp	DFS	85	775	1,100	500	10,000	50	150	1,800
Dog Tekstil (Textiles)	Exp	PC	86	850	1,360	1,700	4,000	100	260	210
Arat Tekstil (Textiles)	Exp	PC	86	500	2,600	700	6,000	50	140	117
Tat-Beytas (Food)	Exp	S	86	1,100	3,500	1,800	32,000	1,000	3,000	2,000
Kartal Markana (Pasta)	Exp	PC	82	4,550	9,100	8,000	10,000	120	140	450
Meret (Meat)	Exp	S	87	(5) 0	9,500	(5) 0	10,000	(5) 0	450	4,300
Total				9,825	30,268	19,501	80,548	1,634	4,572	10,589
Average					1,598		5,753		327	756

ANNEX 3B

REPRESENTATIVE SAMPLE OF COMPANIES BORROWING FROM RAM

Company	Product	Amount Outstanding*	Location
Bogazici et-Gida Sanayii A.S.	Meat	$ 59,422	Istanbul
Coskun et Mamulleri A.S.	Meat	38,360	Istanbul
Apikoglu	Meat	78,272	Istanbul
Istanbul et-Gida Pazarlama	Meat	54,570	Istanbul
Maret A.S.	Meat	1,213,171	Istanbul
Mehmet Kurt	Meat	98,679	Istanbul
Ozdabak A.S.	Meat	41,224	Ankara
Servet Deri Sanayii A.S.	Leather	53,067	Istanbul
Sezer Tavukculuk A.S.	Poultry	21,463	Istanbul
Ayvacilar Kerestecilik A.S.	Lumber	73,318	Istanbul
Aycam Ahsap Urunleri A.S.	Lumber	132,225	Istanbul
Birlesik Ambalaj Sanayii	Packaging	8,679	Istanbul
Elektro Ev Aletleri	Household Goods	15,936	Istanbul
Topsan Kereste A.S.	Lumber	3,693	Istanbul
Birlik Kerestecilik	Lumber	47,391	Istanbul
Lider Gida Ve Tiçaret	Food	155,380	Istanbul
Migros Turek A.S.	Food	18,665	Istanbul
Oztiryakiler Madeni Esya	Household Goods	192,605	Istanbul
Ilhanlar A.S.	Household Goods	1,549	Izmir
Yildirimlar Gida Sanayii	Food/Text	15,864	Izmir
Arat Tekstil	Textiles	37,040	Istanbul
Halic Tekstil San A.S.	Textiles	16,625	Istanbul
Erka Tekstil	Textiles	1,386	Istanbul
Ulukartal A.S.	Food	4,666	Izmir
		$2,383,247	

* In U.S. dollars [$/TL Exchange Rate as of August 31, 1988: 1533.12].

GOVERNMENT OF TURKEY SPONSORED EXPORT INCENTIVE CREDIT FACILITIES

1. Export-Import Bank of Turkey (Eximbank) Past Export Performance Facility

A company must have a minimum of $100 million in export earnings to qualify for the Eximbank's Past Performance Facility, effectively limiting access to 15 Turkish enterprises. The Facility is accessed by direct application to the Eximbank; however, the applicant's commercial bank participates in the management of the credit.

This Facility's terms and conditions are:

- Amount: Five percent (5%) of a twelve month running average of a company's export sales multiplied by the average U.S. dollar exchange rate during the same period.
- Rate of Interest: 35% p.a. to the Eximbank and a 1% p.a. commission to Ram's commercial banking connection.
- Term: The Facility is adjusted on a net balance basis every six months so that Ram would receive an incremental five percent on its outstanding account if its export revenues are positive. Conversely, if the adjusted running balance is negative because of a decline in export sales, Ram would have to pay interest on the net difference. However, this expense could be balanced out by the depreciation of the Turkish Lira against its foreign exchange earnings.

2. Export-Import Bank of Turkey Post Shipment Facility

This Facility's terms and conditions are:

- Amount: Twenty percent (20%) of the value of the export shipment invoice multiplied by the exchange rate at the time of the shipment.
- Rate of Interest: 27% p.a. to Eximbank and 3% p.a. management fee to Ram's commercial banking connection.
- Term: 90 days.

3. Central Bank of Turkey Rediscount Line of Credit (pre-shipment)

The Central Bank's rediscount line is the most accessible and commonly used of the three new GOT export finance initiatives because it finances a larger portion of the trade receivable, has a longer term than the Post Shipment Facility, and, therefore, can be used as a competitive sales tool.

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The terms and conditions of this line of credit are:

- Amount: Fifty percent (50%) of a commercial bank's letter of credit.

- Rate of Interest: 37% p.a.

- Term: The line of credit must be repaid within a period of 5 days of the receipt of the foreign exchange proceeds up to a period of 120 days. Thereafter, the company has another 45 days grace in which it will have to pay an equivalent rate of interest of 66% p.a. during that time period. If not paid after 165 days, a default penalty which brings the total cost of the line to approximately 90% p.a. must be paid.

It is important to note that no one line can compensate for the elimination of the tax rebate, but a company like Ram can use all three lines concurrently and come out slightly ahead of its previous position. Ram's international finance staff admitted that these initiatives appeared to be complicated, but they were designed to follow the general pattern of Turkish exports sales, and hopefully will prevent further abuses without damaging current export sales benefits with the elimination of the tax rebate.

On the other hand, only large companies can really understand and effectively manage these three lines. This requires a large staff which can invest substantial amounts of time.

GENERAL ECONOMIC ENVIRONMENT AND FINANCIAL MARKETS OVERVIEW

I. ECONOMIC

Despite the strong export growth that Turkey has experienced over the past several years, access to credit continues to be a constraint for both exporters and importers. High inflation, the 1979 debt rescheduling, persistently high levels of foreign currency debt and especially a scarcity of fixed rate, long term funding from the Eurodollar market, have required exporters and importers to rely on short-term, variable rate financing. As a result, companies often mismatch their financing patterns - i.e., using short term revolving lines to finance long- and medium-term requirements such as capital investments and raw materials.

A. Domestic Economy

In anticipation of full membership in the European Economic Community (EEC), Turkey recently adopted economic measures to liberalize the economy and encourage business competition. The impact of these policies, combined with the rapid expansion of public sector investment, resulted in an overheated economy and rampant inflation in 1988. Although the Government of Turkey (GOT) set a ceiling of 40% inflation for 1988, consumer prices rose 86% during the year ending October 31, 1988 compared to 36% for the same period in 1987.[1]

For the past four years, Turkey has experienced a high rate of economic growth. The average annual rate of GNP growth was 6.7% from 1984 to 1987, with 8.1% in 1986, and 7.4% in 1987. The industrial sector recorded the highest rate of growth at 9%, followed by the service sector at 5.5%, construction at 4.6%, and agriculture at 4%. During the same four year period, private fixed capital investment increased (in real terms) by 12%, public investment by 6%, private and public consumption by 6.4% and 6.2%, respectively.

In 1987, GNP was US$ 61.028 billion at current prices. The rate of growth declined sharply in agriculture, rising only 1.8%; this compared very unfavorably with the 7.6% growth recorded for 1986. As a result, the manufacturing sector's share in GNP rose from 23.8% in 1986 to 24.4% in 1987, reducing the share of the agriculture sector from 20.4% in 1986 to 19.3% in 1987. Per capita income for 1987 is estimated at US$ 1,254.80, compared to $1,120.00 for 1986, representing an increase of 12%.

Fixed capital investment, which stood at 17.9% of GNP in 1984, increased to 20% in 1985, 23.2% in 1986, and 24% in 1987. The share of private sector investment in the national total decreased from 58% in 1986 to 54.4% in 1987; its share in GNP, however, rose from 9.7% in 1986 to 10.9% in 1987.

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[1] According to the State Institute of Statistics.

Distribution of Fixed Capital Investment

(% of the total)

	Public		Private	
	1986	1987	1986	1987
Agriculture	6.7	9.0	6.1	6.6
Mining	6.6	3.8	1.3	1.5
Manufacturing	9.7	6.1	33.3	26.1
Energy	23.7	24.4	1.3	0.9
Transportation and Communication	30.6	32.6	14.4	11.8
Tourism	2.5	2.4	3.0	3.8
Housing	1.9	1.5	35.5	44.1
Education	3.4	3.2	0.4	0.6
Health	1.4	1.4	0.6	0.7
Others	13.6	15.6	4.1	3.9
TOTAL	100.0	100.0	100.0	100.0

B. International Trade

After stagnating during 1986, exports increased by 37% in 1987 for a total of $10 billion. Imports grew by 28% for a total of $14.2 billion. However, this created a trade deficit of $3.9 billion (an increase of 9% from 1986), but the coverage of imports by exports increased from 67% to 72% (trade deficit narrowed).

As a percentage of GDP, both exports and imports displayed significant increases. Exports, which amounted to 13% of the GDP in 1986, rose to 21% in 1987 while imports increased from 19% to 29%.

EXPORTS BY SECTORS (1987)

SECTORS	US $ MILLION	(%)
Agriculture and Animal Breeding	1,852.5	18.3
Mining and Quarry	272.3	2.6
Manufacturing	8,065.2	79.1
- Agro Based Processed products	953.9	9.3
- Manufacturing	7,111.3	69.7
TOTAL	10,190.0	100.0

IMPORTS BY SECTORS (1987)

Agriculture and Livestock	782.3	5.6
Mining and Quarry (incl crude oil, 19.1%)	3,034.0	21.4
Industrial Products	10,346.7	73.0
TOTAL	14,163.1	100.0

Favorable developments also occurred in service exports. Although expenditure on travel abroad increased by 50% to $450 million, net income on tourism showed a steep rise, contributing more than $1 billion for the first time ever. A further favorable development was the increase in workers' remittances, which rose by 24% to $2.1 billion compared to declines over the two preceding years.

II. FINANCIAL

A. Institutional Framework

The banking sector boasts a great diversity of banks, ranging from multi-branched state banks to small finance houses operating according to Islamic banking practices. At the beginning of 1987, the Turkish banking system included 51 deposit banks, 4 investment and development banks, and 20 foreign banks. Recent years have seen a rapid expansion in the number of foreign banks operating in Turkey, including joint ventures with Turkish institutions.

1. The Central Bank

Following a financial crisis in 1982, the GOT amended the Banking Law and the Central Bank Law in order to establish and expand the Central Bank's supervisory and regulatory authorities over the financial system. Amendments in 1986 and 1987 extended the Central Bank's powers over commercial banks and introduced a "reporting system" requiring banks to report their accounts to the Central Bank on a periodic basis.

The Central Bank's stated credit policy is based on three principles:

- Increasing the share of private sector credit by decreasing public credit availability;
- Increasing the availability of export and investment credits to the private sector; and
- Operating the credit system in conformity with national development plans.

In 1987 and 1988, the two latter principles could not be met due to the high economic growth stimulated by heavy public sector investment and high inflation. The share of private sector credit in total Central Bank credit increased only slightly - 28% in 1985, 29% in 1986 and 33% in 1987.

2. Depository Institutions

The Turkish banking system has developed in the direction of "branch banking". The 55 existing banks (including 12 public sector banks) have nearly 6000 branches spread across the country, employing about 150,000 personnel. In practice these banks operate as "universal banks" offering a full range of services to all clients. Deposit banks, with a few exceptions, make direct equity investments in industrial and commercial companies, and "profit from participation" contributes significantly to bank incomes. The major private deposit banks are owned and controlled by leading industrial groups. The Koç Group, for example, established its own bank, Koç American Express Bank, in conjunction with American Express Bank in 1985.

a. State-Owned Banks

The 12 state-owned banks are required to serve specific sectors of the economy. The most important sectors served are agriculture, housing artisans and the self-employed, textiles and shipping. However, these banks' activities are not strictly limited to their fields of specialty.

b. Private Banks

There are 30 private deposit banks in Turkey, including four joint venture banks with foreign shareholdings. There are also 14 branches of foreign banks operating in Turkey. Private banks hold 58% of the nation's deposits, and provide 45% of credit. Among the private banks, 88% of deposits and 83% of private sector credit are held by the six largest banks. The largest of the commercial banks is Isbank with 900 branches and assets of over $5 billion.

c. Other Financial Institutions

There are four development and investment banks and two Islamic banks in the system as follows:

(i) Devlet Yatirim Bankasi (DYB), the State Investment Bank, is the largest development bank, with TL250 billion in capital. Its main purpose is to provide long term credits to state enterprises. DYB took on a new role as Turkey's export credit agency in 1987.

(ii) Türkiye Sinai Kalkinma Bankasi (TSKB), the Industrial Development Bank, was established in 1950 as a joint venture between the World Bank and the GOT, with the aim of encouraging private industrial development. The TSKB has established links with international capital markets.

(iii) Devlet Sanayive Isci Yatirim Bankasi (DESIYAB), was established in 1975 to support investment in manufacturing and industry. The bank also holds deposits of Turkish workers abroad.

(iv) Sinai Yatirim ve Kredi Bankasi (SYKB), was founded in 1963 by five of the larger commercial banks and provides medium-term Turkish lira loans.

Two Islamic banks were established in 1985, Al Baraka Turkish finance house and Faisal Finance. Their "profit and loss sharing" accounts avoid paying and charging interest according to Islamic banking practice and provide higher returns than commercial banks.

d. Semi-Financial Institutions

Other institutions -- e.g., social security organizations -- raise funds through social security contributions of individuals. They use these funds to make investments or provide subsidized credit to their contributors.

e. Financial Service Institutions: The Istanbul Stock Exchange

The Istanbul Stock Exchange (ISE) is an autonomous public organization governed by the Capital Market Law and supervised and controlled by the Capital Markets Board (CMB). New regulations of the capital market were enacted in March, 1987. These were followed by regulations specifying rules for external audits of corporate financial statements and reports by independent auditors. Companies issuing securities -- e.g., banks and other financial intermediaries, investment partnerships, and investment funds -- became subject to external audits so as to provide more information to the public about the capital market. Instruments traded on the ISC are: shares of joint-stock companies, bonds, government bonds and treasury bills, revenue sharing certificates, bank bills, commercial papers, and foreign exchange-indexed bonds.

B. Credit Developments

In 1987, commercial bank credits increased by 60%, compared to an increase of 77% in 1986. For the 12-month period ending June 1988, commercial bank credits increased by 57%. This is much lower than the estimated 85% rate of inflation. Nevertheless, the commercial deposit banks' credits continued to be the main source of expansion for the economy's credit stock.

CREDIT AVAILABLE

	(Billion TL)		(% Change)	
	1986	1987	1985-86	1986-87
Central Bank, Direct (Public Sector)	1,130.2	1,955.8	28.6	73.0
Deposit Bank Credits	7,683.2	12,312.4	76.6	60.3
Investment and Development Bank	1,008.1	1,338.5	64.0	32.8
Total Credit Stock	9,821.5	15,606.7	68.0	58.9

The total credit extended by investment and development banks increased by only 33% in 1987, in comparison with a rise of 64% in the previous year. As a result, their share in total credit stock declined from 10% in 1986 to 9% in 1987.

DISTRIBUTION OF COMMERCIAL BANK CREDITS BY SECTORS (%)

	1986	1987
Agriculture	13.9	17.9
Industry	25.7	22.3
Small Artisans	4.7	4.5
Construction	13.6	17.1
Tourism	0.1	0.3
Export	18.8	13.7
Import	1.0	1.0
Domestic Trade	20.6	21.4
Other Financial Institutions	0.2	0.2
Undistributed	1.4	1.2
TOTAL	100.0	100.0

C. Interest Rate Structure

The interest rate policy of the Central Bank is based on two principles:

- Maintain economic growth by keeping interest rates below a level that would restrain economic activities; and
- Establish and encourage positive real rates of interest in order to make financial savings more attractive to the public.

Indeed, these goals are difficult to meet in an economy plagued with a high inflation rate of approximately 85%.

To protect the small investor, the Central Bank has maintained fixed rates for deposits with maturities of one year or less. In February 1987, the interest rate on deposits with one-year maturity was 43%; six-month maturity, 38%; three-month maturity, 33%; and one-month maturity, 28%. In June, 1987, the Central Bank authorized banks to determine interest rates on deposit accounts with one-year maturity, but fixed interest rates on deposit accounts with maturities less than one year were maintained. The Central Bank also ruled that interest rates on certificate of deposits over 10 million Turkish Lira, regardless of maturity, would be determined freely by banks.

The introduction of open market operations in February, 1987 by the Central Bank is another important element of the interest rate structure. Although the purpose of open market operations is to implement monetary policy, they contributed to the development of a secondary market for government bonds and to market determination of interest rates. From the operation's commencement in February 1987 to December 1987, the Central Bank's transactions totalled 8,791 billion Turkish Lira. The average annual interest rates (yield) for the 6-month period ending December 1987 were as follows:

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Months	Average interest rates (%)
June	40.64
July	29.65
August	22.16
September	39.75
October	47.30
November	48.69
December	42.28

Fixed interest rates on short term deposits are also affected by market rates due to periodic adjustments by the Central Bank. The Central Bank's annual report reveals the following interest rates on deposits on June 30, 1987 and on June 30, 1988:

Terms of deposit	June, 1987 (%)	June, 1988 (%)
Sight	10	30
One-month	28	40
Three-month	35	45
Six-month	38	52
One-year	53	65

D. Credit and Capital Market Constraints for International Trade

As mentioned above, a significant constraint for Turkish importers and exporters continues to be the inability of private Turkish companies to borrow fixed rate long- and medium-term credit from international capital markets, including the need for foreign exchange to purchase imported capital equipment and raw materials. Commercial banks typically lend to Turkish borrowers at relatively high real interest rates and short maturities. According to *Euromoney*, during the first two and a half months of 1988, Turkish borrowers publicly tapped the international loan market for over $800 million of credit.[2] More than half of this is short-term money that will need to be replaced with new facilities next year. For long term funding from banks, support is required from a government export agency (Devlet Yatirim Bankasi - DYB), or through programs financed by the World Bank or IFC.[3] Further, long-term funding often relies on securing GOT guarantees before private sector financial institutions are willing to lend to Turkish borrowers. The predominance of short-term maturities is a particular problem for private sector borrowers.

An additional constraint is that the trade credit programs carried out by the Central Bank and DYB are oriented toward larger companies and are generally limited to businesses that have existing relationships with commercial banks and trading companies. This has left a substantial unmet demand for commercial credit from smaller export producers.

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[2] *Euromoney*, May, 1988.

[3] Ibid.