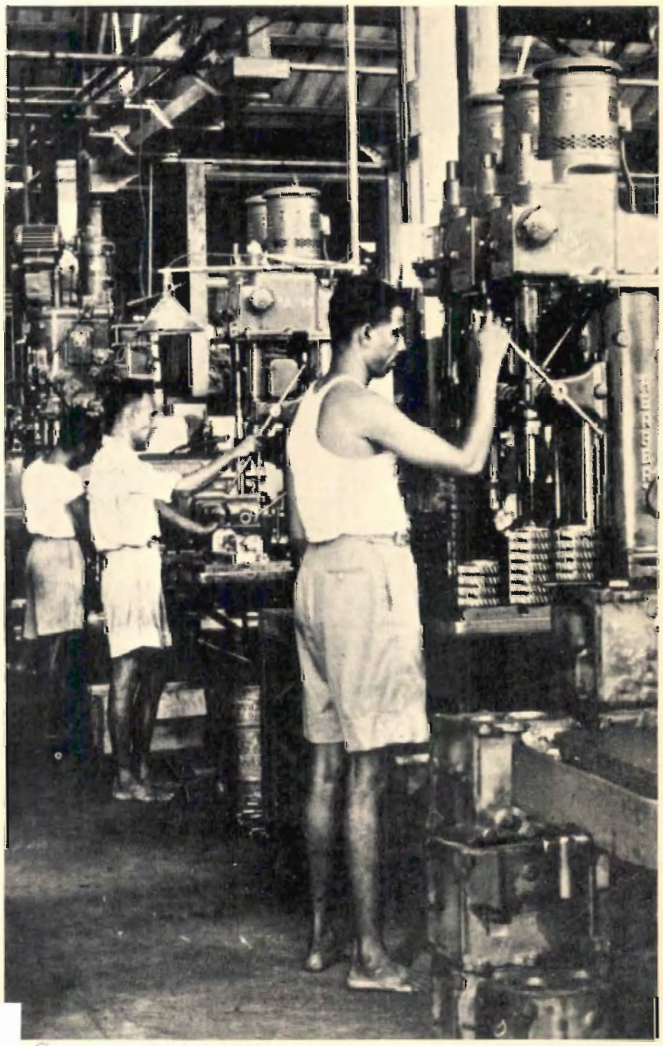
Spring Review

June 1969
USAID

draft

Mission Reports

INTERMEDIATE CREDIT INSTITUTIONS



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CONTENTS

LATIN AMERICA

Costa Rica	COFISA
Ecuador	COFIEC
Ecuador	CV/CFN
El Salvador	FDI
El Salvador	INSAFI
Nicaragua	CNI
Nicaragua	INFONAC
Panama	DISA

AFRICA

Ethiopia	EIG
Ghana	NIB
Ivory Coast	BIDI
East Africa	EADC

NESA

India	OVERALL EVALUATION
India	ICICI
India	IFC
India	IDBI
India	NSIC
* Nepal	NIDC
Pakistan	ICP
Turkey	TSKB

EAST ASIA

Korea	EVALUATION and CONCLUSIONS
Korea	KRB
Korea	MIB
Korea	KDFC
Laos	DBL
Philippines	IGLF
Philippines	PDCP

Vietnam	IDC, SOFIDIV

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*Deleted (classified)

NOTE:

The following is a nearly complete collection of the USAID evaluation reports submitted for the Spring Review on Intermediate Credit Institutions. (One report was omitted because most of it was classified). It should be recognized that these reports were prepared under considerable time pressure, and should be considered more as draft material than as refined finished products.

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COSTA RICA

CORPORACIÓN COSTARRICENSE DE FINANCIAMIENTO INDUSTRIAL, S. A.
(COFISA)

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SPRING REVIEW ON INTERMEDIATE CREDIT INSTITUTIONS

A. Description of Project*

1. Country:

   COSTA RICA

2. Name of ICI:

   COFISA (Corporación Costarricense do Financiamiento Industrial)

3. Class of ICI:

   Public _____

   Private X

   Mixed _____

4. Date Established:

   August 31, 1963

5. Initial assistance from A.I.D.:

Date	$ Amount	Kind
Loan Authorization November 18, 1963 Loan Agreement signed December 12, 1963	$ 5 Million	Dollar Loan

6. Does the ICI take equity participation:

   Yes X No _____

7. Capital structure of ICI as of the date specified in 5. above:

   The conditions precedent to the loan required the borrower to present evidence that the borrower has subscribed capital of the equivalent of no less than one million U.S. dollars and that at least $200,000 had been paid in.

*Much of the information required for the review is available in the Loan Papers prepared on October 7, 1963, for the first loan and June 20, 1968 for the second loan. These documents will be referred to extensively throughout this report.

8. Subsequent assistance from A.I.D.:

A second $5 million loan for COFISA was authorized July 3, 1968. Signing of the loan agreement for this loan, however, is being delayed pending ratification of the Protocol of San José by the Costa Rican Assembly.

9. Capital structure of the ICA at the end of the latest fiscal year:

The balance sheet for the year ending September 30, 1968 is presented below. Note the line marked "Capital Acciones" (Capital Stock). The change from ₡6,650,000 ($1,000,000) to ₡7,049,000 ($1,060,000) represents a 6% stock dividend.

CORPORACION COSTARRICENSE DE I

(San Jose,

Balanc

September
with comparative

Assets	1968	1967
Current assets:		
Cash	¢ 1,140,833	2,051,468
Marketable securities, at cost which equals market (note 3)	1,326,000	2,236,000
Receivables:		
Notes, trade	20,196,686	17,013,737
Accounts:		
Trade	382,722	353,134
Employees	18,308	18,418
Other	66,500	16,625
Total receivables	20,664,216	17,401,914
Prepaid expenses	13,472	6,813
Total current assets	23,144,521	21,696,195
Long-term notes receivable, trade	23,561,578	22,693,940
Investment in shares of other companies, at cost	1,001,663	220,000
Office furniture and equipment, at cost	302,644	234,480
Less accumulated depreciation	74,392	50,793
Net office furniture and equipment	228,252	183,687
Other assets, at cost less applicable amortization (note 2)	414,049	545,122
	¢ 48,350,063	45,338,944
Contra accounts (note 4)	¢ 34,630,067	31,943,471

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See accompanying notes to financial statements.

Exhibit A

ANCIAMIENTO INDUSTRIAL, S. A.

sta Rica)

Sheet

), 1968
gures for 1967

Liabilities and Stockholders' Equity	1968	1967
Current liabilities:		
Notes payable:		
Agency for International Development (note 1)	¢ 1,071,273	-
Trade	4,638,125	1,975,858
Other	83,630	422,142
Total notes payable	5,793,028	2,398,000
Accounts payable, other	12,500	517,201
Accounts payable, employees	8,220	13,188
Interest payable	117,240	49,875
Dividends payable	5,445	3,030
Christmas bonus payable	31,569	27,627
Costa Rican taxes on income, estimated (note 5)	433,954	506,916
Total current liabilities	6,401,956	3,515,837
Deferred income	146,172	100,954
Long-term notes payable:		
Agency for International Development (note 1)	32,138,186	33,091,994
Trade	432,500	-
Other	-	84,414
Total long-term notes payable	32,570,686	33,176,408
Provision for monetary fluctuations, bad debts and other losses (note 1)	650,000	553,619
Stockholders' equity:		
Common stock, authorized and issued, 70,490 shares of ¢100.00 par value each	7,049,000	7,049,000
Retained earnings:		
Appropriated for legal reserve	261,798	160,571
Unappropriated	1,870,451	782,555
Total retained earnings	1,132,249	943,126
Total stockholders' equity	8,581,249	7,992,126
Contingent liabilities (note 5)		
	¢ 48,350,063	45,338,944
Contra accounts (note 4)	¢ 34,630,067	31,943,471

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10. Status of A.I.D. $ loans as of July 1, 1968:

As of July 1, 1968, $4,994,000 of the $5,000,000 had been disbursed. AID/W has been requested to deobligate the remainder of the loan.

11. Interest rates:

Average rate paid by ICI

1-1/4% interest and 3/4% credit fee annually average rate charged to ICI. COFISA may charge interest up to 12% per annum. Most loans are made with terms of between 10 and 12%.

NARRATIVE SECTION

A. The limits on size and use of loans are as follows:

Regardless of source of funds:

i. All subloans for dollar procurement financed hereunder shall be repayable to Borrower in United States dollars or their equivalent on the dates of repayment.

ii. All subloands for colon procurement financed hereunder shall be payable to Borrower in colones.

iii. Loans for dollar or colon procurement shall be made for terms of not less than two (2) nor more than twelve (12) years, and shall allow for grace periods with respect to principal repayment of not to exceed three (3) years.

iv. No subloan shall be made by Borrower which would cause relationship of the sub-borrower's debt to his equity to be greater than seventy to thirty (70:30), without prior written approval of AID. In the computation of such ratio, the proposed subloan shall be included in the sub-borrower's account as debt.

v. No subloan for refinancing shall be made without prior written approval of A.I.D. Borrower shall make no investment in the equity of any enterprise without prior written approval of AID.

vi. No project shall be financed by Borrower by loan or equity participation, in which members of the Board of Directors, officers, or principal stockholders of Borrower or their inmediate families have any financial interest, without prior written approval of A.I.D..

vii. Borrower shall not finance subprojects if such financing would cause its total assistance to any single enterprise to exceed fifty thousand dollars ($50,000) equivalent, without prior written approval of A.I.D..

B. Number of loans and summary by sector follows: (also see page 13 of second loan paper).

DISTRIBUCION DE PROYECTOS APROBADOS Y DESEMBOLSOS EFECTUADOS POR RAMAS DE ACTIVIDAD ECONOMICA

al 30 de Setiembre de 1968

RAMAS DE ACTIVIDAD	APROBADOS			DESEMBOLSOS (*)		
	Colones	%	Nº Proy.	Colones	%	Nº Proy.
1. Agricultura y Ganadería	4.701.111.15	5.1	19	1.420.021.95	1.8	17
2. Productos Alimenticios	20.677.320.25	22.6	83	17.091.716.39	21.0	79
3. Industrias de Bebidas no Alcohólicas	1.481.053.95	1.6	6	1.481.053.95	1.8	6
4. Industria Textil	6.329.253.85	6.9	22	6.126.992.78	7.5	22
5. Fabricación de Calzado y Prendas de Vestir	13.278.390.05	14.5	63	13.059.579.39	16.0	62
6. Industria de la Madera (Exceptuando fabricación de muebles)	2.491.815.15	2.7	30	2.389.766.36	2.9	29
7. Fabricación de Muebles	1.095.504.25	1.2	11	743.918.10	0.9	10
8. Imprentas y Fabricación de Productos de Papel	4.737.880.35	5.2	41	4.651.450.89	5.7	41
9. Industria del Cuero y Productos de Cuero (Exceptuando calzado)	343.103.95	0.4	6	343.103.95	0.4	6
10. Fabricación de Sustancias y Productos Químicos	4.033.528.87	4.4	29	3.978.749.83	4.9	28
11. Fabricación y Extracción de Productos Minerales no metálicos	4.577.013.50	5.0	23	3.634.062.45	4.5	21
12. Industrias Metálicas y de Productos Metálicos	1.959.628.35	2.2	6	1.892.913.95	2.3	5
13. Construcción de Maquinaria (Exceptuando la eléctrica)	1.257.089.60	1.4	10	1.254.119.71	1.5	10
14. Construcción de Aparatos, Accesorios y Artículos Eléctricos	3.427.701.35	3.8	17	3.421.870.35	4.2	17
15. Transporte y Construcción de Material de Transporte	3.273.649.20	3.6	24	2.895.538.68	3.6	24
16. Construcción Industrial	6.092.754.05	6.7	47	5.923.670.73	7.3	46
17. Energía Eléctrica	[illegible]	5.2	11	[illegible]	5.8	11
18. Servicios Industriales	[illegible]	3.4	37	[illegible]	[illegible]	35
19. Industrias Diversas	[illegible]	2.0	34	[illegible]	[illegible]	34
20. Fomento de Invers[illegible] Capital	[illegible].932.773.35	2.1	32	[illegible]	[illegible]	27
TOTALES	[illegible].332.[illegible]	100.0	551	[illegible]	100.0	[illegible]

(*) comprenden las Recuperaciones

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C. Description of the financial environment in which the ICI has been operating.*

1. All commercial banks in Costa Rica with the exception of one small investment bank are publically owned and operated.

2. Commercial banks loan normally at an 8% interest rate with an additional annual service charge ranging around 1%.

3. The banking system is not sufficiently liquid to meet the needs of the private sector. Terms of longer than one year are very rarely given.

4. Consequently, considerable credit is obtained outside the banking systems at exorbitantly high rates; 25% is not unusual. This money is generally obtainable only on short terms.

5. Grace periods are all but unknown and a borrower can seldom obtain credit for more than a small part of his total needs. In fact, at the terms he must borrow, a Costa Rican industrialist is well advised not to burden his enterprise with more than a small amount of debt.

6. The banks are slow, procedurally cumbersome, and undaring. Their loans are generally made on collateral considerations rather than an analysis of the potential profitability of a project.

D. Description of the functions performed by the ICI and how these have changed.

The primary purpose of the first loan was to assist the borrower in making loans to promote the creation and expansion of industrial enterprises in Costa Rica. The second loan maintains this basic purpose, but also attempts through differential interest rates to funnel financing into priority areas. This aspect of the second loan is discussed in greater detail below.

*See second loan paper pp 38 and 39.

SECTION B

EVALUATION OF SPECIFIC POINTS

1. Goals

(a) DESCRIPTION: Generation of Additional Capital

COFISA is encouraged to mobilize additional capital. Before disbursements can begin on the second loan, COFISA must expand its equity base by $1.5 million of which $.5 million worth must be sold to individuals not presently holding stock in the company. In addition to this COFISA has been granted lines of credit from various U. S. and European banks totalling almost $3 million. Only one bank, ADELA of Perú, presently holds equity in COFISA.

(b) Influence on the direction of investment (see second loan paper pp 24-27).

In brief, while the first loan was intended in general terms to assist in industrial development, the second loan concentrates on five priority areas and utilizes differences in interest charged to COFISA for priority and non-priority loans as a means of encouraging activity in the priority areas. The priority areas are:

i. Exports outside the CACM.

ii. Foreign exchange earnings from tourism.

iii. Costa Rican agricultural production.

iv. Agricultural processing.

v. Import substitution (in specified cases).

(c) Does the project aim at getting a securities market started?

Assisting in the development of a security market has been an important objective of the project. Unfortunately few equity positions have been taken to date. (See fuller discussion in second loan paper pp 17 and 18).

(d) Does the project aim at improving business practices of borrowing firms?

Yes, but this is a secondary goal.

Achievement of Goals:

The project has been successful in establishing a financial institution with a demonstrated ability both to evaluate proposals for industrial loans (making loans where deemed advisable) and an ability to mobilize external capital for internal industrial development needs. The GOCR has relied upon the public sector as the primary engine of development. In conformity with this approach AID has sought to strengthen this sector through its lending policies; COFISA has played an important part in this program. Pages 12 and 13 of the Second Loan Paper discuss the way in which lending has been distributed by industry and the changes that have occurred in development priorities.

It is expected that COFISA will continue to grow in strength and that by the time the second loan is disbursed, COFISA will be able, by generating private capital both internally and externally, to sustain itself and prosper without further concessional support.

2. Selection of Borrowers

For the most part COFISA determines its own borrowers. The loan agreements for both the first and second loans proscribe certain types of loans. A fuller discussion of these provisions may be found above in part "a" of the narrative section. As discussed in part "b" of the goals section, AID also exerts influence over the choice of borrowers through the use of differential interest rates. The types of loans qualified to receive the lowest rates of interest are also discussed in part "b".

As a result of the credit situation (discussed above) COFISA does not need to stimulate loan requests. Since the second loan seeks to channel funds into priority areas, however, provision is made in the loan agreement for an agricultural specialist and an economist with an industrial background. These two technicians, who will be hired by COFISA, will devote much of their time to an examination of potential projects in the priority fields.

Allowing COFISA flexibility in the selection of borrowers has had many benefits. The board has become a high quality loan committee bringing together more diverse talent than any comparable organization in Costa Rica. The number of loans in default has been extremely small. Interviews with applicants for loans, including those who have been rejected, disclose a high degree of satisfaction with the businesslike nature in which their applications were processed.

3. Management and Operational Policies

In a developing nation, the number of aggressive, financially astute businessmen is often limited. It is necessary to utilize the talents of these individuals if a successful development banking institution is to be established. It would be difficult, however, to argue that the businessmen involved should not utilize the services of this institution. Under such conditions, many businessmen would refuse to offer their services to the development bank, and the "know-how" crucial to success would be lost.

COFISA was established with the understanding that the stockholders and officers of the corporation would be able to utilize its services as borrowers. To reduce conflict of interest difficulties, limitations were placed on the amount of stock any one institution or family group could hold and COFISA was required to obtain AID approval before granting any loan to a major stockholder or officer.

To date the Mission is basically satisfied with COFISA's performance in this regard. Loans to stockholders and officers have not been excessive and have been granted for purposes beneficial to the development of the nation. It is felt that any slight partiality that may have been shown is overshadowed by the benefits gained from involvement in the corporation of some of the nation's most astute businessmen.

The competent management has resulted in a stable and profitable institution, which makes loans on the basis of an estimation of the future profitability of borrowing enterprises as well as collateral offered. The Loam Agreement limits COFISA to a cash dividend of not to exceed 12 percent. After the second year of operation COFISA earned over 11% on share capital after deductions for taxes and reserves and by 1968 this percentage had climbed to 18 percent.

Thus, little technical or managerial assistance is required by the borrower to attain profitability. On the contrary care must be taken to prevent profitability from becoming the corporation's prime concern to the detriment of development goals. The second loan agreement, by requiring heavy concentration in priority fields, when coupled with significant development interest on past of COFISA's management ameliorates this problem.

4. Specific AID Relationships

The relationship between AID and COFISA has changed over time. When the first loan was signed, a primary goal was the establishment of a financial institution able to sustain itself and contribute to the development of the industrial sector of the economy. Since no one could be sure of the exact way such an institution should be developed within the Costa Rican environment, the loan agreement was written with a great deal of flexibility, and informal consultation between COFISA management and AID was relied upon to deal with the problems as they arose. The approach was successful in that an institution evolved which was able to mobilize capital from diverse sources and utilize this capital in a worthwhile, profitable manner.

During the development of a second loan, the philosophy of the Mission was far less paternalistic as is discussed in detail on pages 29-32 of the second loan paper, the loan was made not to strenghten COFISA, but to use it. COFISA was deemed to be in an ideal position to efficiently channel funds for the development of given priority areas and to assist in the continued development of the industrial sector. The second loan agreement is far more demanding regarding COFISA's obligations. Moreover, when the second agreement takes effect it will supersede the provisions of the first agreement where applicable. Thus through the second agreement we are able to clarify issues which of necessity were left fuzzy in the first agreement and to utilize a local institution as a primary development tool.

SECTION C

OVERALL EVALUATION

Since the second loan paper was written only last year, it provides an up-to-date discussion of what the Mission considers to be the basic issues.

Drafted by: Mr. Howard M. Smolkin

ECUADOR

COMPAÑIA FINANCIERA ECUATORIANA DE DESARROLLO, S. A.
(COFIEC)

AIRGRAM DEPARTMENT OF STATE

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DATE SENT

February 13, 1969

FROM - USAID/Quito

SUBJECT - Spring Review of Intermediate Credit Institutions

REFERENCE - AIDTO CIRC XA-25, January 4, 1969; TOAID-A 44, Jan. 28

1. Attached is loan evaluation report and related documents covering the AID loan to COFIEC, Private Financiera, Loan No. 518-L-026, Project Number DL-518-24-950-026. It is assumed that AID/W has on hand other documents such as the IRR, Loan Paper, Loan Agreement and Implementation Letters.

2. COFIEC completed their annual report for 1968, and while it has not yet come from the printers, a mimeo copy is enclosed. Thus we are able to make the complete evaluation and trust it reaches you before February 15th.

3. Mission does not intend to submit a PAR for this project, as there was no direct AID TC component. PAR information requested in I-C-1 and I-C-2 is included at the end of the evaluation report.

OTHER AGENCY

CROWLEY

Attachments to AAPC 2/17

cc: Markow, Asuncion
Jones, Lima

PAGE 1 OF 11 PAGES

DRAFTED BY	OFFICE	PHONE NO.	DATE	APPROVED BY
George R. Fitch/tdn	Industry		2/6/69	Robert J. Minges, Director

AID AND OTHER CLEARANCES

C. Blankstein
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LOAN EVALUATION REPORT

COFIEC, Private Financiera Project No. DL-518-24-950-026

A. DESCRIPTION OF THE PROJECT

1. Country: Ecuador
2. Name of ICI: Ecuatoriana de Desarrollo, S.A., Compañia Financiera
3. Class of ICI: Private Development Bank
4. Date Established: The Military Junta issued a Codification Law, Number 2646, November 29, 1965 to adapt the existing Law of Financieras to the application of private Financiera, COFIEC; the Minister of Industries duly registered the Company November 30, 1965; January 6, 1966 it was registered in Quito; January 31st was the first general stockholders' meeting; COFIEC made its first loan in June, 1966.
5. Initial Assistance from A.I.D.:

Date	Amount	Kind
1/31/66	$ 3,000,000	dollar loan

6. Does the ICI take Equity Participation: Yes X No____
7. Capital Structure of ICI as of date in (5) above: As of the AID loan date, paid-up capital was 9 million sucres. (See balance sheets in the IRR)
8. Subsequent Assistance from AID: None. Second tranche $ 3 million planned for FY-1967 not implemented due to shortage of AID funds.
9. Capital Structure at end of latest fiscal year FY-1968: Paid-in capital at end-1968 was 45 million sucres, (see enclosed balance sheets of 31 December, 1968).
10. Status of AID $ loan as of July 1, 1968:

$ committed	$ disbursed
$ 3,000,000	$ 2,872,821

COFIEC as of end-1968 had a balance of $ 70,000 committed but not implemented. They requested and received a 6-month extension of committment date.

11. Interest Rates: Average Rate paid by COFIEC 6-7%
Average Rate charged 10-10 1/2%

Rates paid by COFIEC range from 2 1/2% on the AID loan to 7% on loans from Edge Act and international banks.

Rate charged by COFIEC is the legal 10%, except in a few short-term loans which may be discounted 6 months, making an effective rate of 10 1/2%.

Differential rates are not used by COFIEC: They are not free to do so. COFIEC feels the limit of 10% in Ecuador is counter-productive. Industry could pay higher, in line with rising costs of money from foreign private sources which COFIEC has to pay.

12. Limit on Size and Use of Loans: The spread for COFIEC is $ 5,000 to $ 500,000, however a lower limit of $ 10,000 has been put up to the Board for approval this year. COFIEC can make working capital loans, and second loans to the same recipient, therefore there are cases where a $ 5,000 loan does not take excess staff time for review, such as where such a loan is guaranteed by a bank.

The AID L/A permits COFIEC to use up to 25% of the loan for working capital sub-loans. With its own funds, it uses a much higher ratio for working capital.

The Bank is free to make any loan the Board approves and takes a very broad view of "industry", ie., livestock, cotton and rice if there is a component of imported equipment such as pumps or irrigation, warehousing, tourism, etc.

13. Formal Criteria: Loans must go to private industry; other criteria are limited to practical considerations, as determined by the review officers, the Executive Committee and the Board.

14. Number of Loans:

1966	51 loans	62.9 million
1967	128 "	185.9 "
1968	232 "	258.3 "
	411 "	507.1 million sucres

Of the AID loan, the following sub-loans were made:

Dollar loans	38, for	$ 2,333,000
Sucre loans	18, for	468,000
Equity part.	2, for	85,000;

15. Details of Loans: As of end-1968, 507 million sucres were approved for 411 loans; disbursements were 417 million for 369 loans. Agro-industry received 35% of loans, not counting 12% for textiles. Geographical distribution was 37% to the "sierra" and 63% to the "costa".

16. Financial Environment: COFIEC supplements facilities provided by the Public Financiera, through making shorter-term loans, more loans to existing industry and working capital loans. It does not compete with the commercial banks. The industrialist goes to COFIEC for shorter-term loans because he must repay in hard currency for loans for imported equipment, (CV accepts repayment in sucres) and wishes to shorten the time of devaluation risk. Export industries who earn dollars usually go to COFIEC.

17. Changes: When COFIEC opened its doors in mid- 1966, it gained great popularity as it could process its type of loan faster than CV (the Public Financiera). In 1967 CV with experience had speeded up its review process, and in the 1968 election year borrowers were somewhat more reluctant to commit themselves to hard-currency repayments through fear of inflation. Both developments favored CV somewhat; however, there has been no shortage of demand, although good projects are increasingly harder to find, as the "easy" projects have been picked up.

B. EVALUATION OF SPECIFIC POINTS

1. Goals:

a) Mobilization of capital has been actively pursued by COFIEC since inception. Paid-up capital is now 5 times that with which it started. Authorized capital was doubled in 1968 from 36 to 72 million sucres. COFIEC has made considerable effort to obtain maximum local participation and maintain a balance between foreign and domestic capital. The ratio today is 54% national and 46% foreign capital. Local shareholders increased from the original 45, to 142 by end-1968.

Since its initial partnership with ADELA, plus The Company for Investing Abroad, and two banks operating in Ecuador, the 1st National City and the Bank of London and Montreal, COFIEC has attracted loans and lines of credit from the Continental Bank of Chicago, Wells Fargo, Bank of America, New York Hanseatic Corp, and banks in Germany and Colombia, plus a loan from Ex-Im Bank. COFIEC has over $ 15 million in resources available as of end-1968. (See also comments under (c) and Section C.)

b) Increase in availability of investment funding for industry in most LDC's is a goal in itself. In many LA countries long-term development credit does not exist until a Development Bank is formed, thus on initiation of such a bank the demand will be high and the bank can skim the cream of the best projects. The mere existence of medium and long-term credit is sufficient to channel funds into worth-while projects, without too much need for rigidity in specifying goals, criteria and priorities. The interest rate should not be too far below existing levels, except in cases LSD's with virtually no access to capital other than the back door or black market loans. The need is for longer-term money.

For example in Ecuador, with a legal limit of 10% interest, to go to a Commercial Bank would mean renewing the loan every 6 months, with corresponding costs for stamp and registration taxes, renewall of loan agreements, etc. bringing total cost up to 14%.

As for "over-protection", this is a matter of government policy (and hopefully the Ministry involved has good advice before issuing their development law) but in general competetive incentive programs are adapted to existing competition from neighboring countries, and a safety valve is often provided by the commercial sector, who will exert pressure where they can see a chance to prevent "false" industries which would cut down their imports.

Good management in the ICI will realize the danger of financing industry without natural advantage; undue incentive exemptions granted by one government or corrupt official may well be withdrawn by the next, leaving the ICI holding the bag.

c) CV (see TOAID A-44) is authorized to start a Stock Exchange and began to sell shares in January 1969. COFIEC's founding law permits them to issue bonds in the Company. Page 5 of the 1968 annual report states that after consultation with the Superintendency of Banks, they expect approval to begin in 1969 to issue debentures. These will be offered on the CV market, and will pay 10%, of which COFIEC gets 2% commission.

d) Technical, managerial and financial practices of borrowing firms are less affected by COFIEC loans than the loans made by CV. Loans are more for existing industry expansions and working capital and less for new firms which may not have know-how. COFIEC insists on audits by foreign firms when they consider this to be necessary, and the project application and L/A loan agreement teach cash flows, pro-forma balances and the like, but there is definitely less "rub-off" on clients than in the case of CV.

1-a. Achievement of Goals:

a) The AID goal of providing seed capital for medium term credit for increased industrial production has been met in this project. As the project was initially sponsored by ADELA, AID had less to do with setting criteria and providing technical assistance. The credits granted by COFIEC are truly additive, in that, as repayments must be made in dollars or hard currencies, rather than in sucres (as in the case of CV), borrowers do not seek these credits for other than specific purposes of equipment purchase or increasing production. Local currency loans are also made, but COFIEC attempts to check these, and in Ecuador the difference between ICI and commercial loans is not as great as in other countries.

b) There has been little shift in emphasis in COFIEC activities, other than increasingly they must get into the study development and promotion of new projects, and are more actively seeking projects for equity participation. The 500 loans approved to date mean that much of the working capital needs and aid to existing industries has been taken care of. For present policy, see Attachment "E", Statement of Policy Adopted by the Board, 11/27/68.

c) The development strategy of GOE in industry is laid out in the 5-year plan and in the priorities within the sector accorded by the Industrial Development Law and its categories of industry which may qualify for "Special" or "A" tax and other exemptions.

The ICI meets AID development goals in the rapid transfer of AID funds into increasing production, capital mobilization, employment, etc., and to a lesser extent meets goals of Title IX in the stimulus of sub-industries, stabilization of agro-industry commodity prices and the effects of industry wages on betterment of worker living conditions.

USAID finds that the allocation of $ 3 million to this ICI was fully justified by results; the proposed 2nd tranche loan has been held in abbeyance due to the success of COFIEC in attracting foreign and domestic private capital. However, due to the cost of borrowing, a certain balance between development loans at 3%-4% and open market loans is desirable, especially to help the ICI cover organization and initial operation costs, until a healthy revolving fund is established.

d) Alternate sources of funding have been well exploited by COFIEC, (see list of shareholders in Attachment "F", and list of Foreign Bank loans in the Annual Reports). In addition to an Ex-Im Bank loan, COFIEC is helping to place IBRD funds for fishery and cattle development. COFIEC applied to IDB, but states that IDB loans are no longer of interest to ICI's; they charge 7% and insist on

guaranty which costs 2% in the private market, and a private Financiera operates more effectively and is less liable to political influences if it is not tied by a Government guaranty.

e) The experience of COFIEC will certainly be of interest for other LDC's although in-country conditions may not be as favorable elsewhere. This ICI does not see any area in which they would have begun or continued differently.

2. Selection of Borrowers: Remarks under this section would be the same as given in TOAID A-44, January 28, Public Financiera.

While COFIEC handles mainly loans to existing industry, they increasingly try to promote new projects. As an example they have taken equity in Ceramica Modelo in Cuenca, American Mushroom, Warehousing Ecuador, Agro-Livestock Development of Cuenca, and Charcoal Briquettes of Guayaquil. In each case the ICI participated actively in project and market studies and promotion. They hired a German ceramics technician in the first case, promoted the warehousing project (Quito and Guayaquil) for 2 years and raised over 5 million local capital from local banks and insurance companies and introduced a system, new to Ecuador, of loans against "warrants" of products stored in the warehouse chain, which will hopefully in future cover all of Ecuador. In the Agro-Development Company case, they worked with CV/CFN, the public financiera, on a full-scale study of the UZHUPUD complex, refinanced the operation and put in a competent manager. Again, in the Charcoal project they participated in a study of mangrove availabilities in the Guayas river delta, and in the economic and technical feasibility of the briquetting plant.

In 1969, COFIEC will work on study and promotion of a cement plant for Quito, a company renting agriculture and construction equipment, and a project for fattening cattle, These will all require extensive investigation of legislation, raw materials availability, markets and equipment costs.

COFIEC is also starting a new service of seeking foreign direct financing for Ecuatorian companies, through connections it has established with American and foreign Banks, and a financial consulting service providing paid technical assistance to industry.

3. Management and Operations Policies:

Here again, comments in TOAID A-44 apply. COFIEC differs from CV in that, having no guaranty from GOE, it is completely freee of political pressures; on the other hand it has the problem of requiring the borrower to

assume the exchange risk on hard currency loans for imported equipment. They say that their record on bad loans is perfect so far, and the percentage of loans behind in repayments is less than 3/4%. COFIEC has 20 staff in Guayaquil and 20 in Quito, many of them graduates of U.S. Universities.

Safeguard against bad debts is provided through a reserve fund of 2% of loans over 1 year; at present the fund is 1.8 million sucres.

COFIEC, like CV, maintains a flexible policy on security for loans; if equipment financed is standard, it can give 80% chattel mortgage; if equipment tends to be unique it has much less resale or disposal value. They pay a local expert to assess property values for mortgage and require 150% coverage. They find the use of signatures of banks or property holders to be much faster and more reliable than mortgages.

COFIEC loans mainly to existing industry for expansions, new equipment or working capital, but increasingly is getting into new industries, project studies and equity participations. The ICI is profitable; $ 400,000 net profit in 1968 compared to $ 175,000 in 1967.

4. Specific AID Relationships:

a) USAID contributed little but seed capital. An AID-financed study by Cecchi consultants recommended founding a private ICI, and some urging produced the necessary amendments to existing laws covering Financieras. However, ADELATEC stepped in with consultants to do the feasibility study and plan the organization and ADELA provided part of the initial financing.

b) The terms of the loan agreement appear to have been apt. The interest rate of 2 1/2% could have been a bit higher without ill effect; they were allowed to use up to 25% of the AID loan for working capital, which is important for a private financiera.

c) GOE has never implemented its option for two-step guaranty of this loan, and while this would benefit GOE, COFIEC prefers to repay direct to AID and has been doing so. It is thus free of political pressures and is profitable enough to meet the relatively short repayment period. It planned to lose $ 40,000 in its first year (1966) but actually made a profit of $ 1,000.

d) COFIEC has had no serious procurement problems. Like CV, they

will accept a pro-forma invoice signed by a reputable US supplier, and can check dubious proposals through CENDES (the Development Center), and through catalogues and trade periodicals, and they subscribe to Dunn & Bradstreet services. They give more attention to availability of local servicing and spare parts availabilities in selecting equipment suppliers than to the securing of competitive bids, especially in cases where well-known US firms are involved. They secure waivers from USAID in such cases. They insist on quotations from various suppliers when the equipment is less known. In the case of financing used equipment, they secure the services of a US appraisor.

e) AID technical assistance was not required. ADELATEC did the feasibility studies and ADELA provided 2-year services of an Executive Vice-President (Dutch) and a technical advisor (Chilean). Since completion of their term COFIEC has been operating on its own. ADELA also did the promotion to secure stockholders.

f) There is no pipeline problem. Speed in processing applications and reaching decisions has been a key to success, forcing the Public Financiera to speed up their proceedures to keep abreast. By giving the Committee (up to $ 150,000) and the Board authority to decide on loans, on a basis of practical considerations, without too closely limiting criteria and fields of action, COFIEC has been able to approve loans after an average of one month, and begin disbursements on an average of two months later. Naturally, this is easier with loans to existing industry and working capital loans. In one case the ICI received a loan request in the morning, approved it in the Committee that afternoon and signed a check the following morning. For second loans, with satisfactory performance on the first, the loan officer may approve, without the Committee. For loans guaranteed by signature, security investigation may be waived. For a loan for known imported equipment, COFIEC sometimes opens the Letter of Credit <u>before</u> signing the Loan Agreement, on the basis that the equipment can always be disposed of successfully if final loan conditions are for some reason not met. USAID written approval was required on loans over $ 150,000, and this sometimes caused holdups.

g) AID granted loans to both private and public financieras in Ecuador; a somewhat larger loan to the latter. This was in the conviction that both types have a place in Ecuador. While the public ICI is sounder financially from the start and can take on longer range development projects, the private ICI is needed to meet immediate short-term requirements of existing industry and of working capital in most LDC's.

C. OVERALL EVALUATION AND CONCLUSIONS

The comments under this heading in TOAID A-44 apply. Under "mobilization of capital" we should like to quote from the annual report (Attachment "A"): The presence of foreign capital in COFIEC has accomplished a triple purpose; the foreign capital helped stimulate domestic investment in the ICI, the foreign shareholders represented a wealth of connections with the large financing centers which permitted us to give our clients services which changed our dimension from a national to a world-wide bank, and the third beneficial factor was that the true situation and investment possibilities of Ecuador were brought to the attention of the international business world. We were also benefited from the valuable experience and technical advice which our foreign minority shareholders brought to COFIEC .

COFIEC's plans and estimates for 1969 (Attachment "H") are interesting. A net profit $ 450,000, a 30% increase in loans to 260 million sucres for 1969, double costs for staff over 1967, but representing only 16% of total expenses, against 33% for 1967, and so on.

PAR Information:

Part I-C1, Project Significance:

	Relevant Program Goals	Potential Impact	Actual Impact
1	Increase exports of agricultural and industrial products	2	2
2	Foreign exchange savings from import substitution	2	2
3	Promote surveys to attract $ 12 million of new private foreign investment in agro-industry	2	2
4	Encourage increased participation by International financing agencies and foreign government to meet AID goals	3	3

Part I-C-2 General Questions

014 COFIEC has attracted a number of foreign lines of credit. (See Evaluation Reports).

015 No problem.

016 Due to COFIEC success in attracting other lines of credit, AID has postponed a projected 2nd tranche $ 3 million loan.

017 Lessons to be learned are covered in the attached evaluation report.

019 COFIEC has financed a number of interesting projects such as the Charcoal Briquettes plant, Guayaquil, for total export to U.S.A. of $ 1 million a year, Growing, canning and exporting of mushrooms, etc. Write-ups available at USAID if required.

SUMMARY RATING OF ICI: (2), very good

Encl.: Company Statutes, (Attachment A)
Annual Reports for 1966, 7 and 8 (B, C, D)
Policy Adopted by Board Nov. 11, 1968 (E)
List of Shareholders (F)
Balance Sheets as of Dec. 31, 1968 (G)
Projections for 1969 (H)

ECUADOR

COMISION DE VALORES, CORPORACION FINANCIERA NACIONAL
(CV/CFN)

UNCLASSIFIED

TO: AID/W TOAID A-44

FROM: USAID/Quito

SUBJECT: Spring Review of Intermediate Credit Institutions

1. Attached is loan evaluation report and related documents covering the AID loan to CV-CFN, Public Financiera, AID Loan No. 518-L-824, Project Number DL-518-26-230-014. The FY-1968 Annual Report of CV is at the printers, and will be forwarded in February. It is assumed that AID/W has on hand other documents such as the IRR, Loan Paper, Loan Agreement and Implementation Letters. Of possible interest may be an IDB review of CV performance, prepared prior to approval of a loan to the Public Financiera. This should be available from IDB/W.

2. It will not be possible to complete by Feb. 15 the evaluation of COFIEC loan, number 026, Project DL-510-24-950-26, Private Financiera. COFIEC technical staff are holding meetings in Guayaquil prior to present-action of annual reports February 3rd to their Board and will not have time for necessary interviews. Further, their Annual Report is not due until March 26th as it will cover the calendar year. However, preliminary evaluation and such data as are available will be sent AID/W about February 15th, via airmail.

3. Mission does not intend to submit PAR's for the above projects. Projects are completed, and there was no direct AID TC component in either one. PAR information requested (I-C-1 and I-C-2) is included at the end of the evaluation report.

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LOAN EVALUATION REPORT

CV/CFN, PUBLIC FINANCIERA Project No. DL-518-26-230-014 (Loan 014)

A. DESCRIPTION OF PROJECT

1. Country: Ecuador
2. Name of ICI: Comision de Valores, Corporacion Financiera Nacional
3. Class of ICI: Public, (public capital, mixed management)
4. Date Established: Comision Nacional de Valores was established in mid-1958, Converted by Law of the Republic, August 11, 1964, to Comision de Valores: Corporacion Financiera Nacional (CV/CFN)
5. Initial Assistance from A.I.D.:

Date	Amount	Kind
7/20/62	$5,000,000	Dollar loan

6. Does the ICI take Equity Participation? Yes X No._____
7. Capital structure of ICI as of date in (5) above: Balance sheets of the Comision de Valores are included as of June 30, 1962 in the IRR, available in AID/W
8. Subsequent Assistance from A.I.D.: None. Second Tranche $5 million planned for FY-1967 not implemented due to shortage of AID funds.
9. Capital structure at end of latest fiscal year FY-1968: See enclosed price Waterhouse report, dated June 30, 1968
10. Status of A.I.D. $ loan as of July 1, 1968:

$committed	$ disbursed
$4,785,367	$4,701,466

11. Interest Rates: Average rate paid by CV 6-7%
Average rate charged 10-11%

Rates paid by CV/CFN (hereinafter referred to as CV) range from 3/4% on AID loan, 3.21% plus .75% on IDB loan, Dutch and French loan 5.75% to 6.55%, Swiss and German loan 6.75% and ordinary loan 6.5% plus 1% commitment charge.

Rate charged by CV to borrowers since inception has been 10% however, CV is considering adding 1% follow-up charge as of January 1969. As CV performs follow-up in any case this is to some extent a disguised measure to adjust to recent upward trend of interest rates.

The interest rate is of less importance in Ecuador where normal profits allow 12%-15%, than the availability of long term credit, which is normally scarce in Latin America: i.e. an 11 year loan at 11% may be more attractive then an 8 year loan at 8%. At the same time the 1% increase in interest charge means a 20% increase in revenues to the ICI.

Differential rates are not used by CV. Whereas lower rates can be an instrument to channel funds to highly desirable project fields, CV feels the good effects would be cancelled by the danger of strong political pressure to secure the lower rates on marginal projects where influential persons are involved.

12. Limit on Size and Use of Loans: CV will normally not make loans in excess of 1.5 million dollars or less than $10,000. In practice the lower limit should probably be raised to $25,000 due to cost of staff time of bank technicians.

Of the AID loan, CV made $350,000 available to the Banco Nacional de Fomento for small industry credit. BNF in turn made 572 sub-loans for 7 million sucres (average loans of $500).

The L/A does not permit CV to make working capital loans with AID funds, although increasing lending for working capital by CV (35% by 1968) indicates consideration of this need. In most cases of course, the Banks' local capital may be used for this purpose.

CV will not make loans to commerce, small hotels, small printing establishments, apartments, insurance companies or to industries where existing capacity in the country is adequate. Agriculture may be financed where it is part of an industry processing the agricultural product.

13. Formal Criteria: CV is not limited by formal criteria other than the priority categories represented by the Industrial Development Law. Industrial cases are judged by the Bank, against project presentation and evaluation and studies made by the Banks' technical staff.

14. Number of Loans:

1963	3 loans	$ 5.1 million	sucres
1964	5 loans	$ 16.7 million	"
1965	31 loans	$ 90.6 million	"
1966	38 loans	$ 91.7 million	"
1967	40 loans	$110.5 million	"
1968	57 loans	$181.7 million	"
	107 loans	$496.3 million	(US $ 27,000,000)

15. Details: Use of loan funds, geographical distribution, size of loans, etc. are contained in the Bank Annual reports. The FY-1968 Report is being proof-read at the printers, and will be forwarded later. Data from this report include the following:

Loan Agreement signed June 20, 1962, 40 years, 10 year grace period, 3/4% credit fee per annum, repayment guaranteed by GOE.

FY-1968 52 loans approved for 163 million sucres
" 35 loans refused for 133 million sucres

Of total loan approvals to end FY-1968 (409 million sucres), 300 million had been disbursed.

Approved loans were 55.2% for agro-industry not counting 6.9% for textiles.

FY-1965 loans: 80% equipment, 19% building, 1% working capital
FY-1967 loans: 66% equipment, 8% building, 26% working capital
FY-1968 loans: 49% equipment, 16% building, 35% working capital

Loans from 8 years up, comprised 70% of the CV portfolio
Loans less than 5 years comprised 5% of the CV portfolio

Loans went 30% to Quito (Pichincha), 50% to Guayaquil (Guayas) and 20% to the rest of the country.

The Planning Board estimated 1967 investment in industry totalled 461 million sucres; CV financed 21% of this investment.

16. Financial Environment: CV provides longer term loans and is able to assume risks that the commercial banks cannot; it fulfills its role as a Public Development Bank without competing with the financial community. Where as it is able to finance fixed working capital it generally does this as a part of the project loan. Although in some cases it may make a 100% working capital loan where there is under-utilized plant capacity, this is longer term than the commercial banks. CV has established an excellent reputation in Ecuador.

17. Changes: The CV has of course experienced certain changes in its functions as the years go by. With increased financing sources, they are now able to go into larger loans; as the "easy" projects are picked up they find it harder to locate worthwhile projects and are increasingly devoting a part of their funds to feasibility studies and paid foreign consultants.

B. EVALUATION OF SPECIFIC POINTS

1. Goals:

(a) CV's initial capitalization came totally from the government, although GOE takes no profit. As a public financiera it has no share-holders but can issue its own paper for which it pays 8%, thus prefers foreign loans and lines of credit costing 6-7%. It has had great success in attracting foreign credits up to 4 times the amount of the initial aid seed capital, of $5 million.

Through 1967 the use of funds was largely (75%) for imported industrial equipment with the balance split between plant building construction and fixed working capital, (see P.37 of Annual Report for 1967). In 1968 the mix was 48%, 23%, 29%.

Repayments of CV sub-loans are in local currency.

(b) The purpose of CV is both to supply additional investment funds for industry as well as to supply funds on specially favorable terms for high priority uses. It can take greater risks and extend longer term credit than the private financiera, to best serve the needs of Ecuador. Its interest rates are below those of COFIEC and the commerical banks (12-15%), but we would not say that the interest rate policy is used to influence the pattern of investment. This latter is probably more affected by the incentives granted under the Industrial Development Law.

CV does consider comparative advantage of industries financed by them: i.e. they will turn down a project if the CIF cost is substantially lower than the local estimated cost of the product to be produced, taking into consideration, however, advantages to Ecuador such as saving to foreign exchange and providing jobs. Both the CV loan policy and the classification of industries by the Ministry of Industry have largely avoided an undue number of over-protected industries in Ecuador.

(c) The banks name, Comision de Valores implies responsibility for establishing a secruities market and its Charter provides for this evenutally. CV earns a portion of its income handling government bonds, and was ordered by the new Velasco government to initiate a stock market for private securities in January, 1969. CV began inviting the public, including commercial banks and insurance companies, to subscribe to stocks, to be issued in 100-sucre value, from January 10-17th. To date 800,000 sucres has been subscribed in Quito and 300,000 in Guayaquil.

While the financieras have a certain number of projects which would land themselves to sale of shares of the public, in general it is felt that there is a lack of projects and the GOE directive is premature. More know-how is needed, and this can best be assured from Colombia, where successful stock-market would closely parallel conditions in Ecuador. The Bogota " Bolsa" has accepted 3 trainees from CV. The CV feels their role should be to help create, but not operate a stock market, to avoid possible conflict of interest and effect on its to-date excellent reputation.

(d) Technical, managerial and financial practices of borrowing firms are extensively affected by borrowing from CV. In the process of evaluating loans, CV teaches the borrower in many cases a lot about requirements in presenting a prospectus and the necessity of carefully studying every aspect of managing equipment procurement, financial feasibility, etc. The borrowing firm is often forced, for the first time, to initiate a modern accounting system, in some cases CV requires that the accounting system be set up by a professional accounting firm. If management is lacking CV may require that a technician be contracted. Financial management disciplines are imposed in the provisions of the loan agreement, such as prohibition of dividend distribution if the ratio of assets to liabilities is not proper. CV's use of outside audits is sometimes restricted by the local practice of keeping different books for tax purposes. CV staff are empowered to make periodic audits. Thus, although the project may not aim at improvements in this area, improved technical and financial practices "rub-off" on the borrower.

1-A Achievement of Goals:

(a) The AID goal of providing medium term credit for industrial development has been met in this project.

As CV mainly finances imported equipment their sub-loans may be considered truly additive in the sense of contributing to increased industrial production: how much of the local currency loans for working capital may have been borrowed from CV simply so the borrower could use his own funds for higher interest use, has not been estimated (see also B-3 (e).

(b) As the years go by, obviously the picture shifts somewhat. Whereas there was no deliberate shift of emphasis among goals, the case of CV, after 6 years, the major change was that the "easy" projects got scarcer and production for the country's needs in certain fields became adequate. This means that CV had to search harder for good projects, spending more time in feasibility studies to identify new areas, and in promotion, and for example will finance no more textile, printing office, or pharmaceutical projects. CV finds itself moving more, percentage-wise, into fixed working capital tourism, agriculture (where related to industry), and into the area of larger projects, more frequently in cooperation with foreign firms and interests. On the other hand, as CV's financial position improves they are better equipped to finance larger loans and to take equity positions.

(c) USAID's view of development strategy in Ecuador is in accord with host country policy as set forth in the 5-year Development Plan of the Planning Board. That the growth rate of manufacturing set forth in the Plan has consistantly been met and surpassed by industry is due to the integrated combination of (a) application of incentives under the Industrial Development Law, (b) research and investor assistance given by the area development centers and CENDES and (c), the capital mobilization of the Development Banks. In the case of Ecuador, planned second tranches of AID loans to the ICI's could be cancelled due to the extraordinary success of the ICI's in attracting foreign capital, (due in part to the comparative stability of Ecuador). Thus while AID funds may now be allocated in Ecuador for other high-priority purposes, in general it can be said that the financing of the ICI's has proved to be among the most rewarding allocations of the AID dollar, in terms of wealth-creating and self-amortising projects as opposed to social projects imposing a forward debt burden. In addition, ICI's meet the need for capital mobilization, increased production, favorable effect on balance of payments through import substitution and new exports, employment, increased tax base, stimulation of subsidiary benefits through wage increases and subsidiary industries.

(d) As stated above, alternative sources of funding other than AID have already been tapped in Ecuador, (see lists of IDB, IBRD, and other foreign credits in the Annual Reports of CV and COFIEC). CV does not accept borrowing from commercial sources as it is a public financiera. However, the use of the AID investment warranty program should certainly be investigated as a means of increasing support for ICI's in other Latin American countries.

(e) The experience of CV should certainly be of interest for other LDC's considering setting up an Industrial Development Bank. In looking back over the beginning years of CV, it is doubtful that we would have needed to make any major changes in the approach. A sufficient body of experience of Development Banks has been complied to provide adequate guidelines; the human factor and specific country situation are the variables which may spell success or failure.

2. Selection of Borrowers:

(a) The economic criteria of ICI's in Ecuador tend to follow the priorities listed in the industrial development law for tax and other incentives, which in turn affects many of the investment decisions in Ecuador. The Law follows generally established principles by giving "Special" category to projects that use mainly local agriculture raw materials, as well as export industries. Category "A" permits a higher percentage of imported raw materials and Category "B" includes many of the import substitution industries. Lists are published each year by the Planning Board of industries falling under the different categories, for investor guidance. While USAID does not directly participate in formulating criteria, CENDES with AID-financed advisors assist the Ministry of Industry in classifying new industries for benefits under the Law.

(b) CV undertakes both promotional work and research to stimulate borrowing. The Ecuadorian Development Center (CENDES) makes available to the CV its feasibility studies series, with new studies continually being undertaken to identify new production, mainly agro-industry which might be suitable for Ecuador. For its part, CV finds itself moving into paid professional consultations for feasibility studies.

A.D. Little was contracted to complete a tourism survey of the Galapages ($35,000); Planning & Research of California are doing research on candy and caramel market in the U.S.; a Dutch engineer is doing a study on tuna purse-senier design suitable for Ecuador; a Canadian consultant is studying comparative cost of producing wrapping paper pulp (for banana boxes) in Ecuador vs. imported; an agreement has been signed with a Chilean firm to study the possibility of raising rapeseed in the Ecuadorian highlands.

Regarding "equipment salesman", CV and CENDES now have experience in equipment procurement, and consult their Thomas Register and Sweets catalogue, so can avoid purchase of high-cost or falsely-invoiced equipment to a considerable extent. As to purchase of equipment for non-essential industries, the priorities of the lending banks as well as the Industrial Development Law apply.

(c) Technical, market and financial review are conducted by separate specialists of the Bank and appear to be appropriate and effective.

The sub-general manager of CV received 2 months of training in Holland; the sub-manager of budget took the IBRD Development Course in Washington, 6 months; an engineer took the IBRD 2-month course on evaluation of industrial projects; 2 economists got OAS-sponsored training in Germany and Turkey; 1 economist took 2 months of training with IDB in Washington.

The technical division of CV (both Quito and Guayaquil) is 19 trained analysts, (economics, market and engineering).

(d) It is not felt that any substantial change is needed at this time in the field of selection of borrowers.

3. <u>Management and Operation Policies:</u>

(A) For an effective ICI, the experience of CV indicates the following lessons:

(1) It is important to have a general manager with an established reputation for honesty, as the private sector will be initially suspicious of a public financiera.

(2) An impartial 3rd party (the AID appointed adviser, even though paid by the Bank) is essential to provide restraint on political pressures to grant loans. He must be experienced, well paid and have veto or similar power in the loan approval process. Thus the Board has an "out" when loans pushed by Ministers or other politicos are turned down, and the integrity and profitableness of the ICI are protected.

(3) The Board must be mixed; in a public financiera, an all-Government Board of Directors could be fatal; CV's Board has representatives from the Chambers of Industry of the Coast and Sierra and the private agriculture sector.

(4) It is better that the technical staff be young; they can be molded to the Bank's policy and will have a less cynical and more dedicated attitude toward development of their country.

(5) CV has found it important to institute a report on control of time spent by financial, market and engineering project evaluators. A weekly report to the Manager tells him how much time is spent on project appraisal for each project, to avoid undue costly staff time spent on relatively unimportant projects.

(b) Safeguards to protect the ICI against such untoward events as depreciation are essential. In the case of Ecuador, which has a relatively good history of stability, it has not been necessary to make special provisions. CV, as a public financiera, does not have to distribute profits, thus they are creating a reserve (profits in 1968 were $1.5 million) agains contingencies. Private ICI's and those in countries with chronic inflation would necessarily seek special measures.

CV helps proper financial planning by its borrowers through the usual means; it checks balance sheets for the last 3 years (or forward pre-forms balances in the case of a new industry); it checks market and estimates future sales; it requires a "source and application of funds" statement and a profit-loss statement each year; the loan recipient must file a trial balance each quarter; it helps applicant with future cash flow estimates for the project. Loan agreement provisions may require employment of a good accountant or Haskins & Sells auditors in to check the books. Local accountant firms are not used. CV has devised an application form which in itself teaches borrowers many of the necessary data and study requirements of an industry prospective and many of the accounting disciplines required for successful control of a project once it is started.

(c) The security requirements of a loan program can spell the difference between success or failure. When they are too rigid many good loan prospects will be lost and the investor will become discouraged; if too lax profitability of the ICI is threatened. Many ICI's require 200% mortgage or other coverage. CV can give up to 70% of (their own) assessed value on real estate, and up to 80% on chattel mortgage on the equipment to be imported. Further, their flexible policy enables them to give credit against existing inventories (such as stocks of drugs on hand in the case of LIFE pharmaceutical laboratories), and if there is still a problem, they can take up to 50% equity position in the project (as in 15% of the registered capitalization of the Colon Hotel). Equity may also be represented by professional consultant feasibility studies financed by CV. In practice, most Latin enterprises, being often family industries, will resist equity arrangements due to the practice of hiding profits.

(d) CV's follow-up services are available to the borrowers, when requirements do not impose an undue burden on staff time. CV relies more on careful appraisal of management ability demonstrated in the loan application, and if this is lacking, may insist on employment of a competent professional. In practice, CV finds that of the applications they reject (about 40%) the most frequent cause is lack of management ability.

(e) Loans go only to private enterprise, over half to agro-industry, with 80% of the loans in the 500,000, 4,500,000 sucre range, and about 35% to new industries with the rest going into expansions. As stated earlier, Mission has not studied the extent of possible freeing of borrowers' funds for higher-interest purposes through obtaining lower-interest CV loans, as this would appear a relatively miner problem in Ecuador where the interest rate difference is only 2-4%, as compared to countries where 3% a month is not uncommon in the black market.

Conflict of interest questions have arisen. In any Latin country a relatively few magnates are involved in many industries and are on the Boards of many enterprises. Thus to eliminate the Directors on the Board of the ICI would be to lose many good loan prospects. CV's rule is that Board members are not inelligible, but the member must leave the meeting when his loan is up for discussion and he has no vote.

(f) Next to Guayaquil Port Authority, CV is the most profitable of autonomous institutions here. Profits in 1968 were $1.5 million. It could have been more profitable were it free, as COFIEC, to make shorter-term and more working capital loans, but it has stuck to its criteria of development lending and has new and excellent reputation and the confidence of the public. Its effectiveness is reflected in the fact that almost uniquely of LA ICI's it has attracted more lending money than it can find projects for.

4. Specific AID Relationships:

(a) AID has contributed relatively little to the development of CV. AID-financed consultants sketched out the institutional changes needed to convert CV from a bank handling government paper to an industrial development bank. The AID loan of $5 million for seed capital was all that was required, once the bank has established a good reputation. The loan terms required the CV to employ an AID-approved advisor in development banking, and an engineer for review of technical feasibility of projects and equipment procurement, both for 2 years. The latter proved not too effective, but the former played a crucial role in directing the Bank's formation and activities. Although this advisor was often attacked by interested parties, CV was happy to renew his services at each contract termination date. USAID contracts were unlimited to occasional consultation on problems, advice on

coordinating with COFIEC and CENDES and checking of required monthly and quarterly reports. Thus most of the credit goes to the Ecuadorian director manager and technical manager. Obviously in this case, the selection of competent and honest officers was more important than massive injections of AID technicians.

(b) The terms of the AID loan agreement were satisfactory. In this case, 3/4% interest was not necessary, -the rate could have been 3%-4% without affecting the success of the project.

(c) Two-step procedure provides that GOE repays the loan to AID in dollars, and collects from CV principle and interest on the loan in sucres. This enables CV to avoid the troublesome "maintenance of value" problem in dealing with project sponsors.

Local costs financing is over half local industry's loan requirements.

(d) There is no pipeline problem. CV had utilized all but a small balance of AID funds by the end of 1967. Tied procurement has not been a problem here. Reg. 1 of AID can be, and has been in other ICI's a most serious obstacle causing inacceptable delays in getting the project under way. The applicant usually knows nothing of the procedure for securing bids from the U.S. and U.S. suppliers are all too often disinterested, and seldom have local representatives. CV accepts pre-forma invoices from the borrower, compares prices with their catalogues or past experience and has Dunn & Bradstreet service available for special enquiries. It does not insist on more than one quotation if the supplier is well known. It submits the required information to OSB/W and shipping in U.S. bottoms is no problem in Ecuador as there are weekly Grace runs from the U.S. East Coast. Potential Reg. 1 problems however should be exhaustively studied in other LDC's in relation to plans for an ICI.

Tied-procurement may become an increasing problem in LA countries which are increasingly negotiating lines of credit with European and Curtain countries. Whereas Japan and West Germany are agressive in providing local salesmen, catalogues and spares and maintenance, the Italian, Dutch, Spanish, Polish, and other credits CV has obtained present serious procurement problems. Further, as government of LDC's increase the number of bi-lateral credit agreements, the government is increasingly forced to dictate to private enterprise where they may purchase their plant equipment, without assurance of effective supply of spares or maintenance.

(e) Relationship here between AID loan and AID technical assistance is satisfactory to CV and to USAID. The least amount of TC consistent with availability of local managerial and technical talent available to the ICI appears to offer lower cost to AID, relatively more money for loans and less chance of friction between host country officers and foreign technicians.

For Latin countries, a really experienced Latin advisor might be more effective than a U.S. advisor; he will understand political problems and will be familiar with problems peculiarly those of Latin ICI's, rather than attempting to apply criteria of U.S. lending institutions.

(f) A major consideration for success of ICI's is speed. Time is money to the private entrepreneur waiting for a loan; faster turnover means more profit for the ICI and less expensive staff time; public confidence in the ICI is quickly lost if it becomes known that it will take nearly a year to get a loan and this in turn means that often only the more desperate sponsors, with often the most dubious projects, will persist through the maze of paperwork to the end.

As stated earlier, pipeline was not a problem with CV. Approval of loan applications averages only 2-3 months. Advice of formal Board approval, although it may take 6 months more to fulfill conditions precedent, stimulates the borrower to take the further actions necessary. A chart showing dates of receipt of applications, approval, fulfillment of conditions, equipment procurement, first release of funds, plant construction, initial startup, etc. helps keep the ICI staff alert to delays. CV requires analysis of cost of staff time spent on each project, which is another control tool useful to a new ICI. CV staff are instructed not to wait for written replies to requests for further data or estimates, but to get on the phone or visit the plant. As the initial application in a LDC is almost never complete, CV has devised an application form which will provide basic data. From this data they are often able to compute real project requirements and cash flows from past experience, better than the applicant. Where the ICI is not equipped initially to support a full range of technical staff, the local Productivity Organization may be able to help with initial review of applications and helping the sponsor work up a more complete prospectus. Review by a trained team covering a project's market, engineering and financial requirements quickly shows up data lacking in the initial presentation. The USAID might consider providing, short-term- such a team of technicians to teach the Center or ICI review analysts the necessary techniques, rather than try to teach each project sponsor in the country how to cope with the application form.

USAID approvals should be limited to large projects only. Nothing will reduce effectiveness of an ICI quicker than an interminable process of loan approval. The success of the Financieras as a tool to quickly move AID funds into the building of new factories, especially as illustrated in Colombia, is in sharp contract to the old AID of DLF direct loan, with its local reviews, review in AID/W, re-engineering by AID/W - contracted firm, back to the host country for additional information, ad infinitum. Many new Latin ICI's have demonstrated that they can make a good loan, and in some cases their success appears in inverse ratio to the amount of AID technical assistance required.

(g) Both public and private ICI's can be useful in the same country if the public Bank is not merely a State Development Corporation to finance State enterprises. CV finances only private projects, but it will take longer-term, higher-risk projects, while the private ICI can pick up fast turnover, shorter-term and working capital financing activities. For example loans approved by COFIEC, the prive ICI here, in its first year went 91% to expansions of existing industry and were 64% for working capital. Such loans provide the ICI with quick income and are available sooner for relending, establishing a sound financial base from which the private ICI may later direct greater effort into more carefully selected, long-term development loans.

C. OVERALL EVALUATION AND CONCLUSIONS

Selection of Borrowers: Criteria will be similar in all LDC's; use of local raw materials, export industries and import-substitution, labor-intensive industries, economic and social benefits, new know-how, etc. However, for a new ICI it is of first importance that it make money and get strong, thus too-strict criteria may be of hindrance to it. A new ICI will presumably fill a long-standing vacuum in an area where previously only short-term or commercial type credit was available. It should therefore be able to skim the cream of good projects which have long been waiting its entry in the field. As the "easy" projects are picked up, high-profit projects will be harder to find, and the ICI will then have to apply progressively more selective criteria. These will usually coincide with the country's priorities.

For the new ICI, criteria should be aimed at profitable projects, and these will be in order of importance (A) management ability, (B) market and competitive position, (C) financial feasibility and ability to service the loss.

Interest Rates: Interest rates are not as important as long-term availability of credit. In its early stages, the ICI should be able to pick projects with a 20% or more return. A large cement plant, however, cannot be financed on a year-to year basis, as through the commercial banks. Rates to the borrower should perhaps be a point or two lower than the going rate, except in countries where capital is so scarce that only black market money is really available. Too low a rate will stimulate borrowing for its own sake.

As to the AID interest rate charged the ICI, as the AID loan will usually be seed capital, in the hopes that the ICI will then attract other lines of credit, both foreign and domestic, at rates almost as high as the ICI charges on sub-loans, the AID loan at relatively low rate will help provide a reasonable mix to allow the ICI some initial profit and an adequate revolving fund.

Mobilizing Capital: will be a major concern of ICI's In the case of CV, success has been such that they need not be "more concerned" at this time. As certain capital is attracted only by success, the ICI must be particularly concerned from the start with rapid approval of high-return loans.

The ratio of foreign and local capital will depend on whether there exists a free money market, as in Ecuador; however, generally for a new industrial plant, about half its cost will be imported equipment and half local construction, raw material and initial working capital.

Again we point out in the case of CV, there may be strong pressures to accept foreign lending which may not be beneficial to the ICI. The government will wish to accept all offers, from Italy, Poland, Holland, etc, with resulting restriction on the industrialist as to where he may buy his equipment. Consortium offers, often at very high interest rates, are not always of net advantage.

TC and AID loan mix and phasing will depend entirely on the LDC involved. In countries almost without local know-how the high cost of massive AID TC, if applied to the ICI's costs, may well result in unprofitable operation. Even with grant TC, the odds appear against the project, to judge by past history. In the end, it must be host country staff who will be responsible for success or failure and the chances are that if there is no local talent available at the start of the project, there will not be much even after 4-5 expensive years of AID TC efforts.

Where there is local talent in Banking, 1 Industrial Development Bank advisor and 1 industrial engineer/equipment procurement advisor, for 2 years each, appears sufficient. The Bank advisor would be present during the organizational stage and preferably he would have previous experience in a Latin country. Short-term (2months) TC is the form of teaching the ICI's analysts what to look for in the Market study, the financial plan and the technical feasibility aspects of loan application, may be advisable. Training funds should be available for "becas".

Organizational and Managerial Arrangements: This has been covered under B-3(a).

AID Support to ICI's in Future: In the writer's opinion, the advent of the Financieras has proved the most practical solution yet found to the problem of getting AID funds rapidly into the private sector for rapid increase in industrial production. A study of the impact on the economies of LDC's with experienced ICI's operating for 5 years or more might show this to be the best use of the AID dollar. A growing industrial sector attracts investment, provides jobs and income, tax base, a stable market for agricultural products, stimulates intermediate industries and services, reduces balance of payment problems, helps service foreign debt, etc. etc.

Initial AID support is needed: Commercial borrowing cannot start up an ICI; IDB funds tend to lack adequate control and supervision. An ICI requires a mix of low-cost money plus private institution lending. In the case of CV of course, as an autonomous agency of the GOE, it could not use commercial borrowing for initial capitalization.

Changes in an ICI as it matures are inevitable. At the start, it must secure the confidence of its public and clients and create an image; later it can be more demanding. At first it must accept perhaps shorter-term and lower priority but higher-return projects; on the other hand, good projects will tend to become harder to find after the first 100 plants have been built, so the ICI may need to get into the work of feasibility studies. Though projects get progressively more marginal after the "easy" ones are picked up, the ICI's management will have improved, improving their ability to analyze a project and their staff costs will be lower. Slowly, the education process, both for the Bank staff and for the investor, will yield results in better project study and presentation. The ICI may find itself considering larger projects, with more equity participation, or it may staff itself up as to enter new fields, such as credit to small or artesan industry, or into area development, frontier integration projects, or joint Financiera operations with neighboring countries or LAFTA market.

CV figures on loans behind in payments as of December 31, 1968 total 926,000 sucres, or .029% of total loans. Bad loans to date are two, where the CV stands to lose 1,330,000 (although of course repayment for this total amount are not due yet).

PAR Information:

Part I-C-1, Project Significance:

	Relevant Program Goals	Potential Impact	Actual Impact
1	Increase exports of agricultural and industrial products	3	2
2	Foreign exchange savings from import substitution	3	2
3	Promote surveys to attract $12 million of new private foreign investment in agro-industry	3	2
4	Encourage increased participation by International financing agencies and foreign government to meed AID goals	3	2

Part I-C-2, General Questions

014 CV has attracted a number of foreign lines of credit; IDB, IBRD, France, Poland, Italy, Germany, Spain, Switzerland, Holland, etc.

015 The Polish,Dutch, Holland, etc. credits pose a problem in use, as borrowers, here are not acquainted with this equipment.

016 Due to CV success in attracting other lines of credit, AID has cancelled a projected 2nd tranche $5 million loan.

017 Lessons to be learned are covered in the attached evaluation report.

019 It may be that CV's plans for opening the Galapages to tourism would be of interest in the U.S. The A.D. Little report is now being evaluated, and if CV decides to invest, USAID/E should send a story to AID/W on this.

SUMMARY RATING OF ICI: (2) very good.

Encl: Report by CV General Manager to Board, January 16, 1969
CV Annual report for 1966 and 1967
Price Waterhouse audit on CV dated June 30, 1968
List of Projects approved by CV, up to June 30, 1968
New clippings re. CV

EL SALVADOR

FINANCIERA DE DESARROLLO E INVERSION, S. A.
(FDI)

DEPARTMENT OF STATE

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TO - AID/Washington - [illegible]

TOAID A-42

DATE SENT 2-19-69

FROM - USAID/San Salvador

SUBJECT - Spring Review on Intermediate Credit Institutions

REFERENCE - (1) AIDTO Circular YA 25 (PE #21); (2) STATE 12015

Loan No. 519-L-006

A. Description of the Project

1. Country: El Salvador 2. Name of ICI: Financiera de Desarrollo e Inversion, S.A. (FDI

3. Class of ICI: Private 4. Date Established: 4/7/65

5. Initial Assistance from A.I.D.:

Date	$ Amount	Kind
8/17/64	5,200,000	Dollar Loan

6. Does the ICI take equity participation? Yes

7. Capital structure of the ICI as of 8/17/64 (in thousands of U.S. dollar equivalents):

Subscribed capital 1/		1,000
a) 319 Salvadoran shareholders	(70%)	
b) Wells Fargo Inter. Corp.	(20%)	
c) Bank of London and Montreal	(10%)	
Total capital		1,000

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PAGE 1 OF 11 PAGES

DRAFTED BY	OFFICE	PHONE NO.	DATE	APPROVED BY:
D. [illegible]/J. [illegible] D. [illegible]/[illegible]	ECON		2/17/69	Albert J. [illegible], AD

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DCM: TGLeonhardy

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8. Subsequent assistance from A.I.D.: None

9. Capital structure of the ICI as of December 31, 1968 (in thousands of U.S. Dollar equivalents):

Subscribed capital 1/	1,200
Legal Reserves	25
Undistributed profits	90
Total capital	1,315

10. Status of A.I.D. loan as of July 1, 1968:

$ Committed	$ Disbursed
4,826,000	4,465,136.36

11. Interest rates: Average rates paid by the FDI range from 2% to A.I.D. to 7-3/4% to private commercial banks (short-term) and 8¼% to private commercial banks (medium-term). Average rates charged by the FDI range from 8% to 9 a year.

Differences in rates are linked to degree of risk rather than to type of borrower.

The Financiera is authorized, under the Loan Agreement, to make loans and limited equity investments in sub-projects promoting the creation, expansion and more effective operation of private industrial enterprise in El Salvador and other member countries of the Central American Common Market. While no limits are set on the size of individual sub-loans, those exceeding $100,000 or its equivalent require prior A.I.D. approval.

Sub-loans must have a minimum maturity period of 3 years but may not exceed 15 years without prior written approval of A.I.D. The interest rate charged to sub-borrowers may not exceed 12% (including all commissions, fees, and other charges) per annum on the disbursed balances of sub-loans. Also, sub-loans to projects in which FDI directors have any financial interest require prior written approval of A.I.D.

As of December 31, 1968, the FDI utilized A.I.D. funds for 127 sub-loans totalling $5,003,190 (¢12,507,976). These loans were distributed among the following activities:

1/ Paid-in capital figures not available for these dates. However paid-in capital as of December 31, 1965 was $392,000. As of March 31, 1967 it was $1,000,000.

FDI Loans Granted by Activity and A.I.D. Component
As of December 31, 1968
(In thousands of Colones)
(¢2.50 = US $1.00)

Activity	Total Loans Granted	% of Total	Loans Granted with AID Funds	% of Total	AID % of Activity
Agriculture & Livestock	1,208	3.6	897	7.2	74.3
Poultry	525	1.6	197	1.6	37.5
Fishing	1,852	5.5	1,334	10.7	72.0
Electric Light & Power	2,350	7.1	982	7.9	41.8
Food Products	3,022	9.2	288	2.3	9.5
Beverages	372	1.1	235	1.9	63.2
Textiles	3,317	10.1	1,269	10.1	38.3
Shoes and Clothing	2,001	6.1	213	1.7	10.6
Wood Products	180	0.5	180	1.4	100.0
Furniture & Accessories	1,717	5.2	186	1.5	10.8
Paper & Cardboard Products	922	2.8	724	5.8	78.5
Printing Shops	296	0.9	179	1.4	60.5
Rubber Products	1,983	6.0	824	6.6	41.6
Chemical Products	2,246	6.8	506	4.0	22.5
Non-Metalic Mineral Prod.	343	1.0	82	0.7	23.9
Base Metals	213	0.6	37	0.3	17.4
Metal Products	1,697	5.1	574	4.6	33.8
Electrical Appliances	902	2.7	616	4.9	68.3
Transportation Equipment	1,394	4.2	1,009	8.1	72.4
Miscellaneous Manufactures	880	2.7	613	4.9	69.7
Transportation	888	2.7	741	5.9	83.4
Construction	1,181	3.6	67	0.5	5.7
Photographic Laboratories	179	0.5	—	—	—
Medical Services & Labs.	248	0.8	148	1.2	59.7
Financial Services	850	2.6	500	4.0	58.8
Distribution of Industrial Products	1,400	4.2	—	—	—
Others	802	2.4	41	0.3	5.1
Total	32,968	100.0	12,508	100.0	37.9

The financial environment in which the FDI and INSAFI operate and the importance of the institutions to private sector financing are shown below:

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Portfolio of Loans and Investments to the Private Sector by Commercial Banks, INSAFI, and the FDI
End of years 1966 - 1968
(In Millions of Colones)

Portfolio of Loans and Investments	1966	%	1967	%	1968	%
Commercial Banks 1/	476.5	92	487.5	90	499.2	87
INSAFI	32.6	6	38.5	7	43.0	8
FDI	9.5	2	18.6	3	22.7	5
Total	518.6	100	544.6	100	574.9	100

1/ Includes six local banks and two subsidiaries of foreign banks.

It was originally intended that the FDI was to make loans to businesses which did not have access to other sources of financing, and that its loans were all to be made for industrial purposes. As stated in Audit Report Number 68-7-51 of October 7, 1967, the organization did not completely conform to these terms.

The changing nature of the FDI's loans and investments from 1965 to 1968 are shown below, in thousands of colones.

Loans and Investments	End of Year 1965	%	1966	%	1967	%	1968	%
Loans:								
Short-term (less than 1 year)	576	28.7	3,556	37.2	8,482	45.7	10,585 1/	46.6
Medium-term (1 to 5 years)	745	37.1	3,527	36.9	6,531	35.2	8,077	35.5
Long-term (5 years or more)	688	34.2	2,092	21.9	3,129	16.8	3,620	15.9
Investments	0	-	375	4.0	425	2.3	438	2.0
Total	2,009	100.00	9,550	100.0	18,567	100.0	22,718	100.0

1/ Includes ¢4,869,000 from the Central Reserve Bank and ¢2,101,000 from foreign commercial banks used for export financing programs.

Much of the information requested regarding the operations of the FDI was submitted to AID/W in reply to a questionnaire prepared in December, 1968 by the term from the Office of the Inspector General of Foreign Assistance (IGA). A copy of the response to that questionnaire has been sent to D. McClelland (PPC/POL/ES).

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B. Evaluation on Specific Points

1. Goals

(a) The FDI consistently has sought to mobilize additional capital.

In August, 1968, it effected an increase in its subscribed capital from ₡2,500,000 ($1,000,000) to ₡3,000,000 ($1,200,000). In addition, it has negotiated numerous lines of credit from foreign commercial banks to permit a greater activity in short-term financing of industrial and certain agricultural activities aimed at increasing the supply of raw materials for industry. There has been no reliance on GOES financing. Although the FDI has a lengthy list of stockholders, the control is in the hands of some of the wealthiest people in El Salvador.

(b) The increase in the supply of investment funds is to be used for financing industry in general and related agricultural activities. The FDI's interest rates are about 0.5% higher than those of INSAFI (the government development bank) but compare favorably with those of the commercial banks in El Salvador (9-10%) and the CACM.

Interest rate policy has not been used by the FDI to influence the pattern of investment. Nor is consideration given to comparative advantages. Loans are made on the basis of projects available for financing, their technical and financial evaluation by the FDI's staff, and approval by the Board of Directors. It cannot be said that any well defined system of development pricritics has been employed in project selection. A "Small Financiera" was established within the FDI with $200,000 of the AID loan, and was designed specifically to assist small industry and commerce. However, loans were made at higher rates and to businesses with more financial strength than was originally envisioned.

(c) While the project may, in time, assist in getting a securities market started, it has not yet served this purpose.

(d) The technical, managerial, and financial practices of clients are considerations in the FDI's review of loan applications, and recommendations are made to sub-borrowers on these points. Stress is placed on the sub-loans' contributions to increasing the profitability of the sub-borrowers (more efficient operations; expanded production; improved marketing).

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Achievement of Goals

(a) The project has suffered in recent years from a leveling off in Salvadoran industrial growth and consequent deterioration in the quality of sub-projects received for financing. There is little doubt, however, that new plants and plan improvements have come into being as a result of the FDI's credit activities; the fish industry certainly has benefitted from the availability of FDI credits for new vessels and fish processing equipment.

(b) The decline in the rate of industrial growth during the past few years has resulted in the financing by the FDI of some projects on the margin of the intent of the Loan Agreement. However, A.I.D. keeps a close watch on the FDI's sub-lenging activities involving the use of A.I.D. funds and will insist on more development-oriented financing as the economic situation warrants. The use of roll-over funds from the AID loan is not subject to prior USAID approval, as were the original funds.

(c) Industrial development has been and is a key factor in the growth of the Salvadoran economy. However, in El Salvador as in many other Latin American countries, the commercial banks do not play a lending role which fosters rapid industrial progress; for the most part they do not meet the medium-and long-term financing needs of the industrial sector. As a source of these funds, the ICIs are a necessary, although not sufficient, condition for rapid industrial growth.

While the specific attitude of the GOES toward the FDI is not known, it can be assumed that the Government recognizes the importance of the Financiera in promoting the progress of the industrial sector. In this respect, the FDI plays an important role in the growth of the economy and therefore should be looked upon favorably by the GOES.

In the view of the Mission, the basic flaw in the operation of the FDI is that it has not been the risk taking institution that it was envisioned to be. Its interest rates have been high, close to the national average, and it has focused its lending operations on dealings with large and medium borrowers. Loans have at times been made on a short-term basis, and projects have been financed which could have been handled by private sources of capital. Loans for the more difficult, high-risk, smaller-scale investment projects requiring supervision and technical assistance have been virtually non-existent.

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Nevertheless, the FDI can be expected to play a role in the continued industrial growth of El Salvador, The FDI and INSAFI are still the principal sources of medium- and long-term funds in the country. However, as mentioned, the existence of the ICIs is not a sufficient condition to produce the desired level of industrial growth (9.8% per annum between 1969 and 1972). Programs of promotion, export market development, research, management and product improvement, and marketing must be developed to provide a suitable base for industrial expansion.

The AID loan to the FDI was of unquestionable value in the development of the organization into a viable institution, and in providing a capital base which multiplied many times over in helping to finance the rapid industrial expansion of the past few years. However, since the FDI did not perform in the nature of the development bank, the benefits of the low interest AID loan did not reach down tothe small business subsector, an area of high AID priority. Further AID lending to the FDI should depend upon the degree to which the ICI indicates and displays a desire to assist the small industrialist -- the one who at present has no source of low-cost funds, but who would provide increased employment for Salvadorans and possibly contribute to a more equitable distribution of income. Future loan agreements should be carefully worded to achieve this end.

For further details see the PAR on this project.

(d) The FDI has obtained short-term credits at 5½% to 7-3/4% from private commercial banks in the Netherlands, Germany, Switzerland, and the United States. These total U.S. $2.3 million. However, such credits are not designed to be used for medium- and long-term lending. Medium- and long-term borrowing from international institutions such as the IFC and the Eximbank is difficult for a private financiera, interest rates are relatively high, and the loans are often tied to national procurement. However, Eximbank financing has been sought, and is presently in negotiation. The use of suppliers' credits might be increased somewhat, but will result in short-term strain on the national balance of payments position.

(e) Experience with this project indicates the need for a much greater degree of specifying goals in the loan documents, with emphasis on project priorities, a clear definition of projects ineligible for financing with AID funds, and provisions for development of joint ventures and CACM projects. Also, we would insist upon much greater attention to the technical and financial needs of small enterprises and the development of linkages between these and larger production units. We also would recommend that the ICI enter into a sustaining contract with the Central American Technological Research Institute (ICAITI) to promote research and

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development and to apply the results to forming specific projects that could be financed by the FDI.

2. Selection of Borrowers

(a) The criteria for sub-lending by the FDI, within the framework of the Loan Agreement and implementation documents, are set by its Board of Directors. An attempt is made to encourage industries that will utilize domestic raw materials and generate exports. The managerial and financial condition of the sub-borrower are analyzed, substantial security of the sub-loan is required (collateral is often 150% of the loan amount) and the economic viability of the enterprise is assessed.

(b) The FDI processes applications submitted to it. Occasionally, it will advertise in the newspapers, however, in the past, it has not done very much by way of research, surveys, and/or promotional work. More emphasis is being given to these matters currently. The processing of the wrong kind of applications is more a matter of the availability of projects than of promoters' activities. USAID surveillance is one means of controlling this situation.

(c) Although A.I.D. auditors found difficulties with the FDI's lending criteria, these criteria now are believed to be applied effectively.

(d) Clearer definition of the purposes of the loan; required investment in research, development, and promotion; special attention to linkage possibilities and creating industrial complexes; development of investment intentions surveys and other statistical analyses upon which to base investment programs -- all of these for future ICIs at the time an A.I.D. loan is made.

3. Management and Operational Policies

(a) Appears to be effective.

(b) Adequate security for sub-loans is obtained; reserves against bad debts are established in accordance with the Loan Agreement; and repayment experience vary largely has been satisfactory.

(c) Too much emphasis appears to be placed on security for loans. Little real risk is undertaken by the FDI. More effort is needed to identify and form broader capital participations in worthwhile projects and to develop a securities market.

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(d) The FDI can and does provide assistance on technical and managerial problems of sub-borrowers. Presumably, judging by its repayment record, the assistance has been effective.

(e) Both established and new firms have been recipients of FDI loans. Some of the loans probably have served, in part, to free borrower's own funds for other uses, but not necessarily those of a higher priority. We have no actual information on this point. Most worthwhile projects financed tended to be medium to large size, and risk-taking has been slight. The FDI at times attempted to finance projects that at the very most were marginal to the intent of its loan agreement with A.I.D. In some cases, several loans were made to the same firms. In the cases of the few small projects financed, they pertained to persons or families well known to the Directors of the FDI. The conflict-of-interest situation is partly covered by the Loan Agreement requirement that prior A.I.D. approval is necessary for sub-loans to enterprises in which a director has any financial interest.

(f) The FDI is a profitable institution. A part of its profits have gone to increase its capitalization. Much of its profit derives from short-term financial transactions, with leverage from lines of credit from foreign commercial banks and from the Central Reserve Bank. Net profits in 1968 amounted to ₵309,440 (US$123,776).

4. Specific A.I.D. Relationships

(a) AID objectives and criteria should be made specific, in writing, to the ICI, and borrower's periodic reports to be required by AID should follow a format responsive to these objectives and criteria.

(b) No. The legal language was unclear, basic considerations (such as re-use of AID funds) were not touched upon; too much attention was paid to provisions respecting shipping, source and origin of goods, marking requirements, etc., some of which were unenforcible in practice; and the limits for autonomous sublending (i.e. without prior AID approval) were set too high.

(c) The 2-step procedure is not involved in the case of the FDI loan. Were local cost financing more readily available, it is likely that more projects would be submitted for FDI financing.

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(d) Several extensions of disbursement termination dates have been required because of delayed deliveries from U.S. suppliers, inability to obtain U.S. shipping, lack of required markings, etc. The whole concept of tied procurement and investment controls needs re-thinking if more efficient use is to be made of A.I.D. loan funds (see Fritz Machlup, "The Transfer Gap of the United States", Princeton University. Reprints in International Finance No. 11, October 1968).

(e) No. The AID technical assistance program during the past 2 - 3 years has been limited to the salary of the private enterprise Development Officer. This position is being abolished at the end of FY-1969.

The PDO approved ICI loans over $100,000 and provided some technical advice to the ICIs. However, the major area identified for the application of the talents of the PDO has been the small business subsector: the people who did not have access to financing from the ICIs or the banks, and who lacked technical assistance from any source.

(f) Pipeline due to external factors rather than FDI activities. More rapid use of funds would encourage new investors and make El Salvador a more attractive place for locating industries. No problem in screening loans.

(g) Assistance to both types of ICI has been given in El Salvador. Both have been useful but not sufficiently differentiated as to their activities. INSAFI has acted too much like the FDI, rather than take the risks that should be taken by a government development bank that need not show a profit. INSAFI has, however, given more attention to smaller and artisan-type enterprises and has assisted in promoting investment in El Salvador.

C. Overall Evaluation and Conclusions

For an overall analysis of the effect of industrial development in El Salvador on the Salvadoran employment situation see the enclosure to TOAID A-614 of August 31, 1968. It is certain that the AID loans to the ICIs were the basis for the rapid development of these agencies. For the most part the subloans provided by the agencies were additional and did not substitute for lending that would have taken place anyway; they therefore helped to accelerate industrial growth in El Salvador. However, the quality of certain investments was less than the USAID would have preferred, and probably few new capitalists were created as a result of these AID loans.

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In addition, industrial growth in El Salvadorans, in no small way, been encouraged by the formation of the CACM and the expanded market for products thus offered. It is difficult to pin-point any one factor - be it the CACM, the ICIs, GOES fiscal incentives, or USAID technical assistance - as being the principal contributing factor to this growth.

BOWDLER

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EL SALVADOR

INSTITUTO SALVADOREÑO DE FOMENTO INDUSTRIAL
(INSAFI)

AIRGRAM

DEPARTMENT OF STATE

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CLASSIFICATION

For each address check one ACTION | INFO

DATE REC'D.

DISTRIBUTION ACTION

TO: AID/Washington TOAID A-47 *

DATE SENT 2-20-69

FROM: USAID/San Salvador

SUBJECT: Spring Reviews on Intermediate Credit Institutions

REFERENCE: (1) AIDTO Circular, XA 25 (RM A21), (2) State 10012.

LOAN No. 519-L-005

A. Description of the Project

1. Country: El Salvador

2. Name of ICI: Instituto Salvadoreño de Fomento Industrial (INSAFI)

3. Class of ICI: Public

4. Date Established: 1961 as successor to INSAFOP (established in 1955)

5. Initial Assistance from A.I.D.:

Date	$ Amount	Kind
09/18/63	4,500,000	Dollar loan

6. Does the ICI take equity participation? Yes

7. Capital structure of INSAFI as of September 18, 1963: (In thousands of U.S. Dollar equivalents)

Operating Capital Fund	
Initial Capital	$2,423
Other GOES contributions	$1,107
Administrative Fund (GOES)	$ 251
TOTAL CAPITAL	$3,781

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PAGE 1 OF 9 PAGES

DRAFTED BY	OFFICE	PHONE NO.	DATE	APPROVED BY:
IND/JPinto ECON/DYoung	IND/ECON		2/17/69	ADOM:Albert J. Einstad

NO AND OTHER CLASSIFICATION

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OFFICE - When ACTION completed, return this document to CENTRAL FILE

(DS-32) W/S REC'D STATION on appropriate OFFICIAL FILE (Check box below if [illegible])

NO ACTION NECESSARY

DATE | SIGNATURE

8. Subsequent assistance from A.I.D.: None

9. Capital structure of INSAFI as of December 31, 1968 (In thousands of U.S. dollar equivalents):

Operating Capital Fund:	
Initial Capital	$2,423
Other GOES Contributions	3,672
Administrative Fund:	
Initial Capital	251
Reserves	64
Total capital	$6,410

10. Status of A.I.D. loan as of July 1, 1968:

Committed	Disbursed
$4,478,500.00	$4,399,014.25

11. Interest rates paid by INSAFI:

To A.I.D.	3/4%
Eximbank	6%
I D B	6%
First National City Bank	6½%
CABEI	5%

Interest rates charged by INSAFI: 8% - 9% a year, depending upon the purpose of the sub-loan.

Much of the information requested on INSAFI is contained in the "Loan Application Presented to the Agency for International Development" in June 1968 for a second-tranche loan. This application is available in AID/W/LA/CD.

The financial environment in which INSAFI and the FDI operate and the importance of the institutions to private sector financing are shown below:

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Portfolio of Loans and Investments to the Private Sector by Commercial Banks, INSAFI, and the FDI, end of years 1966 - 1968
(In millions of colones)

Portfolio of Loans and Investments	1966	%	1967	%	1968	%
Commercial Banks 1/	476.5	92	487.5	90	499.2	87
INSAFI	32.6	6	38.5	7	43.0	8
FDI	9.5	2	18.6	3	22.7	5
Total	518.6	100	544.6	100	574.9	100

1/ Includes six local banks and two subsidiaries of foreign banks.

Audit Report Number 68-11-52 of November 6, 1967 indicated that some of the organization's loans were made to firms which had commercial sources of financing. This was directly contrary to the intent of the loan agreement. As a result of dialogue undertaken during the negotiation of a second AID loan, INSAFI embarked upon a program to increase its small industry capability. A new small industry Division is to be established soon. UN/ experts are being obtained to assist, and a 5-year small industry development plan has been incorporated into the 1968-1972 Salvadoran National Development Plan. Adequate funding and manpower and a new orientation in the thinking of INSAFI's Board of Directors and principal officers will be required to put muscle into this program. The decision by AID/W not to consider a second tranche loan means the Mission will have virtually no leverage in pushing this program forward.

As of June 30, 1968, INSAFI had utilized AID funds for loans totalling $4,300,000. 1/ These loans were distributed among the following activities:

1/ The difference between this figure and the disbursement figure of Item 10 above is accounted for by the technical assistance component of the loan.

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INSAFI LOANS MADE WITH AID FUNDS AS OF JUNE 30, 1968
(In U.S. Dollar Equivalents)

Activity	Loan Amount	% of Total
Foods (not including beverages)	165,320	4
Textiles	894,868	21
Footwear and clothing	717,475	17
Paper and Allied Products	797,196	19
Publishing and Printing	324,500	8
Non-metalic mineral products	263,465	6
Metal Products	183,003	4
Electrical Products and Fixtures	596,210	13
Transportation material	86,088	2
Miscellaneous	271,877	6
Total	4,300,000	100

INSAFI LOANS GRANTED BY PURPOSE AND AID COMPONENT
As of December 31, 1968
(In thousands of U. S. Dollar Equivalents)

Purpose	Total Loans	% of Total	Loans with AID Funds	% of Total	AID % of Total Loans
Building Construction	4,293	16	1,100	26	26
Industrial Refinancing	1,436	5	--		
Machinery & Equipment	12,944	48	2,232	52	17
Working Capital	8,307	31	968	22	12
Others	1	-	--	--	--
	26,984	100	4,300	100	16

I. Evaluation on Specific Points

1. Goals: Description

(a) INSAFI has succeeded in obtaining additional capital from public, private, and international lending agencies, as stated in the above mentioned loan application. The ratio of loans with external resources to loans with internal resources in 1967 approximated 2:1.

(b) INSAFI attempts to select projects of high priority to the national development, although due to its conservative collateral requirements (as high as 1.67 times the value of the loan) and the fact that it usually lends only 60 percent of the required financing, many small industrialists have been unable to utilize its resources (including those obtained from AID).

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Its interest rates are slightly below those of the private financiera and other local credit sources. No consideration is given to the comparative advantage of the industry on an international scale, although in the case of large projects, where competing plants may be under study in other CACM countries, some regional consideration may be given.

(c) INSAFI may take an equity position in enterprises to which it sub-lends. The equities are to be sold eventually, and to that extent a "securities market" may be started. No such sales yet have been made.

(d) The project aims at providing technical assistance to borrowing firms, but a shortage of trained manpower has inhibited any large scale action in this direction, especially in relation to small industries. INSAFI provides some guidance in increasing the efficiency of capital use. It maintains technical and financial departments that can provide such advice, and also contracts with U. S. firms for technical studies and evaluations.

(e) INSAFI is interested in promoting projects that will utilize national raw materials and labor, and attempts to relate its activities to the national development plans for industry.

Goals: Achievement

(a) The project has been effective in helping to meet some development goals (see IRR for second tranche and TOAID A-522 of 6/8/68; Loan Paper on second tranche request by INSAFI; TOAID A-209 of 11/15/67). It has not been effective in meeting the needs of small industries having little collateral to support a loan and requiring a supervised credit program. It has tended to be interested in large-sized projects where its contracted technical services could be utilized efficiently. It has been understaffed and little oriented toward the needs the small businessman has. In short, INSAFI has behaved like a commercial bank rather than as a government development agency theoretically should behave. It has taken on projects that, it is felt, private capitalists and private lending institutions might have financed because they were highly promising ventures.

(b) The growing needs of small industry have led INSAFI to undertake a reorganization plan designed to give particular attention to this sub-sector (see item 11 above). It remains to be seen if, and how well, this reorganization plan will be implemented.

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(c) Industrial development has been and is a key factor in the growth of the Salvadoran economy. However, in El Salvador as in many other Latin American countries, the commercial banks do not play a lending role which fosters rapid industrial progress; for the most part they do not meet the medium-and long-term financing needs of the industrial sector. As a source of these funds, the ICIs are a necessary, although not sufficient, condition for rapid industrial growth.

INSAFI is a semi-autonomous agency of the GOES and an integral part of GOES efforts to develop the industrial sector. The National Planning Council works with INSAFI in developing the industrial sector discussion in the National Development Plan, and INSAFI is regarded as a prime mover in achieving the Plan's objectives in this sector.

In the view of the Mission, the basic ~~fa~~ flaw in the operation of INSAFI is that it has not been the risk-taking institution that it was envisioned to be. Its interest rates have been high, close to the national average, and it has focused its lending operations on dealings with large and medium borrowers. Many of the larger firms which borrowed from INSAFI had access to other funds -- either domestic or foreign -- and only were taking advantage of the institution's somewhat concessional rates (0.5% to 1.0% below the national average). Only to a limited extent have loans been granted for the more difficult, high-risk, smaller scale investment projects requiring supervision and technical assistance.

Nevertheless, INSAFI can be expected to play a role in the continued industrial growth of El Salvador. The FDI and INSAFI are still the principal sources of medium- and long-term funds in the country. However, as mentioned, the existence of the ICIs is not a sufficient condition to produce the desired level of industrial growth (9.8% per annum between 1969 and 1972). Programs of promotion, export market development, research, management and product improvement, and marketing must be developed to provide a suitable base for industrial expansion.

The AID loan to INSAFI was of ~~[illegible]~~ unquestionable value in the development of the organization into a viable institution, and in providing a capital base which multiplied many times over in helping to provide financing for the rapid industrial expansion of the past few years. AID technical assistance has been and, if needed, could continue to be of vital importance in the maturation of the institution. However, since INSAFI did not perform in the nature of a development bank, the benefits of low interest AID loans did not reach down to the small business subsector, an area of high AID priority. Further AID lending to INSAFI should depend

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upon the degree to which the ICI indicates and displays a desire to assist the small industrialist -- the one who at present has no source of low-cost funds, but who would provide increased employment for Salvadorans and possibly contribute to a more equitable distribution of income. Future loan agreements should be carefully worded to achieve this end.

For further details see the PAR on this project.

(d) Alternative sources of financing on favorable financial terms are not readily available for small industry financing. For larger-sized projects, Eximbank, IDB, and CABEI funds may be available, but on terms more costly than if AID funds were available.

U.S. specific risk investment guaranties are available in El Salvador, and negotiations are in progress regarding a new agreement to cover all investments guarantees offered by AID.

The greater use of suppliers' credits will require an educational process and active promotion by U.S. firms. Thus far, the use of such credits has been relatively small in El Salvador.

(e) The first A.I.D. loan has been fully utilized or deobligated. Experience with this project indicates the need for a much greater degree of specifying goals in the loan documents, with emphasis on project priorities, a clear definition of projects ineligible for financing with A.I.D. funds, and provisions for development of joint ventures and CACM projects. Also, we would insist upon much greater attention to the technical and financial needs of small enterprises and the development of ~~kkg~~ linkages between these and larger production units. We also would recommend that the ICI enter into a sustaining contract with the Central American Technological Research Institute (ICAITI) to promote research and development and to apply the results to forming specific projects that could be financed by INSAFI.

2. Selection of Borrowers

(a) INSAFI emphasizes loans to industries that utilize local raw materials, that import-substitute, or that are export oriented. It has more recently begun to increase its lending to small industry, an area which the Mission has been encouraging for some time. As noted above, INSAFI has not been the risk-taking institution which it was originally envisioned to be.

INSAFI determines its own lending criteria, although it does attempt to relate its activities to the national development plans for industry.

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(b) The institution does undertake surveys, a Polyvinyl Chloride study being the most recent example. In addition, INSAFI has been working in the development of artisan industries. A recent survey, in cooperation with Peace Corps Volunteers, of the entire country has resulted in the discovery of new crafts; the development of a market for these handicrafts is progressing.

(c) Until recently it could have been said that those criteria were appropriate and effectively applied. However, INSAFI's latest report shows that delinquencies have increased. The fact that the absolute number of delinquencies is high (over 300) while the dollar amount is a small amount of the portfolio (4½%) indicates that the cause of the problem is loans to small businessmen. At least one of the reasons for this problem is INSAFI's lack of qualified personnel to provide technical assistance for the small-business subsector.

(d) As indicated above, INSAFI needs a larger and better trained technical staff so that it will be able to devote more attention to the technical assistance needs of small business.

3. Management and Operational Policies (see June 1968 Loan Application)

4. Specific A.I.D. Relationships

(a) AID objectives and criteria should be made specific, in writing, to the ICI, and borrower's periodic reports to be required by AID should follow a format responsible to these objectives and criteria.

(b) No. The legal language was unclear, basic considerations (such as re-use of AID funds) were not touched upon; too much attention was paid to provisions respecting shipping, source and origin of goods, marking requirements, etc., some of which were unenforcible in practice; and the limits for autonomous sublending (i.e. without prior AID approval) were set too high.

(c) The 2-step procedure is not involved in the case of the INSAFI loan. Were local cost financing more readily available, it is likely that more projects would be submitted for financing.

(d) Several extensions of disbursement termination dates have been required because of delayed deliveries from U. S. suppliers, inability to obtain U.S. shipping, lack of required markings, etc. The whole concept of tied procurement and investment controls needs re-thinking if more efficient use is to be made of AID loan funds (see Fritz Machlup, "The Transfer Gap of the United States", Princeton University, Reprints in International Finance No. 11, October 1968).

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(e) No. The AID technical assistance program during the past 2-3 years has been limited to the salary of the Private Enterprise Development Officer. This position is being abolished at the end of FY-1969.

The PDO approved ICI loans over $100,000 and provided some technical advice to the ICIs. However, the major area identified for the application of the talents of the PDO has been the small business subsector: the people who did not have access to financing from the ICIs or the banks, and who lacked technical assistance from any source.

(f) Pipeline due to external factors rather than INSAFI activities. More rapid use of funds would encourage new investors and make El Salvador a more attractive place for locating industries. No problem in screening loans.

(g) Assistance to both types of ICI has been given in El Salvador. Both have been useful but not sufficiently differentiated as to their activities. INSAFI has acted too much like the FDI, rather than take the risks that should be taken by a government development bank that need not show profit. INSAFI has, however, given more attention to smaller and artisan-type enterprises and has assisted in promoting investment in El Salvador.

See also Loan Paper for second tranche and Loan Application for second tranche.

C. Overall Evaluation and Conclusions

For an overall analysis of the effect of industrial development in El Salvador on the Salvadoran employment situation see the enclosure to TOAID A-614 of August 31, 1960. It is certain that the AID loans to the ICIs were the basis for the rapid development of these agencies. For the most part the subloans provided by the agencies were additional and did not substitute for lending that would have taken place anyway; they therefore helped to accelerate industrial growth in El Salvador. However, the quality of certain investments was less than the USAID would have preferred, and probably few new capitalists were created as a result of these loans.

In addition, industrial growth in El Salvador, has in no small way, been encouraged by the formation of the CACM and the expanded market for products thus offered. It is difficult to pinpoint any one factor - be it the CACM, the ICIs, GOES fiscal incentives, or USAID technical assistance - as being the principal contributing factor to this growth.

See also IRR on INSAFI second tranche application.

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NICARAGUA

CORPORACION NICARAGÜENSE DE INVERSIONES
(CNI)

AIRGRAM

DEPARTMENT OF STATE

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DISTRIBUTION
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TO - AID/W TOAID A X

DATE SENT
March 25, 1969

FROM - USAID/Managua

SUBJECT - Spring Review Intermediate Credit Institutions (ICI's)

REFERENCE - (a) AIDTO CIRC A-25; (b) TOAID A-59 and (c) Managua 0409

I. Introduction

This message completes USAID submission as requested in Ref. (a) and is concerned with the Nicaraguan Investment Corporation (CNI). As noted in Ref. (b), A.I.D. has had different objectives in financing industrial investment through CNI versus financing through Informe. It was necessary to create CNI. CNI was brought into existence primarily as a result of A.I.D. assistance because we felt that a private development bank was necessary to our overall contribution to industrial development in Nicaragua. Consequently, we have regarded both CNI itself, as well as the sub-projects, as "inputs" to Nicaraguan development financed by the A.I.D. loan.

We also tend to take a longer view of C.N.I. operations and think of it as an institution that will ultimately expand further in the CACM. Moreover we expect CNI to become more than just an investment bank since it can play a broader role in the development of the private investment and capital mobilization market-place as it matures.

II. Description of the Project

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A. Outline of Project Information

1. Country: Nicaragua

2. Corporación Nicaragüense de Inversiones (CNI)

PAGE 1 OF PAGES 10

DRAFTED BY	OFFICE	PHONE NO.	DATE	APPROVED BY
CDO:JACHaselle CDO:PDMassey	CDO		3/24/69	C.B. Johnson Acting Director

AID AND OTHER CLEARANCES

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AID-5-40 (9-62) W/O HECTO (Do not type below this line) PRINTED 4-67

3. Class of ICI: Private

4. Established: May, 1964

5. Initial A.I.D. assistance: May 25, 1965
A.I.D. Loan No.524-L-010
for US$3,000,000
Final Disbursed Amount: $2,976,648.25

6. CNI does take equity participation

7. Capital Structure: December, 1964
Common shares $1,045,000 equally divided among: Foreign Credit Institutions, Local Credit Institutions, Private Investors. Plus reserves and retained earnings of $17,000.

8. Subsequent assistance from A.I.D.: September 27, 1966
A.I.D. Loan No.524-L-016
for US $5,000,000

9. See Balance Sheet Attached

Attached is CNI's Balance Sheet for the period ended December 31, 1968.

Some comments on the Balance Sheet follow:

CNI's capital structure consists largely of short term loans from foreign banks, long term foreign loans including A.I.D. loans and capital stock. The structure reflects a debt-equity ratio of about 6.4:1 which is somewhat higher than forecast in the CAP dated June 10, 1966. However, CNI has concentrated less than expected in equities and more in loans, particularly short term lending. This is indicated by the substantial 41.7 million short term cordobas due to foreign banks, which further suggests the great pressure on CNI to supply working capital (the latter point is also applicable to Infonac). In fact, CNI's short term bank debt is of the same magnitude as its total long term debt of 42.6 million cordobas. CNI's expansion of debt is limited by the second A.I.D. Loan Agreement to a maximum of $15,000,000 equivalent. In 1968 CNI earned net profits after taxes of 2,512,000 vs. 2,000,000 *cordobas in 1967. Dividends were paid in the years (excluding under A.I.D. loans) 10% for 1967 and 9% for 1968.

* 7 cordobas = one U.S. dollar

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CNI paid in capital is 15,000,000 cordobas. This is split equally among foreign credit institutions, local credit institutions and private investors. The second A.I.D. loan requires that an additional 3,500,000 capital be paid in which will increase paid in capital to 18,500,000 cordobas. The stockholder's General Assembly of March 10, 1969 authorized an increased of capitalization to 20,000,000 cordobas of which 1.5 million was called immediately.

10. Status of A.I.D. dollar loans as of December 31, 1968:

	Committed	Disbursed
A.I.D. Loan No.524-L-010	$2,976,648.25	$2,976,648.25 (100% disbursed)
A.I.D. Loan No.524-L-016	2,300,000.00	694,489.96

11. Interest Rates:

Paid by CNI: 2½% A.I.D. #524-L-010
5½% A.I.D. #524-L-016
7¼% average for commercial borrowings (estimated).

Charged by CNI: 9% plus 1% commission on A.I.D. funds.
10½% plus 1% commission on non-A.I.D. funds.

Criteria

Limit on Size of Loans: Present limit on maximum loan is $1,000,000 but no loans in this amount have been made. Loans are also limited by a maximum 70/30 debt equity ratio. Loans are limited to industrial, agricultural and development purposes. No commercial type loans.

Uses of Loans: See Attachment A and B for economic sectors and number of loans for year 1968. Attachment C shows total amount of loans since organization as to economic uses.

The Financial environment of CNI is described in the CAP dated June 10, 1966, (for the second CNI loan) pages 15 and 17. However, the level of interest rates are now generally higher. As noted above, CNI is charging more interest on non-AID funds and the interest rate to AID sub-borrowers (10.56% c[illegible] of money)

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is now slightly less than the going commercial bank rate in Nicaragua (11-12%).

The functions of CNI are described in the Loan Application from CNI dated January 1965 pages 1 and 2. This document should be in AID/W files. CNI is still a relatively new ICI and as it matures will change [illegible] As mentioned in the above referenced document, CNI aims to help [illegible] capital market through appropriate stages. This objective is being realized today as the CNI Board of Directors has authorized formation of a mutual fund, yet to be publicly announced, the delay having been largely due to the recent problems in the C.A. Common Market. It is appropriate that CNI initiate a mutual fund and that it be promoted from the private sector.

As mentioned in describing the financial environment of Infonac (Ref.b) CNI operates in a country without exchange or import controls. Moreover, CNI is not answerable to the Central Bank for its foreign borrowing activity. As long as CNI's credit is good with U.S. banks, it can borrow dollars, convert them to cordobas and lend them to Nicaraguan borrowers for local cost and working capital purposes. It can in fact, use such funds where the problems of tied procurement make A.I.D. funds unattractive or excessively difficult to use.

B. Evaluation of Specific Points

1. Goals

a) A.I.D. has emphasized the mobilization of additional capital. The second A.I.D. loan requires that $500,000 additional capital be subscribed and that $250,000 be paid in before disbursement in excess of $3,000,000. The remaining $250,000 is required to be paid in before disbursements in excess of $4,000,000. It is anticipated that these increases in capital will come from the private sources listed in Item #7 above. One third of the new capital will come from U.S. dollar investors and the balance from private local currency sources.

b) The increase in supply of investment funds will be applied [illegible] in general. Special emphasis is on export oriented projects but not special terms. As in the case with Infonac, interest rate policy is not a tool used for influencing the investment pattern. CNI has followed the pattern set forth in the A.I.D. Loan Agreement and supported a wide variety of projects in agriculture and industry as indicated in Attachments A, B, and C. Local industries as a rule do not benefit from "high levels of protection" although duties and tariffs on imports are

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an important share of GON revenues. Furthermore, CNI has not tended toward support of import substitution type projects.

c) CNI does aim to help establish a securities market by appropriate stages. Recently, CNI's Board of Directors has authorized a mutual fund, as mentioned above.

d) CNI maintains a project supervision department which oversees all of its investments and loans. Technical and managerial services and advice is extended to all its accounts at no direct cost to the client. Emphasis is on regular supervision of the larger accounts and all projects that need assistance.

A major objective of A.I.D. has been to finance through the CNI a program of medium and long term loans and equity investments in the industrial and agricultural sectors as well as development type activity. The loan funds are mainly used to promote new enterprises, new jobs in private industry, export-minded industries and industries using indigenous raw materials. A.I.D. anticipated that funds channeled into these directions should promote economic growth through new production and exports.

e) As mentioned, a major goal of the CNI loans, as distinguished from the Infonac loans, is the creation of a private development bank not only to cause a contribution to Nicaraguan development through sub-lending but to become itself a vital part of the institutional structure of development.

Achievement of Goals.

a) The goals of the first CNI loan were met. Among the A.I.D. financed projects were eleven new industries having assets totalling $12,500,000. Several of these export products to the U.S. and elsewhere. The second A.I.D. loan is not moving as well as the first loan and, as in the case with Infonac, may reflect inadequate mobilization of local capital for carrying out new projects.

b) Substantial amounts of the second CNI loan (and the second Infonac loan) are still available and sub-commitments have been slower than

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under the first loan. Foreign capital appears to be plentiful for investment in equipment. A shortage has developed for working capital funds that may delay the sub-commitment of the A.I.D. loans. These changed circumstances would require a shift in the technical impact of new A.I.D. funds for sub-project financing at this time.

c) As mentioned, we felt that a private development bank should be created not only to further industrial development through sub-lending but as an essential part of the development machinery. This view has been in perfect accord with GON policies.

As to sub-projects, CNI has been given wide latitude in its choice of projects and investments within the development priorities of the GON. One original CNI project, for instance, financed the purchase of chicken and poultry equipment and has become a large exporter of eggs and consumer of domestic feed products. This project has furthered a GON priority for conversion of indigenous agricultural and other raw materials for export and consumption.

d) CNI already borrows heavily from foreign commercial banks (U.S.) for short term requirements. This activity is likely to continue and even increase. CNI should be able to obtain long term loans from the BID in the future. Such a development would improve CNI's operating results as some higher cost short term resources would be replaced by long term funds at lower cost.

e) CNI has operated very well within a development framework as an autonomous unit complementary to Infonac. We hope for increased initiative and accomplishment from CNI in the future but at this time we feel our goal to establish CNI has been achieved.

As indicated earlier and also in our report on Infonac, a shortage of funds for working capital has developed. As for new ICI's we suggested that the demand for industrial credit of all types, obtained from a more reliable forecast over several years, be a more important element in goal selection.

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2. Selection of Borrowers

In general, CNI finances manufacturing sub-projects as well as other sub projects important in the development and strengthening of the private sector. Specific criteria provided by the A.I.D. loans are: (a) promotion of private industrial development in Nicaragua with emphasis on new enterprise, new jobs, development of exports and use of Nicaraguan raw materials; and (b) prospect for repayment or, in the case of equity investment, earnings. These criteria have been set by agreement between A.I. D. and CNI. CNI must and does operate to earn profits. CNI has done so without inhibiting its overall goal. The distribution of those profits as dividends is limited by agreement to ten percent of paid-in capital.

CNI originates research and surveys for product financing and promotes project organization. In such cases CNI frequently becomes a lender and less frequently an equity holder. In other instances, CNI has brought new projects to the attention of investors to complete the financing. No special problems involving equipment salesmen have arisen.

USAID notes that reviews submitted in support of sub-lending and equity investment are reasonably good. Technical review is usually better than market analysis. Adequate market surveys are often hampered by lack of statistics and records and incapacity to apply modern techniques to obtain such data. Consequently, decisions often must be made where more comprehensive or specific findings would be desirable. CNI appears to have avoided the worse consequences from these circumstances. We would recommend for other ICI's at an earlier stage a heavy dose of technical assistance in the form of market analysis and even marketing techniques. These would be complementary to and should be provided along with the improved physical and technical processes financed under the sub-loan.

3. Management and Operational Policies

At the time both A.I.D. loans were approved we felt that the form of CNI's organization, its management and staff were strong, positive factors. Moreover, at the time of the second loan we reduced somewhat the degree of A.I.D. supervision over CNI and the requirement for reference to A.I.D. for prior approval. We are pleased with CNI's overall performance. This performance reflects some progress in the delegation of greater responsibility from CNI's Board to its management and credit committee, as we had envisioned in the CAP document (June 1966). The CNI Board exercises

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less day to day controls today and more reliance upon middle management is evident and producing results. The CNI Board is able to give more attention to growth, e.g. expansion into a new mutual fund, as aforementioned.

In one instance that we know of, a project became bogged down because management failed to protect it from poor contracting action. This situation has now been corrected and the project seems to be moving well and profitably.

Repayment experience has been satisfactory. We note that charge-off for bad debts have been low in the past. CNI also advises that delinquency ratios are low and they consider the condition of their loan portfolio quite good. We will have a chance to review the portfolio when the annual audit report is submitted in the near future. We also intend to be more interested than heretofore in the condition of CNI's sub-borrowers as to adequacy of working capital and the achievement of sub-borrower's objectives.

CNI does insist upon financial planning from its borrowers. As indicated in the previous paragraph, we will be interested to see if such planning has been adequate as revealed by a review of the sub-projects. We will also use our review of the sub-projects to assess the adequacy of CNI's technical and managerial assistance to the sub-borrowers under the A.I.D. Loan.

At the present time, our impression of management and operational policies is favorable. After the additional reviews, mentioned above, to be made after CNI's audit report is submitted, we will expect to prepare a report to be submitted to the Private Enterprise Division of LA/DR.

4. Specific A.I.D. Relationships

Annex I to the second Loan Agreement described the kind of lending and investment desired by A.I.D. and expected of CNI. This Annex also called for continuing consultation between CNI and USAID on investment priorities and objectives. Implementation Letter No.3 to that Loan Agreement (an identical letter was issued on the first loan) also discussed certain considerations which CNI should take into account for various kinds of loans. These documents are illustrative of the continuing nature of AID's relationship to CNI. Possibly because AID helped create CNI, possibly because it is a

private institution and not sensitive to questions of sovereignity, or maybe just because of the personalities involved, USAID and CNI enjoy a much closer relationship than Infonac and USAID. As a result, although the actual terms of the CNI Loan Agreements have proven workable, the A.I.D. contribution toward achieving desired impacts has grown more out of this continuing dialogue between CNI management and USAID management. It is interesting to note that the close relationship continues despite changes in USAID personnel and leadership. Furthermore, there is nothing patronizing about this relationship; CNI's president is a clever, experienced financier and a most useful source of information on local business and economic connections.

The only relevance of the two step procedure in the case of CNI was that it permitted the establishment of an appropiate cost of money to the institution.

The need for local currency, the fact that A.I.D. funds are tied and the pipeline are, of course, all related. As discussed in the airgram on Infonac, the tying of A.I.D. funds means that local costs and working capital must be mobilized to complement A.I.D. funds if the latter are to be used. At the moment there is apparently a shortage of local investment capital, or at least a marked reluctance to undertake new local investment. Given the condition of free exchange and free imports plus CNI's easy access to foreign lines of credit, it is doubtful that any use of A.I.D. funds for local cost financing could be justified. To attack both problems, pipeline and shortage of working capital, the Mission is currently discussing (in the context of the Annex and paragraph 4 of Implementation Letter No.3) with CNI possible increases in financing the importation of raw materials, spare parts, tools and light equipment. We would expect to see increased production and sales resulting from higher utilization of installed capacity. This activity would not require any relaxation of criteria or standards of analysis, in fact analysis for such sub-loans is usually more strict.

We have already discussed private or public institutions and the need for both in the previous airgram. This question should be related to what we have said in the introduction to both airgrams. Based on the Nicaraguan experience, in those cases where we are primarily interested in institutions and particularly interested in the long run development of capital market institutions, we would probably concentrate our assistance and attention on the private financiera or financieras.

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C. Overall Evaluation and Conclusions

The Mission feels that the two investments in CNI have paid off both in the creation of the institution and in the direction and effectiveness of most of its sub-lending activity. A review of the capital assistance papers indicates that we based our original decisions to support CNI on three considerations: the knowledge and experience of the top management; the evidence of successful mobilization of private investment capital, local and foreign, and the considerable support of CNI's activity, existing and potential, from local and foreign banks. From this Mission's experience these judgements as to management tend to assume more importance than routine analysis of financial projections. The economic considerations, particularly the need for expanding credit flows to industry were taken pretty much for granted.

It is interesting to note that less emphasis was placed on technical assistance to the private institution than to Infonac. None of the funds from the first loan were used by CNI to procure outside technical services and from the second loan no funds are available for technical assistance. Maybe CNI must be considered an exception in this respect, possibly because of the heavy representation of bankers on the Board of Directors.

Regular commercial borrowing has already become a possibility for CNI, in fact, it was a part of CNI's operations from the very beginning. Not all of this borrowing is short term, CNI reports some lines of credit for as long as five years. But commercial borrowing especially from abroad could become a dead end for a private financiera. The real need would seem to be the creation of further capital market institutions such as mutual funds, marketable securities, including possibly participation certificates of some kind, and finally a securities market. It is interesting to note that CNI management is already thinking along these lines.

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Attachments: As stated above

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NICARAGUA

INSTITUTO DE FOMENTO NACIONAL
(INFONAC)

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Mar. 14, 1

FROM - USAID/Nicaragua

SUBJECT - Spring Review on Intermediate Credit Institution (ICI's)
PE No.21 (Infonac)

REFERENCE - AIDTO CIRC A-25

I. Introduction

This airgram responds to the instruction contained in refair as far as assistance to the Nicaraguan Institute for National Development (Infonac) is concerned. A later and separate message will cover the Nicaraguan Investment Corporation (CNI).

The guidance contained in reference airgram is very complete. We feel, however, that one basic consideration or question may have been overlooked. We are sometimes interested in the institution, sometimes in the sector, sometimes in both. In Nicaragua we have examples of all three concerns:

a) We have made two loans to Corporacion Nicaragüense de Inversiones (CNI for industrial relending. In this case, we were mostly interested in the institution. Other devices or institutions for channelling, A.I.D. funds into industrial investment already existed and operated with a considerable efficiency. But we felt that the very existence of a private investment bank was a necessary part of our overall contribution to industrial development and the eventual creation of a capital market.

b) We have also made two loans for industrial investment to the Instituto de Fomento Nacional (Infonac). Although we have an interest in improving the institution, our primary interest has been in using it as a means to

Attachments to ARPC 3/18/69

PAGE 1 OF PAGES 11

DRAFTED BY	OFFICE	PHONE NO.	DATE	APPROVED BY:
CDO:PD Masseyjav	CDO		3/13/69	Director, Ragnar Arnesen

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channel A.I.D. funds to industrial development along with local funds. We have been primarily interested in the economic effect of the investment rather than building the institution.

c) We have made a loan, the Smali Enterprise Loan, to the National Bank where we are almost indifferent to the institution. In this case, we are most concerned that funds be available to small enterprises and our technical assistance, attached to the loan, is primarily designed to get guidance and advice to this group.

In summary, this Mission hopes that the Spring Review, in focussing on Intermediate Credit Institutions, will keep this distinction in mind. Whatever may be the nature or purpose of the ICI, industrial, business, agricultural, housing, cooperative, we are sometimes more interested in the sector than in the institution which acts merely as a conduit. We are sometimes more interested in the institution itself as a necessary part of the developmental machinery.

II. Description of the Project

A. Outline Project Information

1. Country: Nicaragua

2. Name of ICI: Instituto de Fomento Nacional (Infonac)

3. Class of ICI: Public X
   Private _____

4. Date established: January, 1954

5. Initial assistance from A.I.D. Development Loan No. 524-L-009, $4,000,000, December 23, 1964.

6. Infonac takes equity participations.

7. See Balance Sheet. Annex II, Page 9, Capital Assistance Paper, AID DLC/P-285 revised, September 24, 1964.

8. Subsequent Assistance from A.I.D.: October 23, 1967, $5,000,000 Development Loan No. 524-L-018.

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9. See Balance Sheet Attached.

Attached are copies of Infonac's balance sheet as of June 30, 1966 and December 31, 1968, the most recent available, The following are some comments on the recent balance sheet with some comparisons to 1966.

The capital structure is, of course, shown on the right hand side of the balance sheet where we note that Infonac has a debit-equity ratio of less than five to one, which would normally be considered quite conservative for a long established development bank. An examination of the debt confirms Infonac's role as a mobilizer of foreign capital, obligations in foreign currency are 138 million córdobas compared to local currency deposits and obligations in local currency of 82 millions. These figures should be compared with June 1966, when foreign obligations were much smaller than domestic obligations. The great increase in Infonac's lending activity over the past two and one half years has been financed virtually entirely by foreign loans.

Within this category, foreign obligations, we also note that seventy five percent of the debt is to foreign banks. The back up data we have seen indicates that 70 million cordobas of this 102 million cordobas represents debt to U.S. commercial banks which is either short or short-medium term. The rubric "other financial institutions" includes a little over $3,000,000 owed to AID under 524-L-009.

Capital and Resources show paid in capital of 53,504,000 cordobas. This is made up of 50,000,000 córdobas, original capital from the Government plus the Government contribution for 1957 called for by the AID Loan Agreement. The paid in capital should show an additional 3.5 million cordobas paid in during 1968. It so happened that this amount was not included in the regular 1968 GON Budget and was not paid in until early in 1969. It should show up in the March 31, 1969 balance sheet. By the end of 1969, there should be another contribution of the same amount and losses covered by the Government paid in Capital and reserves would then exceed 60,000,000 cordobas by the end of the year.

On the left side of the balance sheet note the three fold increase over the last two and one-half years of the loan portfolio and the similar increase in investment positions. We will at the time we receive the annual audited report, take a long look at how many of the loans outstanding are current and how much of the investment portfolio represents actual present value.

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10. Status of A.I.D. Loans as of December 31, 1968:

Loan	Committed	Disbursed
524-L-009	$4,000,000	$3,005,000
524-L-018	$1,300,000	$ 13,000

11. Interest rates:

Infonac borrows from many sources including A.I.D., IDB, CABEI and foreign commercial banks and foreign institutions. No meaningful average rate can be calculated. First A.I.D. loan was at 2%, second at 3½%.

Infonac lends at various rates, but the normal industrial rate is 9% per annum, plus a one percent commission plus one percent for inspection and supervision on some loans. A one percent commitment fee is charged on undisbursed balances.

The descriptive material on loan limits, formal criteria and numbers and types of loans requested on page 4 of the instruction is obtainable from the following documents which should be available in AID/W:

"Instituto de Fomento Nacional (Infonac) Loan Application to the Agency for International Development. Industrial Development Program".

Dated November, 1966 (Identified as Document A).

CAP - Infonac II dated June 1, 1967. (Identified as Document B). There is no maximum size loan. See Document B page 10-17 and Annex II for data on uses of loans.

The following is a summary of Infonac's loan portfolio at December 31, 1968, by term and economic sector (in millions of Córdobas):

	Savings Accts.	Agriculture	Cattle	Industrial	Totals
Short Term	1.1	28.2	--	29.1*	58.4
Medium Term	---	5.7	1.4	6.9	14.0
Long Term	---	34.9	1.8	66.1	102.8
Totals	1.1	68.8	3.2	102.1	175.2

* Includes 11.3 loans for export financing, up from 6.7 last year.

The short term portfolio has doubled from one year ago and largely accounts for the expansion of the total portfolio from ₡137,0 million a year ago. This reflects support to working capital needs in the agricultural and industrial areas, particularly for export financing.

The outstanding characteristic of the financial environment in which Infonac operates is the absence of any exchange or import controls. Moreover, Nicaragua has long enjoyed a good credit rating with U. S. institutions. Consequently, lines of credit from U. S. banks are easily available to the local commercial banks, to CNI, to the National Bank and to Infonac itself. This ready access to foreign capital is not an unmixed blessing. Nicaragua is facing increasing balance of payments difficulties and short term debt should be reduced.

Infonac is able to give slightly better terms to industrial borrowers than can any other institution but CNI. Nevertheless, the availability of credit from many sources clearly limits the role Infonac can play as a guide or control on the direction of industrial investment. It should also be noted here that CNI is not the only private financiera. The commercial Banco Nicaragüense has set up a subsidiary, Indesa, to provide long term financing, and another private group now interested in building, building materials, insurance and savings and loan company, is forming a financiera, at least partly, to finance its own operations.

A free savings and loan system exists which competes for individual savings against commercial banks, Infonac and the National Bank. A description and listing of Infonac functions is presented on page 1 of Document B. A more extended description is available from Document A, page 4-38. Also, AID/W may wish to refer to Document B, pages 18-20 for historical review of Infonac operations. At this point, it should suffice to point out that Infonac is not just a credit institution. Infonac also contributes to government planning. It is a technical industrial consulting firm doing feasibility studies, contracting for such studies and providing technical assistance. It is a management company actually running certain projects (bananas and tabacco) in which it has not been able to interest private investors. It is in competition with CNI as an investment bank, but it also complements the National Bank of Nicaragua and the Central Bank as part of the Government of Nicaragua's set of semi-autonomous institutions used as development tools.

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B. Evaluation on Specific Points

1) Goals

a) The emphasis in both loans to Infonac (009 and 018) was on channelling of A.I.D. funds through the institution, i.e. augmenting the supply of capital for industrial investment. We did include loan covenants calling for the government to meet annual losses, thus avoiding decapitalization, and to contribute $500,000 annually for five years to increase capitalization. The fact that Infonac accepts savings accounts is really irrelevant; its too small a part of its capital to be worthwhile. Other than its original capitalization and the annual contribution of the government, Infonac relies most heavily on foreign loans for its operating capital. On the liability side, 88 million cordobas out of 122 million cordobas was in debt to foreign banks at the end of 1967. About five sixths of the debt was for terms longer than one year. In essence Infonac is a mobilizer of foreign capital not domestic capital.

b) It is the intent of the project and the policy of Infonac to move capital into projects on the basis of priorities; with export capabilities given particular weight. However, interest rate policy is not the tool. Priority is given in the project analysis process with the decision to support or withhold support based on which priority goals the project supports.

The fact that industries supported (fishing, meat packing, lumber and wood products, chemical products) have been exported-oriented indicates particularly inefficient, protected industries have not been supported in the industrial area. Infonac's agricultural ventures into bananas and tobacco have not been particularly successful but those are also export oriented and no bias toward "protectionism" is evident.

c) The project does not aim at a securities market. The only bow in that direction is a loan covenant requiring Infonac to divest itself of equity positions acquired with A.I.D. loan funds within five years. The mechanism is unspecified.

d) Improvement of management has become a major aim of the project. The terms of the second loan differ materially from those of the first loan in this respect and Infonac has taken a particular interest in improving its own capability to serve customers with technical assistance. The fees charged certain borrowers are designed to recover a part of such costs. However, the prime

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concern of the project has been the efficient allocation of capital rather than improved efficiency of use. The latter is considered a by-product of the former. Out of this concept flowed the insistence on improvements to Infonac's project analysis staff as a condition to the second loan. Infonac has acquired, with loan proceeds, technical assistance in staff training and in improved selection, analysis and supervision of projects. This technical assistance is apparently being well used.

c) See Introduction of this report.

Achievement of Goals:

a) The goals of the first loan were substantially met. We were interested in new industrial investment and we got it. By the time the second loan was prepared, we had developed some institutional goals for Infonac, primarily more efficient overall operation. The second loan is moving slowly as far as sub-commitment is concerned although another $1 million sub-loan is in the offing. This may be a result of a general economic slowdown but it may also reflect a failure to mobilize local capital in sufficient amount to create a demand for additional foreign capital. After all our second loan is one hundred percent tied to U.S. procurement and hence, only complementary to local capital.

b) The Mission believes that availability of foreign capital for investment in fixed equipment is no longer a major constraint on industrial development. There seems to be an acute shortage of working capital for industry, both for inventory of domestic and foreign origin, and for payroll and other operating costs. Many industrialists comment that industry is seriously under capitalized, a factor which makes the working capital problem "snow ball".

c) The Government of Nicaragua believes that development priority should be on conversion of indigenous agricultural and other raw materials for export and consumption, on improving the efficiency of agricultural production and the conditions of rural life. Industrial development is considered as supporting those goals. Hence, one priority consideration is how a given industrial venture might support agriculture (insecticide plant) or process an agricultural product (sesame seed de-husking plant). We have tended to agree in part with the Government on this strategy and both our past allocation of funds and the terms of the various loan agreements would support this view.

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d) Infonac already has loans from IBRD, IDB and commercial banks. Suppliers credits are already used exclusively for industrial investment but not through Infonac. Nicaragua's level of short and medium term debt is becoming a problem and more, rather than less, reliance should probably be placed on Infonac as an mobilizer and allocator of long term credit from international institutions including such as the German Reconstruction Bank (KFW).

e) We would suggest that the demand for industrial credit, predicted as reliably as possible over several years, should be a more important element in decisions on goal selection. We would insist on more technical assistance to the institution on project development and analysis and on giving management guidance to sub-borrowers if we were starting over.

2) Selection of Borrowers

As far as Infonac's lending from A.I.D. loan project funds is concerned the formal and actual criteria are: (a) contribution to industrial development with preference to export and use of domestic raw materials; and (b) reasonable prospect of repayment. These is little tendency toward great risk-taking in this part of Infonac's program. These criteria have been determined primarily by Infonac itself with Government and A.I.D. consent. As already noted Infonac conducts research, surveys and studies and has tried to stimulate investment based on such studies. In some cases the study has resulted in a direct Infonac activity. The "equipment peddler" problem hasn't come up.

The Infonac reviews submitted to A.I.D. in support of sub-loan approvals have generally been technically acceptable. Financial projections have sometimes rested on shaky market surveys but that is to be expected. How effectively reviews are applied is a management question and discussed below; in essence, too centralized management lends to vitiate the usefulness of technical studies. The advisor to Infonac on project analysis has prepared a number of reports on this subject and his recommendations are in the direction of more responsibility being given to project managers and project committees at all levels of project analysis, approval, and supervision. Infonac has already taken steps to put some of these recommendations into effect, especially those in the area of tighter project supervision.

3) Management and Operational Policies

The form of managerial organization of Infonac is appropiate. Both A.I.D. and IDB in recent loan agreements or negotiations have sought improvements in

managerial effectiveness. We have seen the need for improved staff training (a prerequisite to effective delegation of authority), tighter financial controls including improvement of Controller functions and information methods and, as noted above, improved capabilities in project management. Not that Infonac is particularly weak in these areas as compared to other institutions; these are the endemic weaknesses of credit institutions in developing countries.

Repayment experience on industrial loans has been satisfactory, some industrial investments have not yet shown a profit and we await with interest an audited year end financial report for 1968 which is due at the end of April. Safeguards against untoward events are not adequate and this is reflected in the fact that Infonac has not insisted on adequate financial planning by sub-borrowers and all are reported chronically short on working capital.

On the other hand both Infonac's and A.I.D.'s insistence on "security" and probability of repayment may be inhibiting investment. It is hard to see how a truly "new" investment could get support. This relates to "who gets the money". In many cases it is a new firm with old ideas, including firms with a U.S. interest. The U.S. interest is welcomed in Nicaragua as an assurance of good management and of a previous good study of market and other factors favoring the investment. In such cases, the U. S. partner provides the "know-how". A more risk minded institution would certainly have to provide much more technical assistance. Infonac is not profitable. But its industrial lending operations taken alone probably are. The fact the government makes up losses may be "fair", i.e. the institution is engaged in non-banking activities at government insistence. However, the fact that Infonac does not break even might indicate a missallocation of resources on certain experimental projects and probably would indicate, in such cases, misallocation of the scarcest resource, management talent.

4) Specific A.I.D. Relationships

A.I.D. has used the process of loan negotiations and the loan agreement itself as the major instruments to contribute toward both our own goals, and the borrowers goals in the industrial investment area. Loan covenants on loans, interest rates, terms etc. have been written to achieve a certain kind of program and we have generally gotten what we expected. We have been disappointed in the development of a pipeline of unused A.I.D. money. Since Infonac is a government agency supposedly prepared to take risks we probably should have written less restrictive covenants and urged a more liberal policy. The two step procedure is almost irrelevant, the rate spread as between government and institution is minimal.

Neither tied-procurement nor the need for local cost financing should be related to the pipeline but as a matter of fact they are. Neither the institution nor its individual investors have enough capital to permit A.I.D. assistance to be limited to providing the U.S. equipment and occasionally some raw materials. However, it may be significant to note at this point that the private financiera, moved by profit as are its borrowers, does not seem to have either the pipeline problems nor the local capital problems which the government institution has. A.I.D. assistance to Infonac has not been determining. Without A.I.D. Infonac would exist and be doing just about what it is now doing but with less money and without the guaranteed capitalization support from Government which is required by our second loan. Without A.I.D. there would be no private financiera, CNI just wouldn't exist. It was necessary to create CNI, to have made CNI the sole channel for A.I.D. industrial investment funds would have been a mistake, if only for public relations reasons. So assistance to both was necessary, has been effective in the main, and there is certainly room for both.

C. Overall Evaluation and Conclusions

The Mission feels that its loan program to the industrial credit institutions has been a success. We have some concern over the slowness with which the second Infonac loan is moving but the first loan did move into the kind of industrial investment we had hoped for and Infonac is proving a fairly efficient channel for investment of foreign capital, ours and others. We will cover CNI in a separate message but at this point we are quite pleased with overall CNI performance; it is a profitable, professionally run organization bringing intelligence and imagination to problems not only of industrial investment but of capital accumulation and investment as a whole. The following is stated within that context.

We would probably accept that tariff policy determines the nature of industrial investment and development for more than all the credit mechanisms we can devise. Given an acceptable tariff policy we should probably use expected profitability as the major criterion in making sub-loans. This is not as easy as it sounds. The ICI needs special skills in accounting, industrial engineering, marketing and management before it can arrive at sound decisions on likely profitability. For these reasons every loan to an ICI should contain a big dose of technical assistance, part of it, grant funded. Infonac was our only choice for a government institution for industrial lending in Nicaragua but it is too big, too diffuse and too political. Consequently our influence on its management is limited. In a similar situation in another country we would recommend putting more emphasis on the private financiera or even on several financieras in a large enough country. But, we would still have to channel

some portion of A.I.D. investment funds through the public institution. In other words, we might seek a change in the public-private mix.

Interest rates to sub-borrowers should probably be a function of procurement tying but the tendency should be to keep the interest rate on A.I.D. loan money a little below the "going" rate as an enticement to local private capital. For the moment, at least, we would not recommend any further A.I.D. development loans to either Infonac or CNI for industrial relending for capital equipment. This by no means precludes the possibility of development lending in the industrial field for some form of capital expansion designed to improve the productivity of existing plant. In such lending both CNI and Infonac might be involved but probably so would commercial banks and the other embryo financieras.

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Attachments: As stated above.

PANAMA

DESARROLLO INDUSTRIAL, S.A.
(DISA)

A. Description of the Project

1. Country: Panama

2. Name of ICI: Desarrollo Industrial, S.A. (DISA)

3. Class of ICI: Private

4. Date Established: 4/19/63

5. Initial Assistance from A.I.D.: Date: 12/23/63

Amount: $5,100,000

Kind: Dollar Loan

6. Does the ICI Take Equity Participation? Yes

7. Capital Structure of the ICI as of the DatesSpecified in 5 Above: $1,000,000 suscribed.

8. Subsequent Assistance from A.I.D.: Date: 10/19/66

Amount: $4,000,000

Kind: Dollar Loan

9. Capital Structure of the ICI at End of Latest Fiscal Year:

Paid In Capital: $2,007,194

Surplus: 263,003

Total: $2,270,197 as of June 30, 19

10. Status of A.I.D. Dollar Loans as of July 1, 1968: Committed: $7,100,000.00

Disbursed: $6,250,540.53

11. Interest Rates: Average Rate(s) paid by ICI 2% & 3%.

Average Rate(s) charged by ICI: 7% from inception to 11/1/68, 7% plus 1% service fee thereafter, i.e. 8% yield.

No differential rates between borrowers.

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12. Limits on Size or Uses of Loan: No limit on size with condition A.I.D. approval be obtained on sub-loans in excess of $50,000 (raised to $200,000 on second loan). Use of initial drawdown on second loan fully tied to U.S. procurement with condition A.I.D. approval be obtained on sub-loans made to directors, officers, members of their families, and principal shareholders. The latter is defined as an individual owning or controlling 5% or more of the common shares outstanding.

Formal Criteria, If Any. Sub-Loans made with A.I.D. funds to be for a term of not less than two or more than fifteen years with grace period not to exceed the three years. The debt-equity ratio of sub loans not to exceed 70-30 without A.I.D. approval. No refinancing or equity participation without prior A.I.D. approval.

Description, to the extent it is revelant, of the financial environment in which ICI operates. Its relation to the financial community and commercial banks. How important it is as a supplier of this type of credit relative together services (including supplier's credits). The overall reputation of the ICI in the country, etc. Due to a variety of factors such as geographical location, dollar currency and unrestricted flow, favorable banking legislation and tax treatment, particularly on earnings from abroad, etc., a large number of foreign banks are operating in Panama including three major U.S. houses (Chase, FNCB and Bank of America). Certain banks have been formed solely for external lending. In total, about $40 millions annually are so lent. The bulk of domestic lending is for the commercial sector. The ICI was created with the objective of partially filling the gap that existed in long term financing of fixed assets for industrial expansion. There is evidence that this has had a salutory effect on commercial banks who have tended to stretch their terms somewhat to accommodate this competition.

Both Chase and FNCB are ICI shareholders. With the exception of one project consortium financing arrangement with Chase, the ICI has not maintained close relationship with the commercial banking community nor attempted to negotiate joint project financing. From time to time there has been some criticism of certain project loans of the ICI which were claimed to have been commercially bankable and, by inference, not development loans.

There is no demand for supplier's credits in Panama but ample latitude for guaranties, underwriting, leasing, and other forms of development financing. In the absence of securities exchange legislation and an organized stock market, the lack of liquidity is a major inhibition to both equity participations and underwritings.

The ICI reputation appears good in the Panama City - Colon area. It is not as well known in the provincial cities and needs to improve its image outside the two major metropoles.

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B. Evaluation of Specific Points

1. Goals

(a) Emphasis on Mobilization of Additional Capital:

From the Government: None

From Private Ownership in ICI: The Loan Agreement restricts any individual or business entity from owning more than 5% of ICI stock (to encourage a broad base of ownership). As of January 12, 1967, there were 265 stockholders of record, 82% individuals, 13% corporations, and 5% finance institutions (banks, insurance companies, etc.). Of the 400,000 common shares authorized, 200,884 had been subscribed as of June 30, 1968. Shares have a nominal value of $10.00 and a book value of $11.50 as of January 12, 1967 with 199,116 shares available for public subscription.

Number of Loans and Classification (as of June 30, 1968):

	LOANS		
	Number	Amount	% Total
Total	114	8,969,729	100.00
Fishing, canning & processing shrimp	9	298,862	3.33
Canning & processing fruits & vegetables	2	205,822	2.29
Manufacture of flour & bakery products	5	1,285,000	14.33
Rice mills	6	126,722	1.41
Milk products	1	60,842	0.68
Processing of cocoa, chocolate, & candy	1	7,000	0.08
Processing of beverages, non-alcoholic	3	1,206,000	13.45
Processing of animal feed	3	91,000	1.01
Manufacture of clothing	17	441,245	4.92
Manufacture of shoes	2	122,290	1.36
Lumber mills	8	152,434	1.70
Manufacture of furniture	1	8,700	0.10
Paper & paper products	6	1,096,246	12.22
Printing & graphic arts	5	529,750	5.91
Manufacture of leather articles	1	3,000	0.03
Manufacture of rubber products	3	143,000	1.59
Processing of chemicals	4	249,000	2.78
Manufacture of plastic articles	3	575,000	6.41
Processing of petroleum derivatives	1	30,000	0.33
Manufacture of non-metallic mineral products	10	1,115,722	12.44
Basic metal industries, non-ferrous	4	440,572	4.91
Manufacture of metal articles	7	278,514	3.11
Repair shops	3	14,000	0.16
Extraction & analysis of stone, clay, earth	3	50,500	0.56
Electric power	3	380,000	4.24
Industrial services	2	28,500	0.32
Miscellaneous	1	30,000	0.33

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Relative emphasis on local currency vs. foreign exchange: This is not applicable to Panama which is part of the dollar bloc and its foreign exchange is basically the money in circulation. The use of second A.I.D. loan, however, is 100% tied to U.S. procurement.

(b) Is the increase in the supply of investment funds for industry in general or to supply additional funds on especially favorable terms for special high priority uses? For industry in general with the intent of filling the longer term fixed investment financing gap. About 65% of commercial bank lending in Panama is absorbed by the commercial sector and around 8% by industrial borrowers. Three year term is in the maximum range although good customers are sometimes extended a refinanciable balloon note in order to stretch term.

How do interest rates compare with those available from other sources, i.e. how is interest rate policy used to try to influence the pattern of investment and what effect does it actually have? The question does not go so much to rate of interest as to yield. Panama has a legal relending interest rate of 7% (currently equal to the New York prime rate). DISA offers more favorable cost of money in that 7% simple interest is applied plus a 1% service charge, providing an 8% yield. Commercial banks employ a range of devices such as either flat or on discount interest rate, commitment fees, service charges, inspection charges, rollover fees, etc. (depending upon theoverall profitability or bargaining strength of the client) with a resultant higher yield. This has had a negative impact in that it is believed certain of the ICI's loans in the three year term range could have been financed by commercial banks albiet at a higher money cost.

Is any consideration given to the comparative advantage of industry, or specific industries, or are high levels of protection and "inefficiency" by international standards accepted? The ICI has not employed criteria or national economic profitability for loan application submissions to a desirable extent although an attempt is made to measure value added. Panama's industrial base is largely import substitution oriented, sheltered from external competition by a system of import quota restrictions, and places heavy reliance on supply and quality of imported goods for intermediate production use. The rationale is based on market dimension. Panamanian industrial investment has not importantly stimulated growth in agriculture, forestry, or fisheries (except for shrimp, fishmeal, and fish oil).

(c) Does the project aim at helping to get a securities market started? This objective was considered by A.I.D. and ICI. As ICI is permitted to participate in equity, it presumably could perform underwriting functions as well.

(d) Does the project aim at improving technical, managerial and financial practices of borrowing firms? In general, what stress is placed on increasing the efficiency of use of capital? This is implied in ICI's application requirements, i.e. an acceptable feasibility study on new industry starts, historical financial performance on expansions, and projected sales, P & L's, cash flow, balance sheet etc. on both. The efficiency in the use of capital, while obviously varying from firm to firm, is probably best demonstrated by the employment lag in the sector as a whole.

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Achievement of Goals

(a) How effectively has the project met (or is meeting) these goals? How much of the local credit is truly additive and how much is simply a diversion of savings from other uses of lower/higher priority? The project has generally met the goals as originally envisaged. Major deficiency has been the lack of an aggressive promotional posture and utilization of a more imaginative range of development financing techniques. Except for the capital subscribed locally from commercial banks, the bulk of the credit is presumed to be additive.

(b) Have developments called for a shift in choice of, or emphasis among, the goals? A shift is being sought in lending policy of the ICI to promote and finance projects that contribute to development of Panama's resource base, particularly agri-business, and industrial growth of interior cities. Within this context a heavier portfolio weight in loans of $50,000 or less and consortium financing with commercial banks is being encouraged.

(c) To what extent do A.I.D.'s views of the appropriate development strategy and the role of ICI's in it accord with the Host Country policies, and what priority do we give to ICI's in light of this? A distinction must be made here between stated policies and administration of policy. GOP development policy, as enunciated in the Industrial Incentive Legislation (Law No. 25), stipulates considerations of national economic profitability for contract awards. In administrative practice, this largely has been ignored in the past. As such, ICI's portfolio generally represents a fair cross section of GOP's industrial development strategy. We are encouraging revision of GOP industrial investment incentive policy and view ICI's role as one promotional tool in making such changes effective.

(d) What are the prospects for meeting these goals now from alternative sources of funding? Assuming Loan Agreement conditions will be satisfied, ICI has $2 million A.I.D. loan funds to be made available for commitment. Projections indicate that thereafter non-concessionary borrowings can be accommodated with a two point relending spread. Use of guaranties is being encouraged as well as other revenue generating techniques such as underwriting, leasing, etc. There is no current market in Panama for supplier's credits.

(e) What guidance does your project provide for new projects in their choice of goals? Would you do it differently if starting over? One of the goals sought by A.I.D. in the second ICI loan was an increase in the legal interest rate of Panama above 7% with disbursement of $2 of the $4 million contingent upon such legislation. The wisdom of this condition is questionable as ICI alone could exert no such leverage on GOP and commercial banking system was apathetic to any change that might open current banking legislation to review in depth.

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A second objective desired by A.I.D. was broad representation of industrial community on ICI Board of Directors resulting in twenty-two members, eleven Directors and eleven alternates. This group represents upwards of 60% of industrial investment in Panama and as such the principal industrial borrowers. As a result, a substantial, but less than 50% of ICI's lending has been related to individuals having direct or indirect relationships with ICI, creating an illusion of favoritism and certain frictions that would have been avoided by a numerically smaller Board.

Another objective encouraged by A.I.D. was a broad base of ICI ownership. To stimulate the sale of common shares to small investors a 7% dividend was paid in the 1968 fiscal year. This practice has, and will, dilute the amount of earnings retained as surplus. In retrospect, it probably would have been better to have issued smaller investors 7% preferred, convertible to common, with the larger initial subscribers holding the common shares for capital appreciation rather than short term dividend earnings.

2. Selection of Borrowers

(a) What economic criteria are employed? Are the formal criteria and the actual ones the same? No formal economic criteria are employed in the selection of borrowers.

(b) Are research, surveys and/or promotional work undertaken to stimulate borrowing for a particular purpose or does the ICI simply process applications submitted to it? With limited exceptions the ICI simply processes applications submitted to it.

Is there a problem of equipment salesmen and other promoters stimulating the wrong kind of application? Not to our knowledge.

(c) Are the technical and financial criteria and reviews appropriate? Effectively applied? Yes.

(d) What changes are appropriate at this stage or would you recommend for other ICI's at an earlier stage. As mentioned previously, we are encouraging a more aggressive promotional posture and directed lending for the ICI in the future.

3. Management and Operational Policies.

(a) Is the form of managerial organization appropriate and effective? What lessons are there on methods of selection of managerial personnel?

From inception until September of 1968 the Manager was a capable economist performing most of the analysis and evaluation with the assistance of a small technical staff. His major deficiency was his disinclination towards active promotion. He has been succeeded by an individual of promotional capability with neither prior banking nor economic training. It is premature to judge the merit of the change. To date the organization structure has been appropriate for its volume of transactions.

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(b) Are safeguards against untoward events - that prejudice the effectiveness of loans - adequate, and is repayment experience satisfactory? Yes. ICI loan security has probably been somewhat more conservative than many would deem desirable in development banking where a certain element of risk taking is implied. On the other side of the coin, the obligations to shareholders and for A.I.D. loan repayment tend to militate against a bolder policy.

(c) Is the balance between security on loans and stimulating of new activities satisfactory, etc.? As mentioned above, the weight is on security after other conditions have been satisfied.

(d) Is assistance on technical and managerial problems to borrower necessary? Available? Effective? In general such assistance is not necessary as most establishments depend heavily on imported technology. Several borrowers have utilized the services of the International Executive Service Corps but not specifically in relation to problems of debt servicing. Several competent management engineering firms offer consulting services in Panama and are generally considered effective. ICI does not directly participate in arranging or directing such services.

(e) Who gets the money? Established or new firms? Approximately 70% of loans are for industrial expansion and 30% for new starts.

Do loans on especially favorable terms "free" borrowers own funds for lower priority uses? In general, no. The industrial community as a whole is fairly tight on liquid assets.

Is there a satisfactory institutional solution to the conflict-of-interest problems when Officer's want to be borrowers? This has been touched on in paragraph (e) Achievement of Goals. The loan agreement provides for A.I.D. review of all loans made to Officers, Directors, members of their families, and principal shareholders. However, no criteria are established for rejection and none have been rejected to date. In this context it should also be pointed out that there is considerable variance between latin and anglo-american moral concepts of conflict-of-interest.

(f) Is the institution profitable? To what extent does the answer reflect its overall effectiveness? The ICI had a net profit of $136,393 in 1967 and $204,578 in 1968 and earned surplus of $151,322 and $263,003 at the end of the respective fiscal years. In relation to the volume of business conducted, we feel this is a reflection of conservative management.

4! Specific A.I.D. Relationships.

(a) How has A.I.D. contributed, where relevant, in each of the areas noted above? How can and should that contribution be improved? The first A.I.D. loan had a $100,000 component for technical assistance to the ICI. Approximately 50% of this was so expended after which management considered itself capable to conduct future ICI affairs. At the present time we consider ICI needs strengthening in internal controls and flow of pertinent information to management' assistance for which is being arranged.

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(b) Have the terms of the Loan Agreement been suitable for achieving the desired impact? If not, how could they be improved for other loans? Certain of the impacts now sought were not visualized at the time the loans were made. Were the Loan Agreements to be negotiated today we would address ourselves more specifically to average size and term of sub-loans, types of qualifying industries, and geographic distribution of ICI resources. We would also consider the advisability of stretching both grace period and loan repayment schedule of ICI over somewhat longer periods.

(c) Has the two-step procedure worked satisfactorily? Could it be improved? The Executive Branch of the GOP desired to execute the two-step procedure but the Legislature failed to enact the necessary authorization. The system possibly could be improved if flexibility in compliance dates could be granted to accommodate contingencies of this nature.

(d) Are there ways of reducing the problems inherent in tied-procurement requirements? How do these affect the pipeline? Overall operations? Tied procurement per se has not been a problem for the ICI in Panama where the market has been favorable traditionally towards procurement of U.S. machinery and tools. No major pipeline problem has existed. It is understood operations problems have related more to inhibitions arising from economy of scale as many U.S. processes and machine tools of minimum dimension cannot reasonably be amortized against Panamanian production requirements.

(e) Is the relation between A.I.D. loans and A.I.D. technical assistance satisfactory to the ICI's and to us? If not, how should it be changed? As mentioned previously, only one-half of the $100,000 loan component for technical assistance was utilized for U.S. contractor guidance and training during the start-up period. Historically this appeared to have been satisfactory to both the ICI and A.I.D.. From a psychological viewpoint it probably would have been better had the remaining $50,000 been limited to future technical assistance needs by the Loan Agreement rather than disbursed in sub-loans.

One flaw in A.I.D. technical assistance has been the past lack of a close working relationship between the A.I.D. assisted Panamanian Development Institute (InPaDe/CDPI) and the ICI in project identification and promotion. Appropriate steps are being taken to effect a closer union of interests between the two institutions. A pilot program in supervised industrial credit has been managed by InPaDe/CDPI with an initial fund of $20,000 made up of matching contributions by A.I.D. and the ICI. This program gives promise of the possibility of increasing cooperation between the ICI and InPaDe/CDPI in providing financing for smaller enterprises.

(f) How can the pipeline be shortened? What local gains would there be from more rapid use of funds? What sacrifices, if any, would have to be made in the process of screening and application of criteria to move the sub-loans faster? Would it be worth it? Our opinion is that the ICI has demonstrated a reasonable balance between prudence and speed in the processing of applications. Obviously there are case-by-case variances that relate to the

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thoroughness of application preparation, prior experience with, and knowledge of, the borrower, and inherent evaluation differences between an expansion loan and a new industry start. As we anticipate a larger percentage of new lending to be in agri-businesses where comprehensive market analysis will be a key factor in loan decisions, we doubt that it would be wise to encourage accelerated application processing.

(g) Where relevant, what has been the relative influence of A.I.D. assistance to public vs. private ICI's? Can both be useful in the same country? This is not revelant in Panama as far as A.I.D. is concerned. I.D.B. made a $1 million loan to the Banco Nacional (government bank) for industrial lending. The results of the 42 sub-loans made from this fund are now being studied by an I.D.B. Industrial Economist. Preliminary information indicates that performance has been inferior to the private I.C.I.

C. Overall Evaluation and Conclusions

In relation to theother ICI's of the area of which we have knowledge, we would rate the performance of the Panama I.C.I. as good. To be very good or excellent will require the adoption of a range of more imaginative financing techniques, assumption of a more aggressive promotional posture, and concentration on developing projects that contribute to the growth of commercial agriculture, forestry, fisheries, and foreign exchange earnings. A new lending policy supporting these aims is now in preparation by the Board of Directors of the ICI.

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ETHIOPIA

ETHIOPIAN INVESTMENT CORPORATION
(EIG)

UNCLASSIFIED

TO: AID/W TOAID A-125

FROM: Addis Ababa

SUBJECT: Spring Review on Intermediate Credit Institutions (ICI's)

In compliance with the referenced airgram, the Mission submits herewith the requested report on the Ethiopian Investment Corporation (EIC) which is one of the two Intermediate Credit Institutions in Ethiopia to which AID has made loans. The report on the Development Bank of Ethiopia, which is the second of these institutions, will be forwarded as soon as possible.

A. Description of the Project - AID Loan No. 663-H-012

1. Country - Ethiopia

2. Name of ICI-Ethiopian Investment Corporation S.C. (E.I.C.)

3. Class of ICI - This is a Public Corporation with practically all the shares held by the Ministry of Finance, Imperial Ethiopian Government.

4. Date Established - September 2, 1963

5. Initial Assistance from AID - None

6. Does the ICI take equity participation - Yes

7. Capital structure of the ICI as of the date specified in 5 above - Not applicable

8. Subsequent assistance from AID

Date	Amount US$	Kind
August 17, 1967 (effective only June 25, 1968 after parliamentary ratification & conditions fulfilled)	8,000,000	Loan

9. Capital structure of ICI at end of latest fiscal year - The capital structure of the Ethiopian Investment Corporation SC

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as of July 7, 1968 is as follows:

Authorized & Registered:

350,000 shares of Eth $100 each 35,000,000

Issued & fully Paid:

269,335 at $100 each	$26,933,500
Legal Reserve	31,388
General Reserve	500,000
Profit and Loss A/C	96,375
	$27,561,263

US/AID Credit $8,000,000-E$20,000,000
Less undrawn amount - - do -

Long-term obligation (more than 1 year)	$ 2,876,156
Guarantees Acceptance & L/C issued	7,406,430
Loans from Bankers	---
Other Creditors	2,198,183
Total	Eth$40,042,032

10. Status of AID $ Loan as of July 1, 1968 (Available only from April 22, 1968)

$Committed	$Disbursed
US $713,000	None

(Jan. 31, 1969 - Committed US $3,441,481)

11. Interest Rates: Rates paid by ICI (EIC) - 3% per annum at 30 days notice (other creditors above)
- 4% per annum on USAID loan
- 5-6% per annum on long term liabilities (above) according to maturity.

Rates charged by ICI - 7% to 8½% per annum

AID Loan is granted to the Imperial Ethiopian Government on a 40 year term with 10 year's grace. The interest rate is 1% during the grace period and 2½% thereafter. The EIC undertook to pay the loan to the government in 20 years including 5 years of grace at 4% interest.

Narrative Description

The Ethiopian Investment Corporation during its few years of existance under able management has grown rapidly and has been of paramount importance in encouraging participation of private enterprises in development projects. Considering the limited resources at its disposal, EIC's contribution in mobilizing savings and for placement of investment in industry, large scale agriculture and other productive activities has been commendable. Though a public enterprise, it operates like any business corporation guided by sound business principles.

In order to alleviate, at least partially, the unlimited demand for local and foreign resources, AID granted a loan for US$8,000,000 based on detailed participation and feasibility studies. The purpose, terms and conditions are outlined in the loan agreement, application and pertinent implementation letters.

The loan is designed to assist in financing foreign as well as local costs, the latter not to exceed a maxium of US$2,000,000. Though the loan because operative only a few months ago, indications are that it will definitely have a greater impact on the economy than most other loans or grants offered to Ethiopia.

Outstanding Loans as of July 1968 (in Eth. $ 000)

	Eth.$	Approximate U.S. Equivalent US$1.00= Eth. $2.50
Plantation	3,750.0	1,500.00
Farm		
Coffee	218.0	87.20
Dairy	251.5	100.60
General	1,583.7	633.48
Industry		
Boot Shoe	195.2	78.08
Bottling	-	-
Cement, Brick & Tile	149.1	59.64
Coffee Processing	3,784.4	1,513.76
Film	13.1	5.24
Flour Mills, Bakery	375.9	150.36
Meat	94.3	37.72
Oil Extraction	554.3	221.72
Metal	262.3	104.92
Spice Extraction	125.0	50.00
Paper	1,013.8	405.52
Textiles	2,362.7	945.08
Wood	411.3	164.52
Tannery	89.5	35.80
Others	36.4	14.56

	Eth.$	Approximate U.S. Equivalent US$1.00= Eth. $2.50
Transportation		
Shipping	-	-
Road	316.4	126.56
Hotel and Bars	135.4	54.16
Wholesale Business	-	-
Retail Business	-	-
Other Business	318.3	127.32
TOTAL	16,040.6	6,416.24

Financial Environment

The rate of increase in supply of money is not yet fully in acord with the expected expansion in industry and agriculture. Perhaps faster expansion of the money supply may alleviate credit shortage and stimulate growth of the economy.

On the other hand the strong monetary policy and banking laws make the possibility of inflation remote. Short-term business loans and overdrafts are obtained on reasonable terms from the Commercial Bank which is the largest bank in the country. There are also other small Commercial Banks and another intermediary financial institution, the Development Bank of Ethiopia. The maximum interest rate of the banks is 9%. However, the unofficial market rate for money between merchants varies from 1 to 2% per month or 12 to 24% per annum.

Function of E.I.C.

In its first year of operation, the Ethiopian Investment Corporation went through the usual stage of formation which was rather unsatisfactory. However, since 1965 under new management and with competent personnel heading the two main departments of Accounting and Investment, the Corporation showed immediate improvement and has stimulated great confidence within the country as well as outside the country. The function of the Ethiopian Investment Corporation has been detailed and transmitted to all concerned in connection with the loan agreement. Briefly, its objective is mobilization of investment of all available funds in profitable development projects. The Corporation acts as an active investor seeking, on the one hand, individuals or organizations capable of managing productive enterprises, and, on the other hand, appropriate sources of funds for investment either directly or through the Corporation.

B. Evaluation on Specific Points

1. Goals

Description

(a.) It is difficult to quantify the rate of capital formation. However, great emphasis is placed in the Third Five Year Plan of Ethiopia on the mobilization of additional capital from the government, private and foreign resources. Though no reliable statistic are available, Ethiopians have a high propensity for saving and investment. True savings of individuals are difficult to estimate because they do not go through financial institutions, but directly into house building and other such uses.

Local capital formation is still not sufficient to achieve the planned development program. Thus foreign resources are most important not only for financing machinery and equipment but also for helping the mobilization of local capital. Intermediary financial institutions are needed in order to give local loans which in turn will encourage reinvestment of profit by existing enterprises (including those in non-Ethiopian ownership) and encourage participation of new investors in new projects or extensions of existing projects.

(b.) The aim, at present, is to increase the supply of investment funds for profitable development projects envisaged in the Third Five Year Plan, i.e. industry, agriculture, mining, transport, etc. Interest rates are established according to the cost of funds to E.I.C. which aims at a margin of 2% for reserves and expenses. Interest rates are not set to influence the pattern of investment; the main factor considered is the earning capacity of a development project over the shortest period possible. At this stage it is felt that concentration on profitable operations meets the needs of the economy and of E.I.C. Infra-structural investment is not within the field of E.I.C. and has been adequately financed directly by AID and from other sources.

Not all of E.I.C.'s existing investments are viable without artifical protection but inefficiency is not readily tolerated and, of current projects, none are yet known to be at a material comparative disadvantage. High transport costs between the coast and Addis Ababa give distinct advantage to consumer-oriented interests with local raw material content (e.g. Glass) and to export processing industries increasing the value/volume proportion of the product (e.g. Spice extraction).

(c.) E.I.C. now has a share dealing group which meets every Tuesday morning. Business is rather lax but the security market will gradually develop. E.I.C. also buys and sells shares over the counter. They are pioneers in this field and continue to work towards developing an active security market. Many holdings (transferred from Government's direct portfolio) are not marketable because they are long-term projects which will take time before dividends are generated to make the sale of share attractive to the public.

E.I.C. makes a feature of buying as well as selling, with long term object of developing an orderly market permitting eventual excesses of market sales over market purchases to raise funds for new projects.

(d) The Ethiopian Investment Corporation, in granting loans, ascertains whether there is an organization capable of undertaking the projects and in suitable cases takes the initiative in creating such an organization. The Ethiopian Investment Corporation also assists its associate companies in management and accounting on a fee basis and takes equity position where appropriate. Ethiopian Investment Corporation requires appointments to the boards of the companies, as corporate director, where its investment is large, in order to follow the activity and progress of the project.

(e) Other Goals - Covered above

2. Achievement of Goals

(a) Though it is too early to judge the effectiveness of the loan, it can safely be said that the impact of this $8,000,000 will have a far reaching effect on the planned goals of the Corporation in encouraging and promoting investment in profitable development projects.

(b) At present, no major shift of emphasis of choice in goals is necessary.

(c) As pointed out above, the EIC (ICI), though a public corporation, is managed like a business concern and acts in accordance with the Commercial Code of the Empire. All these points have been analyzed and justified to the satisfaction of all concerned AID officials. The loan fund is now lent in strict accordance with rules and procedures elaborated by AID.

(d) In order to have full impact on other goals, it is necessary to obtain a generous and perhaps more flexible loan from other sources. The IBRD and AID could play a role in this field though, generally, their activity is limited to financing directly government projects of infra-structure, utilities, etc. Suppliers' credit and guarantees, though helpful, do not fully satisfy EIC's requirements. EIC has, at present, lines of credit in various countries but these are for terms of 5-7 years.

Some of the Corporation's planned development projects may take over 10 years before they yield sufficient cash for loan repayment. EIC is now being cautious in giving suppliers credit guarantees because if such projects do not yield the necessary funds to pay the required yearly installment to foreign creditors, the EIC will be forced to pay. Such cases could become a great burden on its resources and retard its operations.

(e) As mentioned above, the projects under the loan are still in preparation. The goals outlined are satisfactory, provided some flexibility is introduced and routines in processing projects through AID are minimized. Comments in this regard will be given under the proper heading.

2. Selection of Borrowers

(a) The economic and financial criteria for all loans and guarantees are established by EIC. The criteria used are standards which are universally applied. All guarantees and loans are analyzed by the Investment Department using the established criteria. Loans under $40,000 are presented to a Management Committee and larger ones to the Board of Directors. The aim is not to encourage a particular type of industry but to consider the quick earning capacity of development projects in the fields of industry, agriculture and transport.

(b) Research and feasibility studies for various major projects are undertaken by the Technical Agency, and I.E.G. institution within the Ministry of Planning and Development. The Technical Agency has recourse to expert help from Europe and the U.S.A., and also has its own permanent staff of economists and engineers. The Stanford Research Institute and a German consultant have been undertaking research and surveys on agricultural and industrial projects. The Glass & Bottle Making S.C. was initially studied by the Technical Agency. The EIC will also require and encourage feasibility studies and detailed technical and economical analysis before it enters into any commitment. In some instances it will hire consultants to do a study. All such studies are subject to review by the E.I.C. staff.

(c) Technical and financial criteria developed from the experiences of similiar institutions in other countries are effectively supplied.

(d) We suggest greater flexibility to allow such institutions (ICI) to take advantage of various projects without undue loss of time.

3. Management and Operational Policies

(a) The EIC is an appropriate instrument for attaining the stated objectives. Government initiative to stimulate private initiative is essential. At the same time, EIC operates independently as another business enterprise with general guidance on policy matters from the Board. This gives it the advantages inherent in private enterprise. Eventually, such institutions will develop sufficient capital of their own so that they will not have to rely on government appropriations for their expansion and growth. Such institutions should be staffed with highly qualified, energetic personnel handling the two main departments of Accounting and Investment. These departments should be supported by professional economists, market analysts, accountants and a minium number of clerical staff. The idea should be to avoid the bureaucratic routine prevalent in government organizations. Managerial personnel should be selected on the basis of education, epxerience and, most important, initiative and originality. The degree of success will depend on the managerial personnel selected.

(b) Repayment experience of EIC have been satisfactory because of close security of all applications mainly with regard to the profitability of the project and not the security given against the loan. The EIC insists on financial planning by its borrowers and assures compliance by a system of follow-up procedures. It does not take a narrow contractual view when circumstances makes it inappropriate to insist on premature repayments; contractual terms are deliberately tight, to get back funds for re-use as quickly as possible but with full knowledge that some concession may be appropriate if forecasts prove to have been over-optimistic.

(c) The EIC generally requires a mortgage over real estate, buildings and machinery for its true value. However, it does not rely on the realizable value of the security in case of failure.

It attempts to select its borrowers by a close study and analysis of the project prior to issuing a loan or participating in equity financing. It follows up the activity and progress of the project and provides the necessary accounting and managerial assistance where deemed essential, in order to protect its resources and assure the success of the project.

(d) EIC has found it necessary to provide managerial and accounting services especially during the formation stages. At present, it is successfully providing such services on a fee basis to the Glass and Bottle Making S.C., Spice Extraction S.C., Metal Tools Private Ltd. Company, Cassen Kebena S.C., etc.

(e) Criteria for issuing loans or guarantees depend on the quick earning power of the development project and not on the basis of new or established firms.

(f) The EIC is profitable and retains the necessary legal and other reserves and provisions for bad and doubtful debts. Profitability is not the only basis for judging the effectiveness of such institutions, but it is an important factor for the survival, prestige and confidence of such concerns, and for the function of mobilizing additional resources.

(g) Others - None

4. Specific AID Relationship

(a) AID made a definite and important contribution by giving loans which finance both local and foreign costs of projects.

(b) The terms of the AID loan could be made more flexible by allowing more local cost financing (e.g. 50% - 50%) and minimizing the routine required in order to finalize a project in Washington. Such details should be left to the Mission in this country. Further flexibility could be introduced by allowing 100% financing rather than the 80% required under the present loan.

(c) The two-step procedure is quite satisfactory though a one-step approach at the low rate of interest offered to the government may help the expansion and growth of such an intermediary institution as EIC which, in turn, results in rapid economic development. The present two step procedure has proved reasonably satisfactory.

(d) Tied procurement is inherently disadvantageous because it limits the market and results in greater costs.

However, since it is a fact of life, such shortcomings can be minimized if EIC HAS AT ITS DISPOSAL SIMILIAR GENEROUS CREDITS IN MAJOR COUNTRIES OF THE WORLD. Depending on the type of project, it will be possible to choose the country that specializes in a particular product. For example, in the case of the Glass & Bottle Factory, tied procurement will have no adverse effect since the U.S. is leading in this field. Outstanding supply and management expertise cannot be obtained elsewhere. The opposite may be true in the case of the Cement Factory where European countries can supply good quality machines at a lower price.

(e) EIC has no technical assistance at present, though it makes use of such help for training personnel as well as to research the feasibility studies from time to time.

(f) Sub-loan processing is rather slow, expensive and discouraging to suppliers. In some cases, it leads to re-negotiation of terms because of condition changes during the process of the loan in Washington. There seems to be undue emphasis on small and trivial matters. Close attention and study are needed in order to simplify processing of sub-loans. As pointed out above, such processing should be delegated to the concerned Mission (such as too many reports and long delays in AID/W action).

(g) AID assistance both directly to the public and through private ICI's is needed. EIC concentrates on profitable development projects that give a quick yield. However, in order to promote economic growth, basic facilities such as roads, airlines, dams, etc are essential. These should be financed through direct assistance or loans.

C. Overall Evaluation and Conclusion

Borrowers are selected on the basis of projects they propose to undertake and their ability to manage such projects efficiently. Generally, the ability to analyze, develop and present projects properly is considered an indication of management talent and capacity.

All projects financed should be economically feasible and within the sphere envisaged in the Third Five Year National Plan. However, economic criteria are useful in eliminating those projects the EIC (ICI) will not finance rather than as a positive guide for selection of projects. Due to the lack of sufficient funds for all investment projects the emphasis should be on those that generate relatively quick cash return.

As already stated, interest rates are set on the basis of cost of funds to EIC. Offering lower interest will, in the long run, endanger ability to raise supplementary capital. A longer repayment and grace period, where deemed necessary, are preferred to lower interest rates. Where a project is viable although the risk element seems high or waiting period long, participation in equity financing is preferred to over-generous interest rates which can only be granted at the expense of other potential uses of funds.

In order to achieve economic development, it is necessary to have efficient financial institutions capable of mobilizing resources saved through the national budget, private persons or institutions (foreign as well as local) and channel them into fixed investment in industry, agriculture and large scale productive processes. Such functions cannot easily be undertaken by commercial banks, since their activities are traditionally directed to short-term businesses. Hence, the ICI (EIC) must undertake the function of mobilizer of funds for fixed investment. Private savings and surplus funds of existing institutions are necessary. However, the greater portion of ICI (EIC) funds must come from government savings through the budget and from sources such as U.S.A.I.D. simply because the rate of capital formation in a man and ox power economy is not and cannot be sufficient to permit the necessary rate of investment.

As a supplement to these loans, suppliers credit generally available from industrialized countries, are useful for extensions of existing projects and for such enterprises as can afford to meet less favorable repayment terms grant of guarantees for such facilities help EIC to keep in touch with industries which already have adequate cash flow and whose credit standing is perhaps higher than others.

For long-term projects, favorable loans similar to the $8,000,000 AID loan, either directly to ICI or through the government, are necessary. Such loans will have a far reaching effect in helping the ICI attain its objective and, eventually, develop its own resources. USAID support in granting such generous loans through ICI (EIC) with more flexible terms, especially with regard to local funds is essential. As the country matures and the economy grows, EIC will become financially strong, independent and self-generating.

GHANA

NATIONAL INVESTMENT BANK
(NIB)

[redacted]

(Unclassified when pages 17 & 18 are removed)

TO - AID/W TOAID A-63

ABC

DATE SENT Feb 14, 1969

INFORMATION ACTION

FROM - Accra

INFO.

SUBJECT - Spring Review on Intermediate Credit (ICI's)

REFERENCE - AIDTO Circular A-25

This message constitutes USAID Ghana's response to the referenced airgram's request for information concerning our experience with the National Investment Bank. Included are (1) a Project History and Analysis Report which has just been completed in conformance with the FY 1970 Program Memorandum, and (2) a research paper prepared by USAID Ghana, entitled "The Role of Credit in Ghana's Economic Development". We consider that these reports, together with the answers provided herein to the questionaire in the refair, should constitute most of the data needed for the Spring Review on ICI's. Should it develop, however, that additional insights are needed in respect to particular points, we will be happy to be responsive to an indication of what these might be.

All of the data provided in this airgram is unclassified except Paragraph III.C. "Overall Evaluation and Comments" of the questionaire.

Answers to Questionaire

OTHER AGENCY

A. Description of the Project

1. Country : Ghana.
2. Name of ICI : National Investment Bank - Project No.641-15-920-030.
3. Class of ICI : Mixed
4. Date established : June 15, 1963.
5. Initial assistance from A.I.D.:

Date	Amount	Kind
April 22, 1963 (Pro Ag)	$80,000	TC

(This document unclassified when pages 17 & 18 are removed)

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PAGE 1 OF PAGES 16

	OFFICE	PHONE NO.	DATE	APPROVED BY
Gibble/MHicks:jf	Industry	64914	2/5/69	Richard M. Cashin, Director

ADDITIONAL CLEARANCES

AID/PPC

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[redacted]

ACTION OFFICE - When ACTION completed, return this copy to OFFICIAL FILE STATION or appropriate OFFICIAL FILE.

NO ACTION NECESSARY

DATE | SIGNATURE

6. Does ICI take equity participation : Yes
7. Capital Structure of the ICI as of date specified in 5 above:

Government of Ghana	..	N¢5.0 million	(75 percent)	
Private	..	1.5 "	(25 ")	
Total	..	N¢6.5 "	(N¢1.00 = $.98)	

8. Subsequent assistance from A.I.D.:

Date	Amount	Kind
April 23, 1964	$80,000	TC
April 26, 1966	$54,000	TC
May 19, 1966	$9,000	TC
Feb.10, 1967	$433,000	TC
May 17, 1967	N¢333,000	LC
March 29, 1968	$265,500	TC
May 31, 1968	N¢1,000,000	LC

9. Capital Structure of the ICI at end of latest fiscal year:

Government of Ghana	..	N¢5.0 million	(71 percent)	
Private	..	2.0 "	(29 ")	
Total	..	N¢7.0		

10. Status of A.I.D. $ loans as of July 1, 1968 : None

11. Interest rates : average rate paid by ICI : 5½ percent
average rate charged by ICI : 9 percent

/rates paid by NIB reflects cost of PL-480 funds sub-loaned by GOG to NIB. The NIB does not accept deposits/

Narrative Section:

Loans by the NIB are legally limited to a minimum size of N¢10,000 ($9,800), and to repayment periods of from three to 15 years. The Bank's total loans, guarantees and equity investments in any one type of industrial production cannot exceed 10 percent of its entire funds. Further, it will not make loans or give guarantees in excess of N¢200,000, except for public sector operations, to any one enterprise, or group of

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enterprises owned or controlled by a single interest. Total equity investments are limited to a maximum of 10 percent of the Bank's share capital, and overall assistance and/or participation in a project, except for public sector projects, is limited to 75 percent of the project's total cost. Criteria for making loan guarantees and investments are based on the economic and technical feasibility of the project. The Bank at the same time, however, is prohibited from providing financing for projects which involve either an unjustified relocation of an industry, where management is inadequate, for speculation, or which encourage a monopoly.

As of December 31, 1967 the Bank had made 43 loans with commitments totalling $5.5 million. Of this amount there was $4.0 million outstanding loans on the books at the end of 1967, of which 75 percent represented public sector projects.

Since the change in government in February, 1966, the Bank has increasingly emphasized private sector loans. During 1967, 79 percent of new loans (about one million dollars) were in this sector.

The NIB is the primary source of long term credit for industrial projects in Ghana, and along with the Agricultural Development Bank, is also a principal source of long term credit for projects in the agricultural sector. Its key role is a result of the policies of the commercial banks in Ghana who lend only on short term bases of a year or less, primarily to meet working capital requirements.

The total of loans on the books of all banks in Ghana at the end of 1967 was about $104 million. The $4 million of loans granted by the NIB therefore, represents a relatively small share. Nevertheless, the impact on the country of the NIB loans, from a development viewpoint, is much greater than those made by the commercial banks.

The Bank also issues guarantees, which are principally on overseas supplier credits. The Bank's liability on these guarantees totalled $5 million at the end of 1967. Before 1966, guarantees were a more important part of the Bank's business, since it was during this period that most of the supplier credits were contracted. Equity investments by the Bank have represented a small portion of its total activity, and the Bank held only $130,000 in equity at the end of 1967.

For additional information on the activity of the Bank and its place in Ghana see the attached "National Investment Bank - Project History and Analysis Report" and the research paper prepared by USAID/Ghana "The Role of Credit in Ghana's Economic Development".

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B. Evaluation on Specific Points

1. Goals

(a) How much emphasis is placed on the mobilization of additional capital? From the Government? Private ownership in the IDI? Other donors? The borrower? What is the relative emphasis on local currency vs foreign exchange? Quantify this answer to the extent possible.

The answer to the above, in general, is considerable. The NIB has sought, and was pleased to obtain, two PL-480 Section 104f loans from the Government of Ghana, one in 1966 for N¢333,333 and one in 1968 for N¢1,000,000. An additional loan of this type in the amount of from N¢1.7 to N¢2.5 million is being sought in 1969.

In 1967 the NIB was pleased "to welcome the Bank of Ghana as a shareholder in the Bank". The Bank of Ghana's investment was N¢500,000.

In 1967 the NIB encouraged the IFC to participate in its equity. After an on-the-spot survey of this possibility in late 1967, the IFC is understood to have made an offer to participate which was conditioned, among other things, on the reduction to a minority position of the GOG's equity. To date the NIB has not been able to accept this offer.

In its 1967 annual report the NIB reported conversations with a number of financial institutions in Europe and the US on possibilities for "ways in which we might collaborate to bring together foreign investment and local funds... Negotiations were initiated in Bonn and Frankfurt by the Bank and officials of the West German Government and Kreditanstaldt Fur Wiederaufbau on arrangements for granting long-term capital aid to the National Investment Bank. We expect negotiations for such assistance to be finalised during the current year"

Concerning the mobilization of other local capital, the 1967 report states: "Encouraged by our success in organizing consortium financing for projects whose investments exceed the lending ceilings permitted by our Act and Bye-Laws, the Bank undertook yet another excercise to channel substantial funds into housing. The Bank organized a consortium comprising the Ghana Commercial Bank, Barclays Bank, D.C.O., Standard Bank of West Africa, State Insurance Corporation, and Royal Exchange Assurance to raise N¢1,100,000 for the construction by the State Housing Corporation of the first phase of the Teshie/Nungua housing scheme".

On the question of local currency vs foreign exchange, the NIB has not noticeably emphasized the importance of the latter. Some discussions have been had on the possibility of AID supported assistance

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for a dollar loan under an extended risk investment guaranty. The main question towards which these talks were oriented was the relatively higher interest rate that would be involved, rather than a particularly emphasized attention to the hard currency question.

A lack of attention to the foreign exchange question in Ghana is perhaps understandable to a degree due to the ready availabilities of convertibility under the AID Program Loans.

(b) Is the increase in the supply of investment funds for industry in general or to supply additional funds on especially favorable terms for special high priority uses? In this connection, how do interest rates (and other terms) compare with those available from other sources, i.e. how is interest rate policy used to try to influence the pattern of investment and what effect does it actually have? Is any consideration given to the comparative advantage of industry, or specific industries, or are high levels of protection and "inefficiency" by international standards accepted?

NIB financing, either loan or equity, is available to either industrial, commercil, agricultural, or other enterprises, without particular distinction as to sector. Relevant NIB guidelines as established in its by-laws, are as follows:

"In financing projects, the Bank shall be guided by its yearly investment program, specifying economic priorities as approved by the Finance Sub-Committee of the Board, and by the technical market and economic feasibility of the projects and managerial competency of borrowers as investigated and reported by the Development Service Institute. In specifying economic priorities the Finance Sub-Committee shall have due regard for the needs of Ghana and the broad economic development plan and policy of Government.

(1) The Bank shall not finance any project:-

(a) unless the economic, technical and market feasibility of the project has been examined and confirmed by the Development Service Institute and the management competency, organization and accounting system of the project has been established to the satisfaction of the Bank;

(b) if it involves the re-location of the enterprise and the re-location will cause a substantial increase of unemployment in the area from which the enterprise is being moved, or will result in the avoidance by the

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enterprise of obligations incurred in the location from which the move is to be made;

(c) if the enterprise is being re-located from another area, unless there is demonstrated to the Bank a need, (a) to re-locate closer to the source of basic materials or to major consumers, or (b) to consolidate operations in one location, or (c) unless re-location is justified by other reasons satisfactory to the Bank;

(d) if the finance is to accomplish an expansion or conversion which is unwarranted in the light of the past experience and management ability of the enterprise;

(e) if it will subsidize inferior management;

(f) if it will provide funds for speculation; or

(g) if the effect of the Bank's finance will be to encourage monopoly".

Concerning interest rates, as compared with other sources, it is useful to note that the NIB is the primary source of long term investment financing in Ghana. The only other institutions which make such loans in this country are the Commonwealth Development Corporation, the Standard Bank Finance and Development Corporation (an affiliate of the Standard Bank of West Africa), and the Agricultural Development Bank. The activities of these institutions, however, are much more limited than those of the NIB, and those of the Agricultural Bank are only for agricultural projects. Interest rates of all these institutions, however, are essentially the same.

There is no particular NIB interest rate policy which could be characterized as designed to influence the pattern of investment, since all loans, large or small, or for whatever type of activity, pay essentially the same rate. This, in the view of USAID, Ghana, is unfortunate. Use of a variable interest rate, permitting higher interest for smaller and/or more risky firms which would be almost entirely small Ghanaian businessmen, would increase the attractiveness of granting loans to this category of borrowers. Under the present policy, however, where this is not permitted, the NIB makes no loans to small businessmen. Such potential borrowers have, as a result, no place to turn for credit except to the private unofficial money lenders, where usurious rates are demanded.

Unfortunately, contrary to what would appear to be good sense, the idea of raising interest rates on loans to small borrowers is considered

to be an anathema from a political point of view. Consequently, there is little likelihood that the leverage potential of variable interest rates will be available in the near future to assist in solving the problem of the need for loans to small businessmen.

On the question of the degree to which attention is given to the relative comparative advantage of a proposed activity, until recently the NIB was probably relatively little concerned so long as the project appeared viable in Ghana. More recently, however, as a consequence, at least in degree, of counsel provided in the summer of 1968 by several AID financed economists who came to Ghana to assist the Bank in surveying the economy for valid investment opportunities, more attention may now be given to whether a proposed project is really a desirable undertaking for the national economy.

(c) Does the project aim at helping to get a securities market started?

The following, on this subject, is quoted from the statement of the NIB Managing Director presented at the Fifth Annual General Meeting on March 23, 1968:

"Stock Exchange

The Bank is aware of the absence of an organized mechanism for dealings in shares of existing publicly-owned companies. Recent revival of economic activity in the private sector has given some indication of the likelihood of more publicly-owned companies emerging in the economic scene. In that event, the present system of bringing together sellers and buyers of publicly-held stocks might prove inadequate and unsatisfactory. The Bank considered that the time was ripe for a study to be undertaken to verify whether or not conditions exist now, or are likely to exist in the near future, to justify the establishment of a stock exchange.

The Bank believes that indigenous investors will exhibit an increasing willingness to invest in Ghanaian enterprises if they are able to invest moderate funds in such enterprises and are not necessarily committed to responsibility for, or participation in, their management. This emerging confidence in the economy will be encouraged if moderate-sized investors can more readily dispose of their shares for cash if and when they desire. Accordingly, last year, we submitted a proposal to the Government which approved it and commissioned the Bank to undertake a feasibility study in conjunction with the Commonwealth Development Finance Company Ltd. I am pleased to report that an expert from the Commonwealth Development Finance Company Ltd. has since visited Ghana and undertaken a study jointly with the National Investment Bank. The cost of the expert's engagement was borne by

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the United Kingdom Government on technical assistance basis. A project report will soon be submitted by the Bank to the Ghana Government".

Further, most of the NIB equity investments are made within the context of a publicly announced intent to sell such shares eventually to the Ghanaian public. This has already been done in one case with considerable success, the stock issue in question being over subscribed.

(d) Does the project aim at improving technical, managerial and financial practices of borrowing firms? In general, what stress is placed on increasing the efficiency of the use of capital?

Yes, for this purpose the structure of the NIB includes a quasi-independent organization known as the Development Service Institute (DSI). The By-Laws of the NIB describe the functions of the DSI to be as follows:

> "There shall be established within the organisation of the Bank, a Development Service Institute. The Institute shall work under the policy direction of the Bank and shall be responsible for carrying out pre-finance project examination, post-finance project technical and professional service, and general research for the purpose of revealing productive sectors of the National economy and of promoting interest of domestic and foreign investors therein by adequate dissemination of relevant information. The Institute shall actively participate in and contribute to the development of professional education and training of Ghanaians.
>
> Non-clients of the Bank may, upon the payment of a fee to be prescribed, avail themselves of the service of the Institute, on a consultancy basis, for project examination and project technical and professional service, but for no other purpose. Intending applicants for finance from the Bank may receive preliminary advice from the Bank's staff free of charge".

(e) Other Goals?

The objectives of the NIB, as provided in the Act of March 22, 1963 providing for its creation, are as follows:

"(1) The objects of the Bank shall be to carry on the business of assisting industrial, commercial, agricultural and other enterprises in general by:

(a) assisting in the establishment, expansion and modernization of such enterprises;

(b) encouraging and facilitating the participation of internal and external capital in such enterprises;

(c) counselling and encouraging small Ghanaian business concerns; and

(d) seeking to bring together investment opportunities, internal and external capital, and experienced management;

and subject to the provisions of this Act, to do all such things as are incidental or conducive to the attainment of the objects of the Bank".

2. Achievement of Goals

(a) How effectively has the project met (or is it meeting) these goals? How much of the local credit is truly additive and how much is simply a diversion of savings from other uses of lower/higher priority?

An overall evaluation of the activities of the NIB in the areas where its legislative mandate requires its attention to focus, would be that its impact has been and still is considerably less than might be desired. The NIB enjoys the distinction of being almost the sole source of medium and long term investment credit in Ghana. At the same time, however, its policy of restricting its assistance to only relatively larger and well managed projects, of which there are not very many in Ghana, considerably circumscribes its potential of being a generalized catalyst for the growth of business and commerce. The obvious reason for this is that it is the smaller businessman who has the greatest need and represents the greatest potential for the NIB to really contribute to basic development.

The attitude of the NIB towards small borrowers, however, is reflected by the N¢10,000 floor its by-laws place on minimum size loans. In practice, this minimum is probably really closer to N¢25,000.

The reasons for the preference for larger loans are (1) a relatively inflexible interest rate policy that does not permit higher interest rates for smaller, riskier, borrowers, (2) a consequent disparity between the overhead and other costs of such loans as compared with the return they will generate, (3) the usual shortcomings of the management capacility of smaller businessmen, and (4) the relatively much greater attractiveness, in almost all senses, of easier to handle larger projects.

Most of the funds of which the NIB disposes are generated through taxes or other governmental means. It is somewhat difficult to estimate how

much of these represent a net addition to savings and investment in the economy as a whole. Since the Bank does not accept deposits by the public, its role in increasing national saving is not clear cut. Since most of its funds come from the Government, the question of additivity must center around the possible alternative uses of the funds loaned and granted to it. It would seem logical to assume that in the absence of the Bank, the GOG would devote these funds to some other project in its development budget, presumably of lower priority than funding the NIB. If the Bank did not receive such funds, there would be no net saving, but a diversion of savings from a higher to a lower priority. If, on the other hand, the government chose to use the funds to increase its current expenditures, or to lower taxes, there would be a decline in total national saving. In this case, the presence of the NIB in the government's development budget could be considered to be additive to national saving.

(b) Have XXXX developments called for a shift in choice of or emphasis among the goals?

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Within the Ghanaian context, the goals of the NIB were valid when originally established, and are even more so today. This latter derives from the shift, since 1963, from a national economic policy of economic nationalism oriented toward state ownership of a major portion of the means of production, to one of a decreasing role of the state and an increasing one of the private individual in the productive sector of the economy. This change has been accompanied by an increased concern with the question of the comparative advantage of contemplated new undertakings.

The evolution towards an increased role for the private businessman has resulted in a need, however, for a greater emphasis on those of the Bank's objectives concerned with upgrading the smaller businessman. This is so because unless some organization such as the NIB focuses on the requirements of the small businessman, it is likely that the potential he represents for contributing to Ghanaian development will scarcely be tapped at all.

Unfortunately, of all the NIB's objectives, the ones concerned with the small businessman receive practically no attention.

(c) To what extent do AID's views of the appropriate development strategy and the role of ICI's in it, accord with the host country policies, and what priority do we give to ICI's in the light of this? Does our allocation of the available AID funds and the terms of assistance for ICI's support the findings of this analysis as fully as it could?

It is probable that USAID Ghana is somewhat out in front of the GOG

in the significance attached to the NIB in the overall scheme of things. This judgement it must be noted, however, is not to say that the NIB enjoys no prestige with the GOG. To the contrary. Our support of the NIB probably does, however, result in it being accorded more consideration by the GOG than might otherwise be the case.

Concerning the last question, while the NIB may not be every thing that we might like a development bank to be, we have been and are satisfied that the contribution it makes in Ghana is a positive and desirable influence. We have, therefore, allocated considerable resources to helping it, particularly, in its formative period.

While the need for the more comprehensive technical assistance we provided in the past is considered to have now decreased, the requirement for our PL-480 104f type of help for lending purposes, is and will be, a continuing one. The continuation of the allocation of resources of this nature of which we may dispose in the future, is therefore completely compatible with this analysis, and this we consider to be valid even if the Bank does not yet perform completely in all the areas it might.

(d) What are the prospects for meeting these goals now from alternative sources of funding? Borrowing from the IBRD and other international institutions? Borrowing from regular commercial sources? Investment guarantees for private US investments? Greater reliance on suppliers' credits? Other?

This question seems to presuppose that the principal impediment to the attainment of NIB goals is money. USAID Ghana would not completely agree. This is because the goal to which we assign first priority, namely, assistance to small businessmen, does not require a really great deal of money. Our PL-480 Section 104f funds would go a long way to satisfy the requirements if they could be so focussed.

So far as we know, no approach has been made by the NIB to the IBRD for a loan. We have discussed the possibility of a private US loan under the Extended Risk Investment Guaranty Program. As noted earlier, however, this possibility went at least temporarily aground on the question of interest rates. Our conclusion is that the NIB is not presently all that interested in additional high priced loan resources.

(e) What guidance does your project (if now well advanced) provide for new projects in their choice of goals? Would you do it differently if starting over? How?

It is interesting perhaps to observe in approaching these questions

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that they seem to presuppose a degree of influence on the part of AID which, at its best, will never be more than present in degree. The NIB, for instance, was not an AID project. We have since its creation, given considerable technical assistance to it, and lately have provided PL-480 104f funds for onward lending. The extent, however, to which this is translated into any real say in shaping policy is for the most part a question of personalities and persuasion. Within this context, USAID Ghana considers the NIB a reasonably well formulated project that contains the elements required to respond to the need for a development banking institution in Ghana. While the extent to which the NIB devotes its attention to its various objectives may be considered less than ideal in some areas, this does not mean that the original objectives are inappropriate for Ghana 1969.

3. Selection of borrowers

(a) What economic criteria are employed? Are the formal criteria and the actual ones the same?

Encourage particular kinds of industries?
Exporters?
Import substitutions?
Use of domestic raw materials?
Other?

Are the criteria determined by the government?, the ICI?, jointly?

Reference is made to the answer to B.1(b) above which discusses NIB policies in respect to economic criteria for borrowers. USAID Ghana has no reason to believe that practice seriously departs from these criteria.

In addition to the formal criteria, it is probable, that the NIB is now concerning itself more with the comparative advantage aspects of proposed loans. Some projects in the past have been financed where the ability of the local enterprise to be reasonably competitive is less than certain.

As concerns particular kinds of industries, the NIB is basically most concerned with the financial viability and technical feasibility of projects. Any project in any sector that meets such criteria and is also reasonable from a comparative advantage viewpoint, stands a good chance of obtaining NIB assistance.

In addition to the NIB, however, for practical purposes all projects must also receive the approval of the GOG.

The GOG's criteria for approving projects, turns primarily on the extent to which they give promise of promoting development, and, at least, not worsening the country's foreign exchange problems.

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It can be noted that all the several categories of industries cited in the above questions can expect sympathetic consideration by the GOG so long as they meet the foregoing criteria. All of them except small industries will receive the same attention from the NIB.

(b) Are research, surveys and/or promotional work undertaken to stimulate borrowing for particular purposes or does the ICI simply process applications submitted to it? Is there a problem of equipment salesmen and other promoters stimulating the wrong kind of application? If so, how is it dealt with?

The NIB's Development Services Institute has the role of project development research and analysis. It is quite active in this respect. The NIB states in its 1967 annual report that the DSI studied 12 NIB initiated promotional projects during 1967. These included stationery products, chemical complex, aluminum products, textiles, cable and wire, fibre, wood products, packaging, and metal products.

Two projects which the NIB developed and which are now going ahead with its help and participation, are a dry cell battery plant and a cable and wire mill.

Concerning the last question, this was a problem for Ghana under the previous regime. There is little evidence of it being a particularly great one presently.

(c) Are the technical and financial criteria and reviews appropriate? Effectively applied?

The Development Services Institute is considered to do a credible job of examining loan applications and developing projects. It has a reasonably competent staff which is complemented for particular technical requirements by foreign experts supplied by AID, the UK and Germany.

(d) What changes are appropriate at this stage, or would you recommend for other ICI's at an earlier stage?

As noted earlier, the organization and objectives of the NIB are considered valid. The principal change to be encouraged in any similar institution would be that of greater emphasis on and attention to the requirements of the smaller businessman. It is to be emphasized in this respect that such requirements include management advice as well as money.

4. Management and operational policies

(a) Is the form of managerial organization appropriate and effective? What lessons are there on methods of selection of managerial personnel?

The way in which the NIB is organized and functions from a management

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point of view, appears to be quite effective. There is, however, nothing particularly significant to note concerning its methods of personnel selection.

(b) Are safeguards against untoward events -- that prejudice the effectiveness of loans -- adequate, and is repayment experience satisfactory? Does the ICI insist on and achieve adequate financial planning by its borrowers, including adequate provision for all types of short and long-term financial requirements as a condition of ICI financing of a portion of the total investment?

The DSI for the NIB make a thorough evaluation of all loan applications. Its recommendations are a principal consideration in whether loans are made. In addition the NIB requires substantial amounts of security on loans, believed even at times to exceed the value of loans. These safeguards would appear well conceived. However, the USAID has relatively little information on repayment experience.

(c) Is the balance between security on loans and stimulation of new activities satisfactory? To what extent are requirements for security leavened by appraisals of entrepreneurship, worthwhileness of new ventures, etc? What improvements are needed?

USAID considers that NIB policies relative to security and debt/equity ratios tend to be somewhat more conservative than might be optimum for a development institution with a main function of encouragement and facilitating investments. Obviously, better quality of management and particularly viable ventures tend to decrease risk and therefore the need for security. The NIB even in these cases, however, could probably be somewhat less conservative.

(d) Is assistance on technical and managerial problems to borrower necessary? Available? Effective?

Such assistance is often necessary and is available from the DSI at a fairly high cost by Ghanaian standards. For this reason, it is not often feasible for smaller firms to consider it.

The staff of the DSI is reasonably well qualified to provide advice on management problems. Requirements for advice on technical questions, on the other hand, are not easily handled.

Generally speaking, any development banking institution should have available to it the possibility that necessary assistance to clients on managerial and technical problems can be provided.

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(e) Who gets the money? Established or new firms? Do loans on especially favorable terms "free" borrowers" own funds for lower priority uses? Is there a satisfactory institutional solution to the conflict-of-interest problems when officers want to be borrowers?

NIB finances both existing and new businesses. The percentage of new enterprises as opposed to existing enterprises financed through November 1968 was 43% for new and 57% for existing.

Concerning the second question, NIB xxxxx loans are made on fairly hard terms, with a good deal of control and effort to substantiate a real need of the borrower. This latter includes investigations of possible alternate sources of assistance.

Concerning the last question, there is no conflict of interest problem that we have been able to identify. Bank officers are not believed to have obtained Bank loans.

(f) Is the institution profitable? To what extent does the answer reflect its overall effectiveness?

In 1967 profits were 2.2% of paid-in equity shareholdings, plus retained earnings. This result, however, is reflective only of the fact that the institution made some money, not how well it performed in an overall sense.

(g) Other - N/A

5. Specific AID relationships

(a) How has AID contributed, where relevant, in each of the areas noted above? How can and should that contribution be improved?

Since its creation in 1963, AID has contributed a number of opex management advisors at the highest levels of the NIB. These technicians, who had a major role of training, have undoubtedly had an impact in all areas of the Bank's activities. It is difficult to really measure this impact, or even know whether all of it has been good. Some of it may, in fact, have contributed to the insular attitudes of the Bank.

At this point in time, however, the Bank has reached a stage of relative maturity. It's policies may be more conservative than we consider ideal. However, this is a matter of a deliberately chosen course, and not one reflecting a real need for further management advice. We do not therefore, consider, that further AID contributions of these kind are indicated.

(b) Have the terms of the loan agreements been suitable for achieving the desired impacts? If not, how could they be improved for other loans?

Leverage available to the Mission to significantly influence basic Bank's policies through conditions that might be established in local currency agreements for the allocation of PL-480 104f funds, has proven limited. We have in connection with a now pending new allocation of such funds to the Bank, endeavored to have a greater attention given to small borrowers. The NIB, however, has resisted this initiative. For the two previous allocations of 104(f) funds we have, however, required that they be for enterprises that are predominantly private.

(c) Has the two-step procedure worked satisfactorily? Could it be improved? How great is the need for local cost financing?

N/A

(d) Are there ways of reducing the problems inherent in tied-procurement requirements? How do these affect the pipeline? Overall operations?

N/A

(e) Is the relation between AID loans and AID technical assistance satisfactory to the ICI's and to us? If not, how should it be changed? Composition? Phasing? Other?

AID technical assistance has been provided to the Bank to help in creating a viable institution from the point of view of policies, procedures, and professional competence. It preceded any capital assistance by a number of years. The Mission considers that any relationship between the two was slight at best.

(f) How can the pipeline be shortened? What local gains would there be from more rapid use of funds? What sacrifices, if any, would have to be made in the process of screening and application of criteria to move the sub-loans faster? Would it be worth it?

There is no pipeline problem with our local currency loans to NIB. Authorizations and subsequent draw downs occur usually within a year of providing the funds.

(g) Where relevant, what has been the relative influence of AID assistance to public vs. private ICI's? Can both be useful in the same country?

N/A

Pages 17 and 18 deleted.

IVORY COAST

BANQUE IVOIRIENNE DE DEVELOPPEMENT INDUSTRIELLE
(BIDI)

AIRGRAM

DEPARTMENT OF STATE

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TO - AID/W TOAID A 14 X

INFO: CWAORA Dakar USAID A 3 X

DATE SENT 3/12/69

FROM - RAOO Abidjan

SUBJECT - Spring Review on Intermediate Credit Institution (ICIs) PE No. 21

REFERENCE - AIDTO Circular A-25

The following comments are in answer to the questions posed in paragraph III, Information Needed From the Missions, of refair.

A. Description of the Project

1. Country: Ivory Coast

2. Name of ICI: Banque Ivoirienne de Développement Industrielle (BIDI).

3. Class of ICI: Private.

4. Date established: February 11, 1965

5. Initial Assistance from AID:

Date: February 11, 1965 Amount: $5 million Kind: Dollar loan

6. Does the ICI take equity participation? Yes

7. Capital structure as of February 11, 1965: See attached copies of list of shareholders.

Amount of share: 140,000 shares of CFA francs 5,000; total francs CFA 700 million ($2,800,000).

PAGE 1 OF PAGES 11

DRAFTED BY	OFFICE	PHONE NO.	DATE	APPROVED BY:
MDChristopher, AOSA	RAOO		7 Mar 69	Michael Codi, RAOO

AID AND OTHER CLEARANCES

MP Hiller, ECON

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8. Subsequent Assistance from AID: None

9. Capital structure at end of latest fiscal year: same as paragraph 7.

10. Status of AID $ loans as of July 1, 1968:

Committed: Francs CFA 114,558,211 ($458,233)
Disbursed: 4,978,289 ($19,913)

11. Interest rates:

Average rate(s) paid: Banque Central 3-1/2%, rediscountable on medium term loans, no more than 5 years.
AID 4%
Kreditanstalt 4%

Average rate(s) charged:
Medium term rediscountable credit 5-5.5% (base rate + 1.5)
Medium term non-rediscountable credit: Base rate + 3.75 = 7.25%
Long term credit 6.50 to 7.50%

Limits on Size or Uses of Loans:
France CFA 200 million ($800,000) with the approval of the Bank's Executive Committee; francs CFA 10 million ($40,000) with BIDI General Manager's approval.

Formal Criteria:

1. Borrower must be a private organization with an industrial character.

2. Feasibility of the project for which money is being borrowed.

3. The borrower's experience and financial interest in the enterprise.

4. Conformance with the Ivorian Government's industrial development policy.

Number of loans and summary:

According to the Bank's regulations its balance sheet is made up as of 30 September of each year; as of 30 September 1968 AID loans were not all committed. Full commitment was achieved in December. A total of 48 loans were made as of 30 September 1968, amounting to francs CFA 2,773.8 million ($11,095,200) as follows:

Classification	No. Loans	Amount Francs CFA	Amount US $
Textiles	4	583 million	2,332,000
Food	6	438	1,752,000
Wood industry	7	245.9	983,600
Chemical and fat products	2	276	1,104,000
Building materials	2	171.6	684,000
Electricity, mechanical, metalwork	9	240.3	961,200
Industrial plants	2	228.0	912,000
Transportation and distribution	5	312.5	1,250,000
Sundry	11	277.6	1,110,400

Description, to the extent it is relevant, of the financial environment in which the ICI operates, its relation to the financial community and commercial banks, how important it is as a supplier of this type of credit relative to other services (including suppliers' credits), the overall reputation of the ICI in the country, etc.

Ivory Coast's four commercial banks are shareholders in BIDI. BIDI's relations with the other banks are therefore excellent and it has engaged in some joint financing with them. The commercial banks are more oriented toward supply of short-term credit for financing marketing of the country's cash crops. BIDI does not engage in commercial banking but rather in development financing through loans and financial par- [illegible] its money transactions [illegible]

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on loans through four other commercial banks in Abidjan The sub-borrowers' credits are opened at these other banks. The GOIC is the largest single shareholder in BIDI and supplies the Bank's Governor. This further contributes to BIDI's solid reputation and influence locally.

Description of the functions performed by the ICI and how these have changed, if they have, as the institution has matured.

Loans are made only to private industrial development activities. No other loans are made. Loan activity has expanded considerably with presentation of projects for drawdown of the AID credit. The bank has also increased its portfolio of investment aimed at helping local industry get started.

B. Evaluation on Specific Points

1. Goals, Description

a. How much emphasis is placed on the mobilization of additional capital? From the government?, private ownership in the ICI? other donors? the borrower? What is the relative emphasis on local currency vs. foreign exchange? Quantify this answer to the extent possible.

On 11 February 1965 the GOIC provided a no-interest loan of CFA francs 1 billion 250 million ($5,000,000) which is reimbursable in 15 annual payments beginning January 26, 1980. The Kreditanstalt Bank (German) has issued a loan of DM 10 million ($2,500,000) with AID approval. The emphasis is primarily on local currency, plus the US $5 million AID loan.

b. Is the increase in the supply of investment funds for industry in general or to supply additional funds on especially favorable terms for special high priority uses? In this connection, how do interest rates (and other terms) compare with those available from other sources, i.e., how is interest rate policy used to try to influence the pattern of investment and what effect does it actually have? Is any consideration given to the comparative advantage of industry, or specific industries, or are high levels of protection and "inefficiency" by international standards accepted?

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The increase in the supply of investment funds is for industry in general. Interest rates are fixed by the Association Professionnelle des Banques for medium term loans. Long term loan rates were fixed by BIDI and were approved by its Board of Directors in December 1966. On medium term and rediscountable loans, all banks charge the same rate. BIDI rarely makes non-rediscountable loans. Other banks can charge higher rates than BIDI's 5-1/2% limitation. Depending on the soundness of the business involved, the Bank's rate policy encourages investment. Special consideration is given to industries connected with the industrial development planning of the country.

c. Does the project aim at helping to get a securities market started?

Not per se. There is at present no securities market organized in Ivory Coast. However, BIDI is interested in the idea especially as a means of encouraging more African investment and further mobilizing African savings. It has, for example, taken stock in a new local factory and later through a public stock offering ceded these shares to Africans with considerable success.

d. Does the project aim at improving technical, managerial and financial practices of borrowing firms? In general, what stress is placed on increasing the efficiency of use of capital?

The Bank, being a young organization, has not yet developed an adequate staff of its own. It lacks a sufficient number of experts to meet the Bank's desired goals. It is currently looking for an industrial engineer to oversee the borrowers' projects. The Bank does have a German specialist who is training Bank personnel to follow up on loan projects. The Bank has also in the past shown itself alert to the need to help counsel some of the smaller African firms among its borrowers, thus using its loan assistance as a lever to promote sounder managerial practices and increased efficiency on the part of these firms. In so doing it has explored possibilities of cooperative assistance with other local banks.

Achievement of Goals

a. How effectively has the project met (or is it meeting) these goals? How much of the local credit is truly additive and how much is simply a diversion of savings from other uses of lower higher priority?

The local credit is additive in that in many instances it

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could be used for investments that would be given priority status by the GOIC, and, therefore, by private sectors. The project credit from BIDI could therefore be considered as being used for projects that might not otherwise be carried out. Other money being put up for such projects as Klein Chocolate might not be forthcoming if the GOIC did not consider them priority sector, and badly needed. The Bank does successfully require large borrowers to maintain competent staffs. This requirement is not so successful with small enterprises. The shortage of qualified personnel at the Bank makes it difficult to keep an eye on the smaller activities. It must depend on the Government sponsored National Office for Promotion of Ivorian Enterprise (OPEI). The Bank does not have many small loans. There are very few local Ivorian entrepreneurs in industry, although they are being encouraged to get into this field by OPEI.

b. Have developments called for a shift in choice of, or emphasis among, the goals?

The Bank has reconsidered some of the AID loan project requirements. In the beginning it had limited the variety of enterprises that could be termed industrial. It now identifies such activities as transportation and forestry, or other indirectly industrial-connected activities, as industry.

c. To what extent do AID's views of the appropriate development strategy and the role of ICI's in it accord with the host country policies, and what priority do we give to ICIs in the light of this? Does our allocation of the available AID funds and the terms of assistance for ICIs support the findings of this analysis as fully as it could?

The Bank gives emphasis to encouraging such industry as is within the development policy of GOIC. The AID loan goes a long way to help in this encouragement.

d. What are the prospects for meeting these goals now from alternative sources of funding? Borrowing from the IBRD and other international institutions? Borrowing from regular commercial sources? Investment guaranties for private US investment? Greater reliance on suppliers' credits? Other?

A few months ago BIDI provided a five years' projection to IFC. This is being modified to give a yearly projection to IFC. The AID loan finances importation of industrial equipment for which BIDI receives a return. There are three funding sources:

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(1) The $5 million AID loan.

(2) Rediscountable loans up to CFA francs 200 million ($800,000) from Central Bank of West Africa (BCEAO loan).

(3) Kreditanstalt loan for the equivalent of $2,500,000.

Currently the BCEAO and Kreditanstalt loans are not being used. Money returned on projects using the AID loan is reusable by BIDI. Therefore, currently the Bank does not feel it needs help from IBRD, probably for two years. The American Klein Chocolate Company has obtained an approved loan from the AID loan fund. It has also obtained approvals for AID extended risk and specific risk guaranties.

e. What guidance does your project (if now well advanced) provide for new projects in their choice of goals? Would you do it differently if starting over? How?

BIDI is somewhat new to provide significant answers to this one.

2. Selection of Borrowers

a. What economic criteria are employed? Are the formal criteria and the actual ones the same?

That the borrower is offering an activity which falls within general economic policies of the country and project feasibility are the two chief economic criteria employed. Yes, the formal and actual criteria are the same.

Encourage particular kinds of industries?

Local raw material, e.g.:
- Palm oil industry
- Fat products
- Cocoa and coffee
- Cotton

Import substitution - kenaf
Small and medium industries
Exporters

Are the criteria determined by the government?, the ICI?, AID?, jointly?

The Bank determines its criteria. The criteria re use of the AID fund was determined jointly.

b. Are research, surveys and or promotional work undertaken to stimulate borrowing for particular purposes or does the ICI simply process applications submitted to it? Is there a problem of equipment salesmen and other promoters stimulating the wrong kind of application? If so, how is it dealt with?

There is some promotion of the AID loan activities. All other loans are promoted through the Ivorian Chamber of Industry.

c. Are the technical and financial criteria and reviews appropriate? Effectively applied?

Yes. It is a question of organization. The Bank takes every measure to avoid undue problems.

d. What changes are appropriate at this stage or would you recommend for other ICIs at an earlier stage?

Because of BIDI's late start in using the AID loan, and then its need for working rapidly to commit all the funds possible before the final deadline date set by AID/W, the Bank found it difficult to make proper evaluations of especially the larger projects in the time allowed. The complexity of several of the projects, the difficulty of working with complicated AID procedures in the limited time allowed resulted in several panic situations within the Bank. This was complicated by the fact that all documentation for AID review and approval must be in English. This requirement is very burdensome in a small, French-speaking country like Ivory Coast, particularly again when time is limited. Therefore, anything done to make AID/W approval procedures less difficult for a small and under-staffed (with professional personnel) ICI would be of help.

3. <u>Management and Operational Policies</u>

a. Is the form of managerial organization appropriate and effective? What lessons are there on methods of selection of managerial personnel?

The form of managerial organization is appropriate and effective. BIDI is considering improvement of its industrial project evaluation by seeking an industrial engineer. The recently signed Ivorian/German cooperation will probably provide someone. The Bank inaugurated in July 1968 a training program to develop personnel for promotion to its higher ranks.

b. Are safeguards against untoward events--that prejudice the effectiveness of loans--adequate, and is repayment experience satisfactory? Does the ICI insist on and achieve adequate financial planning by its borrowers, including adequate provision for all types of short and long term financial requirements as a condition of ICI financing of a portion of the total investment?

The Bank requires guaranties from its sub-borrowers. BIDI has organized financial control on all business firms to whom it makes loans. It asks for a quarterly report: at least a balance sheet and financial reports, which BIDI studies. Some enterprises must submit monthly reports.

c. Is the balance between security on loans and stimulation of new activities satisfactory? To what extent are requirements for security leavened by appraisals of entrepreneurship, worthwileness of new ventures, etc.? What improvements are needed?

The guaranties required by BIDI of its borrowers do not prevent the development of business. The Bank considers the borrowers' abilities to manage their businesses and how they will meet their commitments. The Bank does have enough experience to make this evaluation. BIDI is constantly seeking ways to improve its own operation.

d. Is assistance on technical and managerial problems to borrower necessary? Available? Effective?

It is very necessary, and is available through the CPEI.

e. Who gets the money? Established or new firms? Do loans on especially favorable terms "free" borrowers' own funds for lower priority uses? Is there a satisfactory institutional solution to the conflict-of-interest problems when officers want to be borrowers?

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Loans are made primarily to business firms which want to improve existing operations. New businesses are also considered. Officers are not permitted to borrow.

f. Is the institution profitable? To what extent does the answer reflect its overall effectiveness?

For the year closing 30 September 1968 the Bank will distribute a divided of 4% of its capital, or CFA francs 200 (80¢) for each share of stock of CFA francs 5,000 ($20). The Bank anticipates the dividend will be increased next year, despite the low interest rate. The Bank feels the rate is good, especially as compared with other countries.

4. Specific AID Relationships

a. How has AID contributed, where relevant, in each of the areas noted above? How can and should that contribution be improved?

AID's only contribution to the BIDI's operation has been the US $5 million loan.

b. Have the terms of the loan agreements been suitable for achieving the desired impacts? If not, how could they be improved for other loans?

It is too early to say whether the recently made commitments on the AID loan will be effective. A newly arisen problem is the requirement for a certificate of origin. American equipment companies have exclusive representatives in Ivory Coast.

c. Has the two-step procedure worked satisfactorily? Could it be improved? How great is the need for local cost financing?

Not applicable.

d. Are there ways of reducing the problems inherent in tied-procurement requirements? How do these affect the pipeline? Overall operations?

The Bank would like an adjustment made to require that representatives of firms in the States come to Ivory Coast to advise on the product being sold. Chase asks that the certification that the loan is

not more than $250,000 be submitted in English prepared by BIDI. This is required in the AID loan agreement. Chase does not want to consider any letter of credit unless it has the certificate. It is BIDI's opinion that any letter of credit could be opened without this certification, and therefore should be eliminated.

e. Is the relation between AID loans and AID technical assistance satisfactory to the ICIs and to us? If not, how should it be changed? Composition? Phasing? Other?

AID technical assistance provided OPEI coordinates satisfactorily with ICI. No technical assistance is provided to the ICI. The AID bilateral program in Ivory Coast is being phased out (since 1967).

f. How can the pipeline be shortened? What local gains would there be from more rapid use of funds? What sacrifices, if any, would have to be made in the process of screening and application of criteria to move the sub-loans faster? Would it be worth it?

See paragraph d above. The pipeline could be shortened with more rapid action on the part of AID/W in approving loan applications over $250,000.

g. Where relevant, what has been the relative influence of AID assistance to public vs. private ICIs? Can both be useful in the same country?

Not relevant.

MORGAN

EAST AFRICA

EAST AFRICA DEVELOPMENT CORPORATION, LTD.
(EADC)

AIRGRAM

DEPARTMENT OF STATE

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TO - AID/W TOAID A-64 X
DAR ES SALAAM USAID A-11
KAMPALA USAID A-12

DATE SENT
2/7/69

FROM - NAIROBI

SUBJECT - Spring Review on Intermediate Credit Institutions (ICI's) PE No. 21

REFERENCE - AIDTO CIRC A-25

FROM EAORA

Although Nairobi is not an action addressee, AID Loan No. 698-H-001 to the East Africa Development Corporation Ltd. (EADC) appears to fall within the category to be reviewed. EADC has not yet disbursed funds under the U.S. loan (see TOAID A-948), but is actively seeking applications. The following is a description of the ICI.

East Africa Development Corporation is a wholly owned subsidiary of the Commonwealth Development Corporation (CDC) and therefore most of the answers apply to the CDC.

1. Country:
East Africa

2. Name of ICI:
East Africa Development Corporation Ltd. - a wholly owned subsidiary of CDC

3. Class of ICI:
public

4. Date established:
1948

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PAGE 1 OF PAGES 3

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[illegible]	EAORA		2/6/69	Carroll S. Hinman Director, [illegible]

AID AND OTHER CLEARANCES
EAO/W:JGreene(draft)

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5. Initial assistance from AID:
Date: November, 1967

$ Amount: $500,000

Kind (i.e., dollar loan, LC loan, TC grant)
dollar loan

6. Does the ICI take equity participation:
Yes

7. Capital structure of the ICI as of the date specified in 5. above:
... has no equity capital but has powers to borrow up to £150 m on a long or medium term basis and £10m on short term.

8. Subsequent assistance from AID:
Date: November, 1968

$ Amount: Loan under 5. above renewed

9. Capital structure of the ICI at end of latest fiscal year:

Same as 7. above

10. Status of AID $ loans as of July 1, 1968:
$ committed: Nil

$ disbursed: Nil

11. Interest rates:
Average rate(s) paid by ICI: variable

Average rate(s) charged by ICI: a margin of between 1 1/4 and 2½% according to the project added on to rate paid by CDC at time of lending.

12. XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

Limits on size or uses of loans:

CDC (and its subsidiary institutions) may, either alone or in association with others, invest in economic development projects by way of equity subscriptions, loans or guarantees. It does not make grants nor does it engage in projects for providing colleges, schools, hospitals, Government offices or other buildings or works for the public service.

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Formal criteria, if any:

The terms of every loan and equity investments are subject to separate negotiations; loan rates of interest and repayment conditions depending, inter alia, on the nature of the project, purpose for which the loan is required, the length of the loans, the value of the security to be given and any exchange risk involved in on-lending in a currency different from that of the source fund.

Number of loans and (to extent practicable) summary by number and amount by sector and/or other relevant categories:

Number of loans at 31.12.67, 154

Amount invested £113.7m
Amount committed £142m

Of the amount committed -

52.1% is basic development (i.e., power, water, housing finance and transport);

20.7% primary production (i.e., agriculture, ranching, forestry and minerals);

27.2% commerce and industry (i.e., factories, industrial development companies and hotels).

100.0%

FERGUSON

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INDIA

OVERALL EVALUATION

INDUSTRIAL CREDIT AND INVESTMENT CORPORATION OF INDIA
(ICICI)

INDUSTRIAL FINANCE CORPORATION OF INDIA
(IFC)

INDUSTRIAL DEVELOPMENT BANK OF INDIA
(IDBI)

NATIONAL SMALL INDUSTRIES CORPORATION
(NSIC)

OVERALL EVALUATION OF ICICI, IFC, IDBI AND NSIC

III-B-1 Achievement of Goals

(a) How effectively have the projects met (or are they meeting) these goals? How much of the local credit is truly additive and how much is simply a diversion of savings from other uses of lower/higher priority?

The goals of the projects can be divided for purposes of discussion into (i) financial assistance goals and (ii) general assistance goals. The Mission assumes that effectively meeting a goal means the meeting of aggregate needs or demands relating to that goal.

(i) Financial Assistance: The projects of ICICI, IDBI and IFC have met and are meeting the goal of medium and long term financial assistance to medium and large size companies very well. USAID is not aware of any worthwhile project of medium to large size which has suffered from a lack of Indian rupees or foreign exchange. NSIC has provided substantial assistance which cost Rs.350 million (equal to $47 million) to 8,000 companies. However, due to a lack of data, it is difficult to analyze whether or not the impact of NSIC has been appreciable in light of the total needs of India. NSIC may have touched only a small percentage of the hire-purchase needs of the small businessmen and the effectiveness has probably been poor.

(ii) General Assistance: ICICI, IDBI and IFC have provided lip service to the goal of general assistance in the form of advice on technical, financial, marketing and managerial matters; however, the actual advice provided has been poor in comparison to potential general assistance which could have been given. The general assistance apparently has been limited because general assistance has not been regarded as nearly as important as financial assistance. The recession in India during 1967 and 1968 has made the ICI's and business and government officers aware of the importance of marketing and technical assistance in the form of quality control and meeting the need of specialized products. An awareness on the part of most businessmen of the need for and uses of modern management concepts such as decentralization of authority and financial controls including monthly cash budgeting is still almost non-existent. Therefore, the effectiveness of the three projects in meeting the general assistance goals has been poor.

NSIC has made credible efforts to assist small scale industry in marketing and technical areas. The effectiveness in marketing might be considered good in coordinating bulk purchases of governments with small-scale industries. Technical training efforts apparently have not

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reached a significant percentage of those who could use the training; therefore, the effectiveness has been poor. NSIC has shown almost no recognition of the need for proper management and financial advisory services. When one considers that poor management and poor financial practices account for most of the failures of bankrupt firms, NSIC's effectiveness in this area is wholly unsatisfactory. This is especially true considering that "the objective of NSIC is to promote and encourage the growth of small scale industries and to help the existing ones."

All of the resources of the ICI's can be considered as diversions of savings from other sources. The ICI's have not shown any inclination to obtain funds from the public at interest rates which might cause a diversion of funds from consumption to savings. It is impossible to judge from what other uses the funds were diverted. In general the central government has been careful to provide funds to meet the medium and long term demand for credit of private industry, while at the same time meeting the credit needs in other high priority sectors.

(b) Have developments called for a shift in choice of, or emphasis among, the goals?

No developments have called for a shift in the choice of the goals. The Indian recession of 1967 and 1968 stimulated introspective thinking which has caused at least two of the ICI's to consider shifting the emphasis from the goal of financial assistance to a balance of the goals of financial and general assistance.

ICICI has shown a great deal of interest in creating with the World Bank or a U.S. commercial bank a subsidiary which would perform the functions of an English "merchant bank". This would involve giving advice on a fee basis concerning management, marketing, financial control, structuring financial resources, technology and exports. IDBI plans to provide services similar to those of ICICI's merchant bank, but will probably not form a separate organization. Both ICICI and IDBI plan to establish branches to provide service which is more convenient to subborrowers. Both IFC and NSIC presently have branches.

(c) To what extent do AID's views of the appropriate development strategy and the role of ICI's in it accord with the host country policies, and what priority do we give to ICI's in the light of this? Does our allocation of the available AID funds and the terms of assistance for ICI's support the findings of this analysis as fully as it could?

AID's views of the appropriate development strategy and the role of ICI's in it generally have been in accord with host country

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policies. Now, however, the Mission personnel concerned with the ICI's would like to see the ICI's take a more aggressive role in general assistance to business firms.

In the past AID has assigned the same priority to aid to ICI's as it has for project assistance. Both the central government and AID have assigned a higher priority for scarce development loan funds to non-project assistance. This has not hurt the ICI's because the timing coincided with the 1967 and 1968 recession in India, and the demand for foreign exchange loans has been below the supply under existing loan agreements. In 1968 AID deobligated with the concurrence of the Government of India a $10.0 million loan to IFC, because the demand for project funds was low and the demand for non-project loans to India was high. The demand for project assistance is reportedly starting to pick up, but given the present priorities and scarce development loan funds both AID and the Government of India would permit only loans of Indian Rupees out of the proceeds of PL 480 sales. AID's allocation of the available development loan funds and the terms of assistance to the ICI's have been as the Central Government requested and this supports the findings of the above analysis as fully as it could.

(d) What are the prospects for meeting these goals now from alternative sources of fundings? Borrowing from the IBRD and other international institutions? Borrowing from regular commercial sources? Investment guarantees for private U.S. investments? Greater reliance on suppliers' credits? Others?

The prospects for meeting the financial goals of the ICI's from alternative sources of fundings depend on (a) the willingness of other countries and international institutions to lend to the ICI's, (b) the Central Government's interest in seeing these funds go to the ICI's and (c) the demand for funds. The demand for foreign exchange will probably slacken in proportion to the total costs of plant and equipment because many items are being made in India which were previously imported. The Central Government has been encouraging the IBRD and other international institutions to lend to the ICI's. However as foreign exchange borrowings from regular commercial sources, private U.S. investments and suppliers credits have become available only at effective interest rates of over 7%, the Government of India has shown great reluctance to pay the price because the interest and principal required is already high in relation to India's foreign exchange resources.

(e) What guidance does your project (if now well advanced) provide for new projects in their choice of goals? Would you do it differently if starting over? How?

The four ICI's under consideration, which are well advanced, provide very little guidance for new subborrowers in their choice of goals. The ICI's and AID loans were starting anew the Mission/might require more emphasis on general assistance to borrowers in the form of managerial, financial, technical and marketing advice. In addition, advanced business training in the U.S. might be required.

It should be noted that AID was not involved with the four ICI's at their inception. The ICI's when they atarted were able to draw upon men who were experienced in the capital markets, and have generally performed in a professional manner in their lending and hire-purchase activities.

3. MANAGEMENT AND OPERATIONAL POLICIES

a) Is the form of managerial organization appropriate and effective? What lessons are there on methods of selection of managerial personnel?

Broadly the form of managerial organization is appropriate and effective. However, it seems that ICICI is more flexible in selecting personnel than other organizations and therefore gets the best available talent in the market. In IFC, IDBI and NSIC, the choice of persons heading these organizations is restricted to the Central Government cadres, although specialists are often recruited. The effectiveness of the ICI's is heavily dependent on the personal abilities and experience of the chairmen and managing directors. Below is a list of some of the senior personnel and their backgrounds:

ICICI

i) Mr. G.L. Mehta, Chairman. Educated at London School of Economics. Chairman of Indian Investment Center and Indian Institute of Technology. Was Indian Ambassador to the U.S., the World Bank and Mexico.

ii) Mr. H.T. Parekh, Managing Director, educated at London School of Economics. Was with a stock brokerage firm for twenty years. Has been closely connected with investment and banking in India.

iii) Dr. Madhera, Assistant General Manager. An economist. Has represented ICICI in 1968 World Bank meeting.

IFC

i) Mr. N.D. Nangia, M.A., L.L.B., Chairman. Had thirty years experience in various departments of the Reserve Bank of India prior to joining IFC in 1967.

ii) Mr. G.D. Khanna, M.A., General Manager. Had ten years of experience in commercial banks. Joined IFC in 1948; was sent to the World Bank for training in 1964.

iii) Mr. Baldev Pasricha, B.Com., M.A. Economics, Secretary. Had seven years experience as sales officer, lecturer and banker before joining IFC in 1948.

iv) Mr. P.S. Gopalakrishnan, B.Com. L.L.B., Manager. Had thirteen years experience in banking; joined IFC in 1968.

IDBI

Mr. A. Bakshi, Chairman, formerly Joint Secretary, Ministry of Finance and Chairman of IFC.

NSIC

i) Mr. C.R. Sundaram, Chairman, served as Director of Bharat Electronics Ltd. and other Central Government activities undertakings. Was also a senior executive with the Tatas in New York.

ii) Board Members: Several of the members of the Board of Directors are recruited from the private sector.

b) (i) Are safeguards against untoward events -- that prejudice the effectiveness of loans -- adequate, and is repayment experience satisfactory?

Safeguards on individual loans are provided by limiting the loans to half of the value of the fixed assets of the companies. The effect may be to provide too much of a safeguard in cases where loan applicants have unusually good cash flows.

IDBI maintains no provision for bad debts, whereas the other three institutions do have such provisions. Given below are the figures and ratios for analysis of the operational safeguards for untoward events and repayment experience.

IFC

Year ended June 30, 1968	(Millions of Rupees)
a) Provision for doubtful debts on balance sheet	6.45
b) Total loans outstanding on balance sheet	1,412.00
c) Write-off for year through income statement	none
d) Income from interest, discount and other receipts on income statement	108.11

	(%)
1. a as percentage of b	0.45
2. a as percentage of c	no write-off
3. c as percentage of d	no write-off

ICICI

Year ended December 31,1967	(Millions of Rupees)
a) Provision for doubtful debts on balance sheet	1.50
b) Total loans outstanding on balance sheet	822.00
c) Write-off for year through income statement	1.27
d) Income from interest, discount and other receipts on income statement	78.56

	(%)
1. a as percentage of b	0.18
2. a as percentage of c	118.00
3. c as percentage of d	1.62

NSIC

Year ended March 31, 1968	(Millions of Rupees)
a) Provision for doubtful debts on balance sheet	2.980
b) Total loans outstanding on balance sheet	1,475.000
c) Write-off for year through income statement	.006
d) Income from interest, discount etc. on income statement	108.810

	(%)
1. a as percentage of b	0.2
2. a as percentage of c	496,600.00
3. c as percentage of d	negligible

Major New York City Bank (for comparison)

Year ended December 31, 1967	(Millions of dollars)
a) Reserve for possible loan losses	19.6
b) Total loans outstanding	842.1
c) Provision in income statement for possible loan losses	4.6
d) Income from interest on loans	48.6

	(%)
1. a as percentage of b	2.3
2. a as percentage of c	427.0
3. c as percentage of d	9.5

A comparison of the major New York City Bank and the ICI's shows that only ICICI attempts to provide a meaningful reserve for bad debts on its balance sheet and income statement; however even ICICI's reserves are probably inadequate. This means that IFC, IDBI, NSIC and even ICICI are probably taking chances of fluctuation in profits and net worth when and if they are forced to make adequate provisions for losses. It has always been difficult to analyse statements of financial companies, because no generally accepted definitions of "weak loans","past due", "seriously past due" and bad debts" exist. In addition it is often at the discretion of the managers whether to write-off a bad debt. As a result the ICI's show misleadingly high profits and net worths. The managements may not be aware of the true conditions of their respective portfolios, due to inadequate evaluations of the strengths and weaknesses of existing borrowers.

The management of the four ICI's estimated that the actual default rate on interest and principal is about 5% of outstanding loans. This would be satisfactory if the figures are reliable. In view of the fact that these organizations are relatively new in the business of development lending and considering AID's Cooley loan experience, it is doubtful that the uniform 5% default rate is a realistic figure. For example, the ICI's may have rescheduled principal and interest payments which would reduce the default rate. To the ICI's credit is their practice of not including"income which is accrued but doubtful for collection in the near future" as part of their annual income.

b) (ii) Does the ICI insist on and achieve adequate financial planning by its borrowers including adequate provision for all types of short and long-term financial requirements as a condition of ICI financing of a portion of the total investment?

IFC, IDBI and ICICI have fairly comprehensive systems of requesting and appraising applications of their borrowers. The financial plan, the

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potential market and the technical competence of the project are evaluated before making a recommendation for the loan. However, applications to NSIC are considered only if recommended by the concerned Director of Industries of a State. Since Directors of Industries may have varying standards of evaluating the application it is difficult to maintain uniform standards of appraising applications. NSIC does not stress the financial planning of applicants.

c) Is the balance between security on loans and stimulation of new activities satisfactory? To what extent are requirements for security leavened by appraisals of enterprenuership, worthwhileness of the new ventures, etc.? What improvements are needed?

The margin required on the loan made by ICICI, IDBI and IFC varies between 40% to 50% of the value of the fixed assets mortgaged with these institutions. In other words, the loans are 50% - 60% of the value of the fixed assets. It is rare that appraisals of entrepreneurship or the worthwhileness of new ventures act as stimulants for relaxing the security requirements. None of these institutions has so far made unsecured loan, although IDBI and IFC are permitted to lend unsecured on the basis of the appraisal of applications. All ICI's except NSIC insist on a legal mortgage which costs the borrowers ½-3% in registration fees depending on the state. IDBI and ICICI very recently have also started accepting equitable mortgages (registration and storage of the deeds with lender) which carries the registration fee. This new approach is considered a progressive attitude for development banking in India.

The ICI's need to make their attitude toward security more flexible, to provide greater assistance to projects which have a strong likelihood of a large cash flow. This would tend to emphasize more profitable companies with possible higher returns to India. If present policies persist, however, the stimulation of new activities would continue to be satisfactory.

d) Is assistance on technical and managerial problems to borrower necessary? Available? Effective?

In most instances the ICI's discuss problems with borrowers and advise them of the various gaps that need further probing. Many borrowers have claimed that some of the suggestions made by these institutions have improved their projects and increased their profitability. However, none of these institutions maintain a formal consulting department to advise their clients.

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e) Who gets the money? Established or new firms? Do loans on especially favorable terms "free" borrowers own funds for lower priority uses? Is there a satisfactory institutional solution to the conflict-of-interest problems when officers want to be borrowers?

Both established as well as new firms receive money. It is difficult to determine whether loans made by these institutions would release borrowers' funds for lower priority uses. This is certainly not the intent of these organizations although it may result in releasing borrowers' own funds. In most of the cases borrowers are asked to invest their own funds in addition to the loans made by these institutions. This generally does not leave the borrowers with much to invest in lower priority uses.

The mission is not aware of any cases where a conflict of interest problem has arisen because a director of a borrowers' company being a member of the board of directors of these institutions. Most of the members of the boards of directors of these institutions are either respected government officials or professional people who have expert knowledge of financing, banking and various industries. The ICI's have been careful to avoid conflict-of-interest situations, because all wish to avoid criticism in Parliament.

f) If the institution profitable? To what extent does the answer reflect its overall effectiveness?

Profitability for these institutions for their latest fiscal years is indicated in following table:

ICICI

Profits for the year ending December 31,1967 Rs.13.97 million
Profit as percentage of net worth $\frac{13.97}{116.40}$ = 12.0%

IFC

Profits for the year 1967-68 Rs.15.8 million
Profits as percentage of net worth $\frac{15.8}{177.98}$ = 8.88%

IDBI

Profit for the year 1967-68 Rs. 30.64 million
Profit as percentage of net worth $\frac{30.64}{760.78}$ = 4.0%

NSIC

Loss for the year 1967-68 Rs.4.21 million loss
Loss as percentage of net worth $\frac{4.21}{27.6}$ = 15.25% loss

NSIC's loss was due (a) NSIC had to absorb a Rs.5.18 million additional debt burden due to devaluation whereas other institutions passed it on to sub-borrowers and (b) departments of NSIC are service oriented and are either run on no profit, no loss basis or subsidised by the Central Government. NSIC's contribution in developing the small scale sector in the Indian Economy might better be evaluated by growth of small companies assisted rather than by profits.

4. SPECIFIC AID RELATIONSHIPS

a) How has AID contributed, where relevant, in each of the areas noted above? How can and should that contribution be improved?

AID's contribution has been primarily in supplying foreign exchange and Indian rupees through the Government of India. At the time the AID loans were made the need for money was obvious, and there was little awareness of the need for improving the operations of the ICI's in the areas of lending procedures and general assistance to subborrowers. The ICI's, subborrowers and the Mission now recognize the need for more emphasis on general assistance.

We suggest that AID's contribution to these institutions be improved by (a) arranging informal discussions where policy and management matters could be discussed, and (b) thoroughly appraising the operational and management policies of these institutions when and if AID considers requests for additional loans.

b) Have the terms of the loan agreements been suitable for achieving the desired impacts? If not, how could they be improved for other loans?

Generally the terms of the loan agreements have been suitable for achieving the then desired impacts.

III-B-4(C) Has the two-step procedure worked satisfactorily? Could it be improved? How great is the need for local cost financing?

We assume that the "two-step procedure" refers to the procedure of repayment in rupees to the Central Government and repayment of dollars by the Central Government to AID. AID has not provided local currency through a "two-step procedure" of buying local currency with dollars and lending rupees to the ICI's; because sufficient PL 480 rupees were

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available to lend to the Central Government.

AID has used the two-step procedure on only IFC. Dollar loans to ICICI and NSIC are repayable in rupees. IDBI has received no dollar assistance from AID. The two step procedure has worked well, but it has no visible effect on the ICI's. The Mission sees no way in which the two-step procedure could be improved as it affects ICI's.

The need for local cost financing is substantial and growing larger as more industry develops in India. The foreign exchange and local resources (debt and equity) of the ICI's are compared below:

Name of ICI and date of outstanding assistance	Millions of Rupees		
	Foreign Exchange	Local Resources	Total Resources
IDBI (June 30,1968)	None (0%)	1,573 (100%)	1,573 (100%)
IFC (June 30,1968)	200 (13%)	1,296 (87%)	1,496 (100%)
ICICI (December 31,1967)	1,388 (71%)	581 (29%)	1,969 (100%)
NSIC (March 31,1968)	63 (30%)	145 (70%)	208 (100%)
Total:	1,651 (31%)	3,595 (69%)	5,246 (100%)

(figures in brackets are percentages of total resources for each ICI)

As shown above, the total foreign exchange resources of the four ICI's are about one-third of the total resources. IDBI utilizes no foreign exchange and IFC has only 13% of its resources as foreign exchange. The bulk (84%) of the total foreign exchange of all the ICI's has been made available through ICICI; whereas only 16% of the total rupee financing has come through ICICI. The management of ICICI hopes to increase its rupee resources to keep up with the changing pattern of demand, which is toward rupee financing. In the past, when foreign exchange and substantial rupee financing were both required, ICICI has loaned foreign exchange and one or more of IFC, IDBI, Unit Trust of India and Life Insurance Corporation of India have loaned rupees.

d) Are there ways of reducing the problems inherent in tied-procurement requirements? How do these affect the pipeline? Overall operations?

The Government of India has been able to minimize problems of tied-procurement requirements by making available foreign exchange from various

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sources to any individual project. As a result most projects have been able to work out a rational program of procurement. The small business advertising requirements may delay projects implementation to three months, but this is doubtful because Mission to India has received very few complaints. As long as tied procurement is necessary, the present system seems to work well.

e) Is the relation between AID loans and AID technical assistance satisfactory to the ICI's and to us? If not, how should it be changed? Composition? Phasing? Other?

No technical assistance has been or is now made to these institutions by AID. The World Bank regularly provides advice and training to ICICI. This question is treated more fully under "C. Overall Evaluation and Conclusions".

f) How can the pipeline be shortened? What local gains would there be from more rapid use of funds? What sacrifices, if any, would have to be made in the process of screening and application of criteria to move the sub-loans faster? Would it be worth it?

Rapid use of funds would increase the economic development of the country at a faster rate. In a developing country like India where it is rather difficult to have realistic long term projections, is always best to minimize the time gap between the preparation of the frame work of the project and its actual realisation into a productive entity. However, to ensure creative and yet prudent allocation of scarce resources the ICI's should not make any sacrifices in the process of screening and application of criteria to move the subloans faster. It is doubtful that the pipe line can be shortened appreciably.

g) Where relevant, what has been the relative influence of AID assistance to public vs. private ICI's? Can both be useful in the same country?

Of the four ICI's two are Government owned (NSIC and IDBI) one is mixed (IFC) and only one is a private organization (ICICI). We believe AID's assistance to all the ICI's has proved very useful for the country. The basic purpose of these institutions is the development of free enterprise and the private sector in India. As already indicated, ICICI, IDBI and IFC meet regularly to exchange their views on various policy matters relating to the growth of development banking in India. Also in case of very large loans, financing is provided by these institutions together.

The Mission's impression is that the privately owned ICICI tends to be faster in deciding on whether to make loans and is more imaginative

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and aggressive. The other ICI's generally are close behind ICICI in services, All of the ICI's are useful in the same country.

C. Overall Evaluation and Conclusions

" What is wanted is not comments specifically on these points (contained in AIDTO Circ XA564), but your best judgment on what you believe the basic issues are."

The basic issues relate to lending judgment and general assistance, independence from the central Government and mobilizing capital.

1) Lending Judgment and General Assistance

ICICI, IDBI and IFC have shown a strong tendency to base the amount of their loans at 50 to 60% of the value of the fixed assets of the borrowers. These ICI's have generally insisted on legal mortgages which cost between ½ of 1% to 3% for registration fees; instead of "equitable" mortgages which cost nothing and are legally binding. All of the ICI's do go through a routine of analysis which includes most of the characteristics of financial analysis used by progressive lenders in the U.S.; however these ICI's are always working within the constraint of loans being no more than 50-60% of the asset value.

This type of security-oriented lending approach has been used by bankers for centuries, but it has been discarded by most U.S. lenders in favor of analysis of borrowers as going concerns. The U.S. method of analysis was greatly stimulated by the experience of the depression in the 1930's when many bankers realized only a few cents on the dollar on mortgaged properties of bankrupt firms. As a result, U.S. lenders have found that it is to their benefit to play a creative role and help the borrowers continue as going concerns. This creative role involves the development of mutual trust between borrower's managements and the lender and constructively critical, problem-oriented analysis of (a) management strength and depth, (b) technical processes, (c) raw material procurement, (d) market potential and competition, (e) balance of the capital structure, (f) internal reporting systems and controls and (g) profitability and cash flow. Discussions which Mission representatives have had with the four ICI's have shown that the managements of the ICI's (a) often do not wish to rely on their own judgment of the prospects of Indian businesses and (b) are unwilling to do much independent verification of information supplied by borrowers. In other words the ICI's

are willing to make loans against fixed assets if the applications are not internally contradictory. Constructive assistance to the borrowers is minimal; statements to the contrary by the ICI's notwithstanding.

As a result of the ICI's lending practices, borrowers in capital intensive industries with lower profitability tend to be rewarded over borrowers with higher profitability and lower fixed assets. In the long run the efficiency of Indian business would tend to be retarded by emphasizing static assets rather than dynamic profits and intelligent management.

The ICI's by their lending against security, rather than the operations of a firm, indirectly endanger their loans by down grading the importance of a stable base of working capital. Working capital is the cushion of the operations of a firm; when the operations do not meet expectations, the firm in a strong working capital position can often weather any reasonable storm. The average ratio of current assets to current liabilities of medium to large Indian firms has steadily declined from 1.65 to one in 1950-51 to 1.18 to one in 1963-64, 1/ whereas in 1963-64 current ratios of manufacturing companies in the U.S. were 2.35 to one and 1.9 to one in the U.K.

The ICI's further hurt themselves and Indian business in general by not taking advantage of their relationships. The ICI's rarely work with their borrowers and clients to improve the quality of management and soundness of the firms before and after lending. The ICI's could do much more to (a) encourage competitive salaries to obtain and keep management, (b) stimulate delegation of authority to middle management, (c) point out instances where additional training would be useful, (d) show how proper production scheduling and use of advanced technology can make more effective use of capital and develop greater profitability, (e) provide guidance in advanced techniques of marketing and (f) teach how financial planning and control can yield large savings and cause avoidance of major blunders.

(2) Independence from the Central Government

The four ICI's have shown themselves at best highly attuned to the wishes of the Central Government in obtaining sources of funds, general lending policies and selection of borrowers. The Mission has observed cases where pressure has been used to encourage an ICI to consider a loan. ICICI, IDBI and IFC are reluctant to try to make unsecured loans or loans against equitable mortgages to the best Indian companies, because of the fear that members of parliament will accuse the ICI's of favoring the large well established

1/ National Council of Applied Economic Research: Capital Market in a Planned Economy. New Delhi, 1966. pp. 13 and 83.

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"monopolistic" business houses.

The ICI's cannot, as is done in the U.S., negotiate interest rates with borrowers on the basis of money market conditions, for fear of a political outcry. The result is that market forces are not allowed to operate to call out weaker businesses.

The concepts of merchant banking schemes have been advanced only recently, and then cautiously, for fear of criticism for trying something new or appearing to make traditionalists look bad.

Similarly salaries of managers in the ICI's have tended to be fixed by the ceiling of salaries on top Indian civil servants, for whom salaries not changed in over 25 years. The result is difficulty in attracting first rate professional managers. In addition to the salary problem, all of the ICI's are now dominated by men tied closely to the Government of India.

3. Mobilizing Capital

The yields on the securities of the ICI's are not attractive to the Indian public because (a) an understanding exists that they should not compete for money with the Government of India. The Government of India is not willing to pay over 5½% interest, and imposes a limit of eight percent on the interest ICI's can charge. In an inflationary atmosphere savings have been attracted to traditional and non-productive investment such as gold, jewels and land which yield more than 10% per year in capital appreciation; or potential savings have been consumed. The barrier to attracting voluntary savings or deflecting funds from consumption may exist because apparently "... some Indian policymakers welcome this dependence (on forced saving such as taxes and life insurance) as a means of controlling the investment process." 2/

"One of the most effective ways of insuring (development of the private sector) is to have an active capital market which would enable the private sector to mobilize the savings of the public for industrial development.3/ To this end the only way to attract the savings is to allow rates of lending and borrowing to seek a semblance of the market rate. The market rate may be closer to the 13-15%. Many companies pay for "deposits" which are unregulated and loaned by the public against demand notes to the companies which are strapped for cash.

2/ Mueller, Eva: The Indian Development Banks: a Problem Oriented Review. Draft. Oct.6,1967. New Delhi. p.6.

3/ NCAER op cit. Preface.

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Recommendations

In light of the foregoing facts and analyses it may be useful for AID to do the following:

1) Encourage closer informal contact with the ICI's to pursuade them of the importance of general assistance, independence from the Central Government and mobilizing capital. If the ICI's managements were stimulated to have more courage of their convictions they could act more as leaders than followers. However, the contact with the ICI's and the Mission to India is presently limited by a small staff in the Mission due to general personnel cuts and an increasing loan portfolio; this limits the amount of contact with the ICI's.

2) Encourage and finance exchanges of personnel with American bankers and insurance and pension investment officers.

3) Encourage the lenders to seek additional assistance from AID. AID could use that assistance to require bolder lending activities and managerial improvements. ICICI has made an application to AID for a Cooley loan of Rs.150 million. Such a loan could be useful as an experiment in putting to use the knowledge gained by us from this review of ICI's on a world-wide basis.

INDUSTRIAL CREDIT AND INVESTMENT CORPORATION OF INDIA (ICICI)

(Responses are primarily from ICICI. Mission comments are contained in "Overall Evaluation of ICICI, IFC, IDBI and NSIC")

A. Description of the Project

1. Country : India

2. Name of ICI : Industrial Credit & Investment Corporation of India

3. Class of ICI : Private

4. Date Established : January 5, 1955

5. Initial Assistance from AID:

Loan No.	Date Loan Agreement Signed	Dollar Amount Authorized ($Millions)	Kind (i.e. Local Currency, Dollar)
92 (through the Central Government)	May 21, 1959	13.33	Rupees

6. Does ICICI take equity participation? Yes

7. Equity Structure of ICICI as of May 21, 1959 (i.e. date when first AID Loan was made).

	(Rupees Million)
Share Capital, authorized, issued, subscribed and paid-up	50.0
Reserve and Surplus	4.0

8. Subsequent assistance from AID:

Loan No.	Date Loan Agreement Signed	Dollar Amount Authorized ($Millions)	Kind (i. e. Dollar, Local Currency)
386-A-037 (DLF-155)	March 23, 1961	5.0	Dollars
92 Supplement No. 1 (Through the Central Government)	Jan. 10, 1964	13.33	Rupees
92 Supplement No. 2 (Through the Central Government)	Nov. 25, 1965	6.67	Rupees

9. Capital Structure of ICICI at the end of latest fiscal year i. e., December 31, 1967:

	(Millions of Rupees)
Share capital, authorized, issued and subscribed and paid up	75.0
Reserve and Surplus	41.4
Government of India Loan	75.0
IDBI Loan	80.0
Debentures	60.0
AID rupee loan (through GOI	250.0
AID dollar loan	112.5
Kreditanstalt fur Wiederaufbau, Germany (KfW)	37.5
IBRD	1237.5
Total	1968.9

AID dollar loan as percentage of total borrowing	6.07
AID rupee loans as percentage of total borrowing	13.49
AID dollar & rupee loans as percentage of total borrowing	19.56
AID dollar loan as percentage of total foreign currency borrowing	8.10

In 1968 ICICI obtained from KFW two additional loans aggregating DM 12.5 million and a further loan of Rs. 25 million from IDBI. Negotiations are under way for a further loan of DM 5 million from KfW and a loan of £ 1 million from the United Kingdom Government. Details of loans are given in Annexure A.

10. Status of A.I.D. Dollar Loan as of July 1, 1968:

	Millions of Dollars		
Loan No.	Authorized Amount (After deobligation	Commitments	Disbursements
386-A-037 (DLF-155)	4.48	4.48	4.48

11. Interest rates: a) average rate paid by ICICI
b) average rate charged by ICICI

Specify types of lender/borrower if differential rates are operative:

Interest rates on 1967-end outstanding amount are as follows:

a) Average rate paid : 5.1% per annum

b) Average rate charged : 7.8% per annum
(Please see Annexure B for details)

The spread between ICICI's lending and borrowing rates from time to time depending on money market factors. It is not ICICI's policy to vary frequently the rate charged to borrowers.

Changes are made only when significant movements occur in interest rate patterns. The spread finances ICICI's administrative expenses, dividends to stockholders, and building up reserves which strengthens its capital base.

No interest is payable on the Government of India's first loan. For the second, interest is payable at 4-1/2%. Rs. 90 million of the third loan bear interest at 5% and the balance of Rs. 10 million at 5-1/2%. The fourth Government of India loan bears interest at 5-1/2%. IDBI loans bear interest at 5-5/8%. Debentures bear interest at 6%.

Interest payable on the AID dollar loan is 5% and on KfW loans it is 5-1/2%. The first IBRD loan is at 4-5/8% and the sixth at 5-1/2%. The rate of interest payable on other IBRD loans varies, the average rate payable on the second, third, fourth and fifth loans being about 5.75%. The seventh loan is likely to carry an interest rate of about 6-1/2%.

Interest receivable on rupee loans is 6% for authorizations up to April 1957, 6-1/2% for authorizations between April 1957 and August 1962, 7% for authorizations between August 1962 and March 1965 and 8% for authorizations thereafter.

Interest receivable on foreign currency loans is 7% for authorizations up to August 1959, 7-3/4% for authorizations between August 1959 and August 1962, 8% for authorizations between August 1962 and March 1965 and 8-1/2% for authorizations thereafter.

12. Limits on size or uses of loans.

There are no stated limits on the assets size of enterprises ICICI will assist, nor are maximum or minimum limits placed on loans or investment that it will make. Various institutions (like the state financial corporations and National Small Industries Corporation) have been set up to provide finance to medium and small industries. In

practice, the floor on assistance provided by ICICI has been set at Rs. 500,000. In the case of foreign currency loans, smaller loans have been granted where required. ICICI does not generally provide assistance exceeding Rs. 10 million to any one company, but exceptions are made where the importance of a project justifies this.

Proceeds of the loans are used to meet the capital expenditures requirements not financed by commercial banks. ICICI does not make loans only for working capital requirements.

13. Formal criteria, if any.

The Mission assumes that formal criteria here means restrictions on lending and procurement under AID loans. The AID Loan Agreement requires that (a) all eligible items financed under a sub-loan utilizing $100,000 or more of AID funds must be of U.S. source and origin and limits the procurement of eligible items costing below $100,000 to countries included in AID Geographic Code 899, (b) ICICI ship at least 50% of gross tonnage of all eligible items on vessels belonging to privately-owned U.S. flag commercial vessels but permits ICICI to ship the remainder on vessels belonging to countries included in AID Geographic Code 899, (c) ICICI obtain prior AID approval to make any sub-loan in excess of $250,000 in foreign exchange from all sources to a single enterprise involving AID funds and (d) prohibits making of any sub-loan for a period of less than 5 years.

In August 1963, AID restricted the unutilized balance of the loan for financing procurement of goods and services of U.S. source and origin.

14. Number of loans and (to extent practicable) summary by number and amount by sector and/or other relevant categories.

AID's foreign currency loan has been utilized to provide assistance to 18 projects, listed in Annexure F. Rupee loans obtained from AID have been merged with other rupee funds, and a pool formed to carry on ICICI's rupee operations which cover underwriting of public issues, loans, equity investments and guarantees. In view of this it is not possible to indicate the number of sub-loans granted by ICICI under AID's rupee assistance.

15. Relations to the financial community and commercial banks.

ICICI maintains cordial relations with other development financial institutions in India and abroad. In appropriate cases consortium packages for individual projects are arranged between several financing institutions. ICICI currently has seventeen consortium arrangements with the Commonwealth Development Finance Company of London, and six such arrangements with the International Finance Corporation. In addition, ICICI maintains regular contact with its local and foreign creditors and shareholders.

ICICI also has close relationships with other development banks, in India and abroad. In 1962, ICICI held the first Regional Conference of Development Banks in Asia at which representatives of many development banks from Asian countries were represented.

ICICI receives trainees from development banks in India and abroad who come to study its procedures and operations. In 1965, ICICI instituted a program under which it provides free training, to officers of Asian development banks for a period of between six and eight weeks. Trainees from Nigeria, Malaysia, Thailand, Ghana, Mauritius and Singapore have visited ICICI under this program. ICICI has invited trainees from development banks in Ceylon and the Philippines during 1969. Details of this training scheme are given in Annexure C.

ICICI obtains credit information about prospective borrowers from commercial banks, who also provide working capital finance, and close and cordial relations are maintained with this group.

The four major financial institutions (IDBI, IFCI, LIC, ICICI) in the country hold regular monthly inter-institutional meetings. These meetings help the institutions to evolve a common approach towards the financing of individual large projects.

16. Importance as a lender relative to other services, such as underwriter, guarantor, etc.

Because of the amortization schedule pre-set by its lenders as also exchange risks associated with its foreign currency operations, ICICI uses its foreign currency funds only through loans for import of capital equipment. In respect of its rupee assistance, however, there is considerable latitude in the use of these funds. ICICI has used these funds for making loans, underwriting capital issues and making direct equity investments.

At the end of December 1967, ICICI had provided aggregate assistance of Rs. 1,995.6 million. Of this, Rs. 1,108.4 million was in foreign currencies and Rs. 887.2 million in rupees. Of the rupee assistance, Rs. 395.7 million was provided as loans, Rs. 54.5 million as guarantees, Rs. 374.3 million underwriting of shares and debentures, and Rs. 62.7 million by direct investment in shares and debentures. (See also answer to 17 below).

17. Description of the function performed by ICICI and how these have changed, if they have, as the institution has matured.

ICICI was established to undertake the normal functions of an industrial development finance company, i.e., medium and long-term lending, investing in equity, underwriting issues of shares and debentures, guaranteeing loans and providing managerial and technical assistance to local enterprises.

Over the years, while the overall range of these functions have not changed greatly, the operational emphasis has varied with the requirements of the economy. For example, in the early years of its existence, (1955-1958), the capital market was less developed and financial facilities particularly relating to underwriting were not adequate. In keeping with its objectives, ICICI engaged in this business even when it was felt that in the conditions then prevailing, it would have to absorb a substantial portion of issues it underwrote. In 1957-1958 when the shortage of foreign exchange began to be felt in the country, some entrepreneurs turned to ICICI for their foreign currency project requirements. In recent years the capital market has become sluggish and underwriting has again become an important element in ICICI's operations. ICICI has also entered the deferred payment guarantee business in a big way, assisting primarily the fertilizer industry. Annexure D gives a breakdown of annual authorizations according to the nature of operations.

ICICI's emphasis has always been on non-traditional industries such as chemicals and engineering. In recent years, ICICI has provided large foreign currency loans to shipping, and also loans for the cotton and jute textile industries for their programs of modernization.

A classification by industry at the end of 1968 is given in Annexure E.

B. Evaluation on specific points

1. Goals

(a) How much emphasis is placed on the mobilization of additional capital? From the Government?, from private ownership in ICICI and other donors, from the borrower? What is the relative emphasis on local currency vs. foreign exchange? Quantify this answer to the extent possible.

ICICI's resource mobilization is determined by the borrowing rates permitted to it from time to time. Consistent with its capital structure, estimates of requirements of foreign currency and rupee resources, ICICI has been augmenting its resources by increasing its equity, by drawing on various sources (IBRD, KfW) for foreign currency loans, PL 480 funds (for rupee resource), and by issuing debentures in the internal market.

ICICI has so far obtained foreign currency loans from IBRD, USAID, and the Kreditanstalt fur Wiederfbau, an Agency of the Federal Republic of Germany. Recently, ICICI has been negotiating for a loan of one million pounds Sterling from the United Kingdom Government.

(b) Is the increase in the supply of investment funds for industry in general or to supply additional funds on especially favorable terms for special high priority uses? In this connection, how do interest rates (and other terms) compare with those available from other sources, i.e., how is interest rate policy used to try to influence the pattern of investment and what effect does it actually have? Is any consideration given to the comparative advantage of industry, or specific industries, or are high levels of protection and "inefficiency" by international standards accepted?

As a development bank in the private sector, ICICI's main objective has been to provide investment funds to private industry. Its main consideration in assisting new projects has been the viability of the project. By and large, it does not discriminate among projects from different industries though in the selection of projects, preference is given to those projects which have a high priority assigned to them in the Central Government's economic plans. ICICI charges uniform rates of interest (currently at 8-1/2% on foreign currency loans and at 8% on rupee loans) to all projects assisted by it. ICICI also has financed projects involving

new technological processes (foam glass and use of bagasse for paper).

In cases where assisted projects are not able to keep to earlier repayment schedules due to delays in completion of projects, recessionary market conditions or other temporary difficulties, ICICI permits postponement of installment payments or amends the amortization schedule suitably. Similarly, cost over-runs necessitated by any of the above factors or as a result of expansion of capacity are sometimes met by further ICICI assistance.

Questions of efficiency or inefficiency by international standards are left up to the Central Government licensing authorities and are not considered as criteria for lending.

(c) Does the project aim at helping to get a securities market started?

The project did not aim at getting a securities market started. A securities market has existed in India for many years. One of the ancillary objectives in the setting up of ICICI has been to supplement and assist the capital market in the country. ICICI has been performing this function by underwriting new issues, by holding these till such time as a demand is evinced in the capital market and gradually selling them in the market. The underwriting function was intended presumably to supplement the private capital market when the underwriting was less attractive to the private purchaser. In the process ICICI is also able to release its funds, setting them free for use in other projects seeking financial assistance, and also realize a profit for this activity.

Until the end of December 1967, ICICI made sales of investments which cost Rs. 43 million, on which it realized a capital gain of Rs. 15.4 million. ICICI's investment portfolio on that date totalled Rs. 213 million (ordinary shares: Rs. 92.6 million, preference shares: Rs. 38.8

million and debentures: Rs. 81.6 million). Of these, investments amounting to Rs. 191.3 million were quoted, and their market value was Rs. 181 million. It may be noted that this valuation is at a point of time when the stock exchange quotations were at historic low levels; moreover, many of the investments in new companies had not fully matured. And the market value of some of the unquoted investments probably was considerably higher than their book value. Market prices are generally unreliable because the market is thin and subject to wide fluctuations according to supply and demand.

(d) Does the project aim at improving technical, managerial and financial practices of borrowing firms? In general, what stress is placed on increasing the efficiency of use of capital?

ICICI undertakes independent evaluation of all projects seeking its assistance. It tries to bring about changes in projects where required, consistent with its assessment of the requirement of the project relating to technical and managerial expertise, market situation and capital structure. The main objective is to up-grade the viability of the project. The process of project appraisal has always been to be helpful to entrepreneurs. ICICI normally reserves a right to nominate a Director on the Board of companies assisted by it. So far, ICICI has nominated Directors in about 25 companies out of about 500 companies assisted.

ICICI impresses upon its clients, through its follow-up functions, the continuing need for financial planning.

(e) Other goals?

The primary function of ICICI is to act as a development finance company. However, it has been ICICI's endeavor to be of greater use to the economy, to adapt itself to its changing needs and to improve its own relative position in the economy. In the course of its work it has realized

that its physical presence in other areas might help to improve its contacts with its clients and thereby to bring them closer to it. For this purpose, ICICI proposes to build up a network of branch offices, beginning with Calcutta in March 1969.

Three ancillary goals of ICICI are:

(i) ICICI has tried to improve management practices among enterprises. It has introduced new concepts like cash-flow planning to Indian industry, and has exerted financial discipline on company managements. This has been done by a gradual process of education, by persuasion rather than compulsion. Many new enterprises have become familiar with concepts of modern financial management as a result of their relationship with ICICI.

(ii) Since India started with a low base of industrialization, it was felt necessary to broaden the entrepreneurial base of the country. As a result, ICICI has tried to encourage new entrepreneurs to come into the industrial field.

(iii) ICICI has played an active part in financing non-traditional industries, particularly in engineering and chemical field.

Achievement of goals: Discussed in "Overall Evaluation of ICICI, IFC, IDBI and NSIC."

2. Selection of Borrowers

(a) What economic criteria are employed? Are the formal criteria and the actual ones the same?

Encourage particular kinds of industries?

Exporters?

Import substitution?

Small and medium industries?

Use of domestic raw materials?

Others?

Are the criteria determined by the government? ICICI? AID? Jointly?

Formal Criteria

Any joint stock company belonging to the private sector can approach ICICI for financial assistance which may be for the purpose of running a new enterprise or for expansion or modernization of an existing unit. Forms of financial assistance extended by ICICI are:

a) Long and medium term loans (both rupee and foreign currency) not exceeding 15 years;

b) Equity participation;

c) Underwriting of new shares and debentures; and

d) Guarantees of loans raised from other private sources.

Economic and Actual Criteria

ICICI will provide financial assistance to any project provided that:

a) It can provide a satisfactory return on its investment,

b) The promoters of the project have a substantial stake in the project, and the financial structure of the project reveals a satisfactory balance between equity and debt; and

c) The project has or undertakes to obtain satisfactory management and has available to it expert technical advice either through its staff or consultancy arrangements.

ICICI has financed projects whose pre-tax profitability ranges from 5 percent to 35 percent. If ICICI is satisfied that other criteria have been met (adequate managerial efficiency and integrity of management), then ICICI is willing to provide assistance. If the pre-tax profitability is higher than 35% it will consider an investment. Cash-flow estimates are obtained through the period of the loan, and greater attention is paid to that period following the cessation of tax shields.

ICICI generally prefers an outside debt-equity ratio of 1:1. Where there is relatively weak management, initial production problems or marketing difficulties, ICICI would prefer that the ratio be better than one to one. For capital-intensive industries like aluminium and nitrogenous fertilizers, ICICI will accept an higher debt-equity ratio, going generally up to 1.5 to one. For the purpose of calculating the debt-equity ratio, debt is defined as only long-term debt, equity includes paid-up capital and other net worth reserves.

Very often, particularly in the case of new entrepreneurs, the projects in the formative stages do not have adequate technical or managerial resources to carry out negotiations for collaboration, selected potential sites or processes, or make market surveys. In such cases, ICICI requires that such projects be strengthened either by direct recruitment of skilled staff and employment of consultants. In the early course of discussions with the promoters, ICICI explains the need to take such steps to strengthen the project.

In India the process of licensing that has been in operation takes care of the various economic considerations underlined in individual projects. Within this framework, ICICI applies certain basic criteria in the selection of projects for its assistance. These criteria which have been determined by ICICI itself include (a) augmenting the flow of scarce goods in the economy, (b) promotion of import substitution and export promotion, (c) development of new entrepreneurs, new products, utilization of hitherto unused raw materials, utilization of by-products and (d) profitability of the project.

(b) Are research, surveys and/or promotional work undertaken to stimulate borrowing for particular purposes or does ICICI simply process applications submitted? Is there a problem of equipment salesmen and other promoters stimulating the wrong kind of application? If so, how is it dealt with?

For the greater part of its operations since its inception, ICICI has financed projects brought to it by entrepreneurs for assistance. Lately, however, with the economy having attained a fair degree of saturation in some lines, ICICI has been undertaking promotional work to identify potential sources of clients; new avenues of industries such as electronics, alloy steel, chemical complexes have been receiving attention by ICICI. On the basis of investigation work, industry studies are performed which cover problems of finance, market and other areas of interest to ICICI in a financing decision. Moreover, visits are also made by ICICI staff to places of concentration of small and medium industries in the country to become acquainted with the operational conditions and investment problems in these industries. ICICI has made studies of cotton textile and jute industries, as also of small industries in Rajkot (Gujarat State) and Ludhiana (Punjab State). The main object of these studies is to keep the institution aware of the changing problems in the

developing economy and to increase its utility and operations as opportunities arise. A member of ICICI's staff prepared for the United Nations Industrial Development Organization a paper on the "Financing of Small Industry".

(c&d) Are the technical and financial criteria and reviews appropriate? Effectively applied? What changes are appropriate at this stage or would you recommend in the process of selecting a borrower?

One of the main conclusions that has emerged out of ICICI's operations is that the nature of problems faced by a developing economy goes on changing in the economy and a development bank, to be effective and useful, has to adapt itself to the needs of a changing economy. As a result, ICICI's procedures, criteria and evaluation system have undergone a continuous process of internal scrutiny and refinement.

The objective of a project appraisal remains the same today as it was when ICICI started: determination of the viability of a project with a view to arriving at a financing decision. However, the procedure and criteria of appraisal have undergone many changes over the period. Some of the areas in which these refinements have been introduced are noted here: (a) The analysis of company accounts has been made more elaborate. Particularly greater emphasis is now laid on the current ratio and the constituents of such ratio to determine the inherent strength or weakness of the company. Accounts of earlier years are also analyzed on a cash-flow basis. (b) In recent years, ICICI has strengthened its analysis of specific industries in which it has or hopes to have projects as also of the relative position of the company financed by it in the industry. Such analysis is made to determine the strong and the weak points of the companies, particularly in respect of their financial strength and market position. (c) With experience, ICICI's estimating procedures have improved. Cost estimates are related

to data gained from earlier projects financed by ICICI; adequate emphasis is given to safety margins and contingencies.

In two other specific areas ICICI has tried to strengthen its procedures: (a) Market research is now given much greater emphasis. More attention is also paid to the role of overall economic developments in influencing the market position of individual sectors or products. (b) Secondly, with increasing portfolio (and economic uncertainties), follow-up of projects financed has become an important element in ICICI's operations. A closer watch is kept on all projects which are financed by ICICI, and an attempt made to anticipate the likely problems that might arise in the course of their execution and initial operation. More frequent visits are paid to projects to keep in touch with them.

ICICI recognizes that procedures must adapt themselves to changing problems. Therefore, procedures are not treated as a constant but are kept under continuous review.

In the course of its operations over the years, ICICI has tried to adapt itself to the environment of the economy in various ways. With the increasing foreign exchange difficulties of the country, ICICI now provides loans for balancing equipment required by very large industries; and improving the quality of the products of such industries. During the last five years, ICICI has also tried to finance a large number of companies interested in making available various agricultural inputs; for this purpose, ICICI has financed companies with programs to manufacture fertilizers, tractors, power tillers and pesticides.

In regard to the capital market, ICICI has helped mobilization of funds in various ways. Approximate estimates show that for every rupee of financing by ICICI, the total

of resources mobilized by companies assisted by it amounts to Rs. 5. In this sense, ICICI finances act as a catalyst which helps to mobilize resources from other sources. In addition, when ICICI undertakes underwriting operations, it tries to get part of such underwriting sub-underwritten so as to broaden the market for securities.

By its Articles, ICICI finances projects in the private sector; this is interpreted to include projects where some amount of public participation is involved, as in cases like Gujarat State Fertilizers. ICICI operations over the years has helped to broaden the industrial base and to widen private ownership of industry.

The following are discussed under "Overall Evaluation of ICICI, IFC, IDBI and NSIC":

3. Management and operational policies.

4. Specific AID relationships.

C. Overall Evaluation and Conclusions.

ANNEXURE B

Working Sheet on Interest Rates

	Rate (1) %	Outstanding amount at 1967-end (2) (Millions of Rupees)	Col: mul: by	(1) ed nn (2)
a) AVERAGE RATE PAID BY ICICI				
Rupee Loans -				
Government of India	0	75.0		
	4-1/2	100.0	4	
	5	90.0	4	
	5-1/2	60.0	3	
IDIBI	5-5/8	80.0	4	
Debentures	6	60.0	3	
Foreign Currency Loans -				
IBRD	4-5/8	15.1	6	
	5-1/2	76.4	42	
	5-3/4	382.6	220	
AID	5	27.7	13	
Kfw	5-1/2	55.6	30	
Total	-	1022.4	517	
Average rate paid	5.1			
b) AVERAGE RATE CHARGED BY ICICI				
Rupee Loans -	6	1.9	1	
	6-1/2	45.0	292	
	7	100.9	706	
	8	90.3	722	
Foreign Currency Loans -	7	11.5	80	
	7-3/4	149.3	1157	
	8	308.4	246[illegible]	
	8-1/2	121.5	10[illegible]	
Total	-	828.8	647[illegible]	
Average rate charged	7.8			

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ANNEXURE A

Details of Borrowings of ICICI Concluded up to December 31, 1968

Source	Year of sanction	Rate of Interest	Amount
RUPEE RESOURCES			(Millions of Rupees)
Government of India Loans -			
I	1955	Nil	75
II	1959	4-1/2%	100
III	1965	5% for Rs. 90 million) 5-1/2% for Rs. 10 million)	100
IV	1966	5-1/2%	50
			325
Industrial Development Bank of India Loans -			
I	1966	5-5/8%	50
II	1967	5-5/8%	30
III	1968	5-5/8%	25
			105
Debentures	1967	6%	60
FOREIGN CURRENCY RESOURCES			(Millions of Dollar
IBRD loans -			
I	1965	4-5/8%	10
II	1950	varying	10
III	1960	according	20
IV	1962	to	20
V	1963	project	30
VI	1965	5-1/2%	50
VII	1967	varying according to project	25
			165
AID Loan	1961	5%	5
Kfw Loans			(Millions of Dolla
I	1963	5-1/2%	20
II	1964	5-1/2%	5
III	1964	5-1/2%	10
IV	1965	5-1/2%	5
V	1966	5-1/2%	20
VI	1968	5-1/2%	5
VII	1968	5-1/2%	7.5
			72.5

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Note: Negotiations are under way for eighth loan of DM 5 million from Kfw and a loan of £ 1 million from the United Kingdom Government.

ANNEXURE C

ICICI Trainee Scheme

ICICI proposes to provide training in practical aspects of development banking to two staff members of development banks in South East Asia, Africa and other countries. The training will consist of five weeks of internship at ICICI, a two weeks' tour of industrial centers in India, and a final week of general summing up at ICICI.

Time: The training schedule will be for eight weeks in the months January-February of any year.

Selection: Rather than having a competitive selection from nominations received from development banks, ICICI will ask two selected development banks to nominate a staff member for training. In selecting a development bank, ICICI will be in touch with the International Finance Corporation. The Central Government of India has been informed of this scheme.

The programme will be focused on various aspects of development banking, such as projects appraisal, accounting implications (including disbursements), follow-up work and legal procedures. It would be useful to emphasise that, to be able to obtain the maximum benefit out of the training, the nominee should have had a working experience of about one year.

Training: It is expected that of the eight weeks of training at ICICI, two weeks will be spent in the project department, two weeks in the follow-up and one week in other departments.

After a day's general orientation on the Indian economy and ICICI's place in it, the trainees will be assigned for a two-week program in the Project Department. They will first be given active files for study, then allocated to work with officers in the department and will be associated with all the work done by the officers. The third week will be devoted to a tour of industrial centers in Delhi and Calcutta. They will visit not only projects assisted by ICICI but also projects which are of interest from the point of view of the nominating banks. A departmental officer will accompany the trainees on this tour.

The fourth and fifth weeks will be spent by the trainees in the follow-up Department followed by a week's tour of visits to projects and industrial estates in Hyderabad, Bangalore and Madras. In the seventh week the trainees will go through the other departments of ICICI.

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The last week (or three days) of the training program will be devoted to rounding off at ICICI. In this period, the trainees will be given a free run of ICICI, being able to visit any officers or departments of ICICI they consider necessary. This period might also be used by them to write a report on the training and by ICICI in eliciting their views on the training program and means of improving it.

Cost: ICICI would meet the return air-fare (economy class) of the trainees. A per diem of Rs. 100 plus all travel expenses, might be paid.

ANNEXURE D

Annual Net Sanctions

(Millions of Rupees)

	Foreign Currency Loans	Rupee Loans	Guarantees	Under-writing	Direct Subscription	Total
1955	-	1.8	-	18.7	14.9	35.4
1956	-	17.7	-	5.2	1.9	24.8
1957	35.4	2.8	-	27.1	4.3	69.6
1958	14.1	2.5	-	1.5	3.7	21.8
1959	56.7	0.2	-	30.6	8.8	96.3
1960	92.8	30.5	-	13.6	2.0	138.9
1961	107.0	36.6	-	5.5	3.0	152.1
1962	142.0	41.2	2.3	31.1	9.8	226.4
1963	174.0	61.8	20.2	35.3	3.0	294.3
1964	149.7	45.1	-	53.9	8.9	252.6
1965	169.6	55.7	-	50.2	3.1	278.6
1966	103.0	50.8	-	33.1	2.3	189.2
1967	64.1	49.0	32.0	68.5	2.0	215.6
1968	210.4	24.7	13.6	59.0	1.8	309.5
	1318.8	420.4	68.1	433.3	64.5	2305.1

Note: Foreign currency loans for all the years have been converted at the revised parity of the rupee.

ANNEXURE E

Distribution of Financial Assistance by Industry

Industry	Net amount sanctioned (Rs. million)	Percentage of amount sanctioned to total sanctions %
Automobile and cycles	168.1	7.3
Cement	132.5	5.7
Chemicals and Chemical Products	457.1	19.8
Electrical equipment	196.6	8.5
Electricity, gas and steam	54.5	2.4
Food products (other than sugar)	28.4	1.2
Glass, pottery etc.	67.7	2.9
Machinery manufacture (other than electrical)	259.7	11.3
Metal products, ferrous	365.5	15.9
Metal products, non-ferrous	82.1	3.6
Pulp, paper and paper products	110.4	4.8
Rubber products	56.8	2.5
Shipping	83.9	3.6
Sugar	26.7	1.2
Textiles	145.1	6.3
Wood, cork and hardboard	18.1	0.8
Miscellaneous	51.9	2.2
	2,305.1	100.0

ANNEXURE F

Number of Loans under AID Assistance

Name & Location of Company	Product	Maturity Period	Interest Rate	Amount Sanctioned & Disbursed ($ in thousands)	Amount Repaid ($ in thousands)	Amount Outstanding ($ in thousands)
Ahmedabad Advance Mills Ltd. Navsari (Gujarat)	Cold rolled strips	1969-75	8-1/2	639	-	639
Aluminium Industries Ltd. Kundara (Kerala)	Aluminium conductor rods	1966-73	8	91	35	56
Bharat Electrical Industries Ltd. Calcutta (W.B.)	GLS lamps	1964-72	7-3/4	9	4	5
Delta Products Private Ltd. Thana (Maharashtra)	Automobiles leaf springs	1966-72	8	53	-	53
East Anglia Plastics (India) Ltd. Calcutta (W.B.)	Plasticisers	1966-73	8	89	34	55
Gabriel India Ltd. Mulund (Maharashtra)	Shock absorbers	1966-75	8	200	45	155
Hyderabad Allwyn Metal Works Ltd. Hyderabad (A.P.)	Tipping gears and semitrailers	1966-75	8	127	20	107
India Carbon Ltd. Gauhati (Assam)	Petroleum coke	1963-70	7-3/4	27	19	8
Karamchand Premchand Pvt. Ltd. Baroda (Gujarat)	Glass	1966-74	8-1/2	309	84	225
Khodiyar Pottery Works Ltd. Bhavnagar (Gujarat)	Sanitaryware	1965-70	7-3/4	48	26	22
Panyam Cements & Mineral Industries Limited Bugganipalli (A.P.)	Cement	1966-	8-1/2	76	26	50

Name & Location of Company	Product	Maturity Period	Interest Rate	Amount Sanctioned & Disbursed ($ in thousands)	Amount Repaid ($ in thousands)	Amount Outstanding ($ in thousands
Precision Bearings India Ltd. Baroda (Gujarat)	Ball & roller bearings	1966-76	7-3/4	167	18	149
Power Cables Pvt. Ltd. Vithalwadi (Maharashtra)	Welding electrodes	1966-71	8	94	35	59
Sylvania & Laxman Ltd. Delhi	Fluorescent lamps	1968-79	8	418	-	418
Saurashtra Cement & Chemical Industries Ltd, Ranavav (Gujarat)	Portland cement	1966-75	8	292	292	-
Voltas Ltd. Thana (Maharashtra)	Power capacitors & airconditioning	1965-73	8	87	32	55
Wyman Gordon India Ltd. Thana (Maharashtra)	Forgings	1965-71	7-3/4	545	285	260
W.S. Insulators of India Ltd. Madras (Tamil Nadu)	High tension insulators	1967-75	8	1203	-	1203
TOTAL				4474	955	3519
Equivalent Rs. in million				33.6	7.2	26.4

INDUSTRIAL FINANCE CORPORATION OF INDIA (IFC)

(Responses are primarily from IFC. Mission comments are contained in "Overall Evaluation of ICICI, IFC, IDBI and NSIC.)

A. Description of the Project

1. Country : India

2. Name of ICI : Industrial Finance Corporation of India, New Delhi (IFC)

3. Class of ICI : Mixed

4. Date Established : July 1, 1948

5. Initial Assistance from AID:

Loan No.	Date Loan Agreement Signed	$Amount Authorized (millions of $)	Kind (i.e. dollar, local currency)
386-A-034 (DLF-118)	December 7, 1960	10	Dollar

6. Does the IFC take equity participation? Yes

7. Capital Structure of the IFC as of the date specified in 5 above (Dec. 7, 1960)

	(Million Rupees)
Authorized capital	100.00
Issued and paid up capital	50.00
Reserves	12.18

8. Subsequent Assistance from AID:

Loan No.	Date Loan Agreement signed	Dollar Amount Authorized (millions of dollars)	Kind (i. e. Dollar, Local Currency)
386-H-062	March 31, 1966	20	Dollar
386-H-131	April 10, 1965	10	Dollar
93	May 21, 1959	13.33 (equivalent)	Rupees
93	January 10, 1964 (Supplement No. 1)	13.33 (equivalent)	Rupees
146	May 23, 1967 (Amendment No. 1)	13.33 (equivalent)	Rupees

9. Capital Structure of IFC at the end of latest fiscal year i. e. June 30, 1968:

	(Million of Rupees)
Authorized Capital	100.00
Issued and paid up	83.46
Reserves	94.52
RBI loan	4.36
Bonds	414.51
Central Govt.	324.69
AID rupee loan (through GOI)	375.00
AID dollar loan	181.85
Other foreign currency loans	17.78
Total	1,496.17

AID dollar loan as percentage of total borrowing	13.79%
AID rupee loan as percentage of total borrowing	28.45%
AID dollar and rupee loan as percentage of total borrowing	42.24%
AID dollar loan as percentage of total foreign currency borrowing	91.09%

10. Status of AID Dollar loans as of July 1, 1968:

	Thousands of Dollars		
Loan No.	Authorized Amount (After deobligation)	Commitments	Disbursements
386-A-034 (DLF-118)	9,627	9,627	9,627
386-H-062	20,000	19,983	14,620
386-H-131	4,000	2,934	Nil

11. Interest Rates:

(a) Average rate paid by IFC for the year ended June 30, 1968:

	Millions of Rupees		
Source of Borrowing	Average Loans Outstanding	Interest Paid	Average Rate %
Central Government	699.69	35.46	5.07
Reserve Bank of India	4.36	0.23	5.29
Issue of Bonds	414.51	20.50	4.95
Foreign Currency Loans (USA, Germany and France)	199.63	10.87	5.44
Total:	1,318.19	67.06	5.09

(b) Average rate charged by IFC for the year ended June 30, 1968:

Particulars	Millions of Rupees		
	Average loans Outstanding	Interest Charged	Average Rate (%)
Rupee Loans	1,093.25	75.05	6.87
Foreign currency loan	227.93	19.14	8.40
Total	1,321.18	94.19	7.13

IFC has been charging interest from its borrowers at a uniform rate. The present rate of interest is 8% on rupee loans and 8.5% on foreign currency loans.

12. Limit on size or uses of loan

a) Limits on sizes

Under the IFC Act of 1948, no minimum amount has been specified in respect of loans that may be granted to a single industrial concern. Since State Financial Corporation (SFC's) can authorize loans up to Rs. 2.0 million to a single enterprise, IFC normally does not entertain application for rupee loans of less than Rs. 2.0 million. An exception to this rule is made when a company requires other facilities such as a foreign currency loan, underwriting of shares and debentures and guarantees for deferred payments for plant and machinery to be imported in addition to a rupee loan. Loans exceeding Rs. 20 million are made only with the approval of the Industrial Development Bank of India.

b) Uses

Proceeds of the loans are normally used to meet the capital expenditure requirements of the project and the marginal working capital requirements not financed by commercial banks. IFC does not make loans solely for working capital requirements.

13. Formal criteria if any

The Mission assumes that formal means the lending and purchasing criteria to which AID restricts IFC and its borrowers in their activities. Section B-2, "Selection of borrowers" covers other criteria.

a) Criteria for IFC I

The AID Loan Agreement dated December 7, 1960 requires that (a) all eligible items financed under a sub-loan utilizing $100,000 or more of AID funds must be of U.S source and origin and limits the procurement of eligible items costing below $100,000 to countries included in AID Geographic Code 899; (b) IFC ship at least 50% of gross tonnage of all eligible items on vessels belonging to privately-owned U.S. flag commercial vessels but permits IFC to ship the remainder on vessels belonging to countries included in Code 899; (c) IFC obtain prior AID approval to make any sub-loan in excess of $250,000 to a single enterprise involving AID funds, and (d) IFC give notice of publication in the Small Business Circular for goods and services costing more than $5,000.

In March 1963, AID restricted procurement of all goods and services to U.S. source and origin.

b) IFC II

The AID Loan Agreement dated June 28, 1962 requires that (a) IFC give notice of publication in Small Business Circular for goods and services costing more than $5,000 ; (b) all eligible items financed under the loan must be of U.S. source and origin; (c) IFC ship at least 50% of gross tonnage of all eligible items on vessels belonging to privately-owned U.S. flag commercial vessels but permits IFC to ship the remainder on vessels belonging to countries included in AID Geographic Code 899, (d) IFC obtain AID approval to make any sub-loan in excess of $500,000 to a single enterprise involving AID funds and (e) prohibits IFC to make a sub-loan financed in whole or part under the Loan Agreement to any single project in excess of $3 million exclusive of the currency of payment.

14. Number of loans under AID assistance and the amounts thereof classified on industry-wise basis as on December 31, 1968:

Type of Industry	No. of sub-loans	Total U.S.$
1. Manufacture of Textiles - Spinning, Weaving & finishing of textiles	2	160,946
2. Manufacture of artificial fibres	1	393,736
3. Manufacture of wood & cork except manufacture of furniture	2	1,241,380
4. Manufacture of paper & paper products	7	3,420,341
5. Manufacture of rubber products	3	728,059
6. Manufacture of fertilizers	-	-
7. Manufacture of miscellaneous chemical products	8	7,788,928
8. Manufacture of basic industrial chemicals	6	2,690,015
9. Manufacture of glass & glass products	3	838,372
10. Manufacture of pottery, china & earthenware	2	336,000
11. Manufacture of cement	4	2,159,699
12. Basic metal industries - iron & steel	1	363,036
13. Manufacture of metal products except machinery & transport equipment	5	3,235,842
14. Manufacture of machinery except electrical machinery	2	923,530
15. Manufacture of electrical machinery, apparatus, appliances & supplies	6	2,002,588

16.Manufacture of motor vehicles & ancillaries	4	736,481
17.Miscellaneous manufacturing industries	2	458,865
18.Electricity, gas & steam	3	1,401,522
Total	61	28,879,340

15. Relations with financial community and commercial banks

The Cooperation's relations with the financial community and commercial banks are outlined below:

(a) Half of the share capital of the IFC is held by the IDBI, which is a wholly-owned subsidiary of the Reserve Bank of India and the remaining 50% of the IFC's shares are held by (i) commercial banks (20%) (ii) insurance companies and other financial institutions (22%) and (iii) cooperative banks (8%). The IDBI has the right to nominate four directors on the IFC's Board and the other three categories of shareholders elect two directors each to the Board.

(b) IFC obtains credit information on its potential borrowers from the borrowers' banks and close relations are maintained with the latter.

(c) In order to enable industrial concerns to cover fully their financial requirements, the IFC is prepared to share the first charge on the fixed assets with other financial institutions including commercial banks. In certain cases, even a second charge on the mortgaged assets is permitted in favor of most lenders in the financial community. Such arrangements for joint financing of projects provide opportunities for useful interchange of information and views regarding projects for which assistance is required, and have worked quite satisfactorily.

(d) In case of large projects, where it is considered not advisable for any single institution to meet the entire requirements of finance, the IFC participates in the financing of such ventures alongwith other financial institutions like the IDBI, LIC, ICICI, the Unit Trust of India and the commercial banks. Such participation may be in the form of sharing of loans, underwriting of shares and debentures, and guarantees for deferred payments for plant and machinery etc.

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(e) Periodic meetings of the chief executives of the financial institutions like the IDBI, LIC, ICICI and IFC are held under the auspices of the IDBI as the apex body in the field of industrial finance. At such meetings, views are freely exchanged about the technical and financial viability of the new projects seeking joint assistance and also about the problems of the undertakings already financed. Other matters of common interest including matters of policy and procedure in the field of industrial finance are also discussed.

16. Importance as a lender relative to other services such as underwriter, guarantor etc.

The following table shows by type of activity, the breakdown of the financial assistance authorized and disbursed by the IFC through June 30, 1968:

	Millions of Rupees		
	Sanctions (net)		Amount
	No.	Amount	Disbursed
1. Loans			
Rupees	570	1,904.0	1,675.8
Foreign Currency	113	383.9	285.4
Total:	683	2,287.9	1,961.2
2. Underwritings			
Equity shares*	118	97.0	72.9
Preference shares*	88	61.8	41.1
Debentures	16	70.3	59.9
Total:	222	229.1	173.9
3. Direct Subscriptions			
Equity shares	3	01.6	00.9
Debentures	1	18.2	18.2
Total:	4	19.8	19.1
Total of 1 through 3:	909	2,536.8	2,154.2
4. Deferred Payment Guarantees:	38	279.0	274.4
5. Guarantees for foreign currency loans	5	234.7	233.3
Total of 1 to 5	952	3,050.5	2,661.9

* 64 cases cover both equity and preference shares.

It will be observed from the above table, that the bulk of the assistance granted by the IFC has been in the form of rupee loans, and it had authorized through June 30, 1968 rupee loans of Rs. 1, 904 million of which amount Rs. 1, 676 million had been disbursed. Approvals of foreign currency loans to the same date amounted to Rs. 384 million, of which Rs. 285 million had been disbursed. The foreign currency sub-loans sanctioned by the Corporation consisted of Rs. 240 million of dollar sub-loans, Rs. 125 million of Deutsche Mark sub-loans and Rs. 19 million of French Francs sub-loans - the amount of sub-loans sanctioned in U. S. dollars being the highest.

For underwriting the direct subscriptions to shares and debentures, the IFC had authorized the sum of Rs. 250 million of which the amount disbursed was Rs. 194 million. Guarantees for deferred payments sanctioned by the IFC through June 30, 1968 were Rs. 279 million, of which guarantees to the extent of Rs. 274 million had been actually issued. Guarantees for foreign loans sanctioned amounted to Rs. 235 million, of which guarantees actually issued were of the order of Rs. 233 million.

17. Description of the functions performed by the IFC and how these have changed, if they have, as the institution has matured.

The IFC's main activity during the first ten years of its existence was lending rupees. It was felt that the IFC should gather sufficient experience in making medium and long-term loans and also consolidate its financial position, before taking up other operations such as underwriting public issues of shares or debentures. In 1957-58, the IFC began underwriting operations on a modest scale. During the past few years when the capital market was rather weak, the IFC's underwriting activity has been quite sizeable. By June 30, 1968, the Corporation had underwritten issues of shares and debentures worth Rs. 211 million, out of which IFC took Rs. 174 million for its own portfolio.

Beginning with the year 1960-61, when the IFC was able to secure the first line of A. I. D. credit of $10 million (IFC I), it started the sanction of foreign currency sub-loans also. Through 30 June 1968, the IFC had obtained foreign credits of U. S. $33. 63 million from A. I. D., D. M. 92. 5 million from the Kreditanstalt (Germany) and a credit of 15 million French Francs from the B. F. C. E. (France).

Under these credits, the IFC sanctioned 61 sub-loans in U.S. dollars aggregating 28.88 million (Rs.218 million); 67 Deutsche Marks sub-loans for an aggregate amount of D.M. 66.99 million (Rs.125 million); and 9 sub-loans in French Francs aggregating F.F. 12.26 million (Rs.19 million). The total amount of sub-loans sanctioned out of the credits from A.I.D., Kreditanstalt and B.F.C.E. was Rs.362 million.

Consequent upon the amendments made to the IFC Act in the years 1957 and 1960, the IFC took up the business of guaranteeing deferred payments for import of plant and machinery from abroad and of guaranteeing foreign currency loans raised by industrial concerns from foreign financial institutions. As stated under question 16, the IFC had sanctioned through June 30, 1968 guarantees of deferred payments of Rs.279 million and guarantees for foreign currency loans for the sum of Rs.233 million.

B. Evaluation on Specific Points

1. Goals

a. How much emphasis is placed on the mobilization of additional capital? From the Government? From the private sources? What is the relative emphasis on local currency vs. foreign exchange? Quantify this answer to the extent possible.

The main sources of funds of IFC other than its own share capital are borrowings from the market by issue of bonds, loans from the central government and foreign credits.

(i) Share Capital: The IFC was established with an authorized capital of Rs. 100 million of which the first issue of Rs.50 million was made in July 1948. With a view to augmenting its resources, the IFC made a second issue of Rs.20 million in March 1961. Consequent upon the establishment of the Industrial Development Bank of India in August, 1964, when the shares held in the IFC by the Central Government and the Reserve Bank of India were transferred

to the IDBI, a further issue of Rs. 13.5 million was taken up by the IDBI so that its shareholdings came to 50% of the total paid-up capital of the IFC; the remaining 50% being held by commercial banks, cooperative banks, and insurance concerns and other financial institutions.

(ii) Reserves: The reserves of the IFC consist of appropriations from profits to the General Reserve Fund maintained under Section 32 of the IFC Act, the Special Reserve Fund maintained under Section 32A of the IFC Act, and the Special Reserve Fund maintained under Section 36(1) (viii) of the Income Tax Act, 1961. These reserves are being strengthened from year to year to strengthen the resources of the IFC and the amounts held in various reserve categories on June 30, 1968 were:

	(millions of Rupees)
(a) General Reserve Fund under Section 32 of the IFC Act.	Rs. 58.6
(b) Special Reserve Fund under Section 32A of the IFC Act.	Rs. 9.7
(c) Special Reserve Fund under Section 36(1)(viii) of the Income Tax Act, 1961	Rs. 19.8
	Rs. 88.1

In addition to the above reserves, the IFC had built a reserve for doubtful debts aggregating Rs. 6.4 million as on the 30th June 1968.

(iii) Borrowings from the market by issue of bonds: The IFC has been entering the market from time to time to obtain funds by issue of bonds and the aggregate outstanding amount stood at Rs. 432.9 million on the June 30, 1968. A breakdown of the bonds taken up by the various parties as on June 30, 1968 was:

	(millions of Rupees)
Life Insurance Corporation of India	108.37
State Bank of India and its subsidiaries	68.87
Reserve Bank of India	22.02
State Governments	18.01
Banks other than State Bank and its subsidiaries	171.07
Insurance companies other than LIC	6.14
Other miscellaneous parties	38.45
Total	432.93

(iv) Borrowings from the Central Government: Borrowings from the Central Government on June 30, 1968 amounted to Rs. 722.5 million.

(v) Borrowings from the foreign financial institutions: The following table shows the foreign credits which were available with the IFC on the June 30, 1968:

	Amount of foreign credits available (Million)	Amount of effective subloans sanctioned (Million)	Amounts Disbursed (Million)
Loan from AID (USA)	$ 33.63	32.54	24.25
Loan from KFW (West Germany)	DM92.50	66.99	50.69
Equipment credit from BFCE (Paris)	FF15.00	12.26	8.53

To summarize, the Corporation made cash disbursements of the order of Rs. 2,154 million in the form of rupee loans, foreign currency loans and the amounts paid on shares and debentures held in its investment portfolio in pursuance of underwriting obligations as follows:

	(Millions of Rupees)
Rupee loans	1,676
Foreign Currency loans	285
Investment in shares and debentures	193
	2,154

The above disbursements were financed from the following sources:

	(Millions of Rupees)
Paid up capital	83
Reserves	94
Borrowings from the market by issue of bonds	433
Borrowings from the Central Govt.	723
Foreign credits	286
Repayments of rupee loans and sale of investments etc.	535
	2,154

b. Is the main purpose to increase the supply of investment funds for industry in general or to supply additional funds on especially favorable terms for special high priority uses? In this connection, how do interest rates (and other terms) compare with those available from other sources, i.e., influence the pattern of investment and what effect does it actually have? Is any consideration given to the comparative advantage of industry, or specific industries?

The primary role of IFC is to provide medium and long-term credit to industrial projects - medium and large-sized - in the private sector, for the setting up of new industrial enterprises and

also for renovation, modernization, expansion or diversification of the existing ones. Generally, the aim is to make credits more readily available to industrial concerns in India, particularly in circumstances where normal banking accommodation is inadequate or recourse to capital issue methods is impracticable. Any public limited company or cooperative society incorporated and registered in India which is engaged or proposes to engage itself in the manufacture, preservation or processing of goods or in the shipping, mining, or hotel industry or in the generation or distribution of electricity or any other form of power is eligible for financial assistance from the IFC. The IFC has covered in its scope of assistance a wide variety of industries, e.g. basic industrial chemicals, fertilizers, petro-chemicals, ferrous and non-ferrous metals, electrical and other machinery, machine-tools, motor vehicles and accessories, bicycles, agricultural implements, rubber products, artificial fiber, ceramics, refractories, electricity undertakings, cement, paper and pulp, glass mining, hotels, sugar and cotton textile industries.

In consonance with the Government's policy of affording special encouragement to industrial cooperatives, IFC has played a significant role in the development of the cooperative sector. Effective financial assistance sanctioned by the IFC upto the 30th June 1968 for 70 industrial cooperatives (62 sugar cooperatives, 7 textile cooperatives and 1 cooperative unit for extraction of vegetable oil) amounted to Rs. 568 million. Loans to industrial cooperatives, have as a matter of policy been granted on somewhat favorable terms in the matter of margin of security (no concession in the rate of interest is, however, allowed).

The IFC has contributed in a large measure towards the setting up of a new industrial projects; out of the total assistance of Rs. 3,050 million sanctioned by it up to the June 30, 1968, about two-thirds of it (about Rs. 2,0 billion) had been sanctioned for new industrial projects, the total cost of such projects being of the order of Rs. 7,810 million which itself is a measure of resources that had to be mobilised for completion of these projects.

The IFC has not been following a policy of allowing concessional rates of interest for any particular types of industries. During the current year 1968-69, however, the Central Government had earmarked Rs. 50 million to be advanced to the jute industry for its modernization and diversification and entrusted the IFC with the responsibility of disbursing the amount. The loans granted under this arrangement carry a concessional rate of 7% per year effective as against the IFC's normal lending rate of 8% per year effective on rupee loans. The difference of 1% is subsidized by the Central Government.

Under its charter, the IFC can only extend financial assistance for setting up of industrial projects which are broadly within the framework of the country's Five Year Plans and for which the applicant concerns have obtained the industrial licenses or other requisite approvals from Government. The IFC is not expected to promote or initiate any project, on its own, but can only extend financial assistance in the form of loans, guarantees or underwritings of shares and/or debentures, to meet a part of the capital cost of such projects.

Interest rates charged by the IFC are fixed after considering the cost of raising funds to the IFC and the conditions obtaining in the money market from time to time including such factors as changes in the bank rate announced by the Reserve Bank of India. So far, interest rate policy has not been designed with a view to influencing the pattern of investment in particular fields of industries. Only in the case of financing of the jute industry for its modernization and diversification programs as mentioned earlier, has the IFC agreed to charge a relatively lower rate of interest, but here again the IFC will be subsidized by the Central Government to the extent of the concession allowed to the jute industry. Commercial banks make term loans at 8 1/2%.

c. Does the project aim at helping to get a securities market started?

The project did not aim at getting a securities market started. A securities market has existed in India for many years. The IFC has been active as part of the securities market, however.

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The IFC had signed upto June 30, 1968, underwriting agreements in 140 cases for an aggregate amount of Rs. 211 million. In pursuance of its underwriting obligations the IFC has been called upon to take up shares and debentures to the extent of Rs. 174 million as shown below:

	Millions of Rupees		
	Amount underwritten	Amount taken by the IFC	Percentage taken by the IFC
Equity shares	87	73	84
Preference shares	56	41	74
Debentures	68	60	88
	211	174	82

The underwriting operations of the IFC are of considerable assistance to industrial entrepreneurs, particularly for new enterprises the very fact that IFC has agreed to underwrite means that the project has been subjected to careful financial and technical analysis and this helps the company to mobilise financial assistance from other sources. In other words, the underwriting operations of the IFC act as catalytic agent in the capital market.

The IFC is always interested in selling at a profit the shares and debentures it holds as a result of its underwriting operations, to enable it to deploy the funds for further investment. During the year 1967-68, with some revival in capital market, the IFC was able to sell shares and debentures of the total face value of Rs. 16 million.

d. Does the project aim at improving technical, managerial and financial practices of borrowing firms? In general, what stress is placed on increasing the efficiency of use of capital?

(i) In the first instance, the technical, managerial and financial practices of borrowing concerns are reviewed at the time of the appraisal of the project. Deficiencies that are observed are brought to the notice of the entrepreneurs. Where necessary, it is made one of the conditions of the assistance granted that the borrower shall arrange to employ suitable technical and administrative personnel for the implementation of the project, to the satisfaction of the IFC.

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(ii) The technical, managerial and financial practices of borrowing concerns are further reviewed from time to time during the course of periodical appraisals or inspections carried out by the officers of the Corporation. During the construction stage and later on, borrowers are required to submit to the IFC periodical progress reports which are carefully examined and suitable follow-up action is taken.

(iii) In addition to the above, the IFC reserves the right to appoint not more than two nominee-directors on the Board of Directors of the assisted concerns. These nominee-directors serve as the eyes and ears of the IFC, and the reports received from them are carefully examined. Where it is felt that certain aspects of a project need to be attended to, the nominee-directors are advised to bring the matters to the notice of the Board. This right has been exercised in about 25% of the borrowers. Directors appointed could be either IFC's staff members or outsiders who have expertise for that project.

(iv) In terms of the documents executed by the borrower concerns in favor of the IFC, the latter reserves the right to have their affairs audited by qualified auditors. The borrowers are also required to submit to the IFC their balance-sheets and profit and loss accounts which on receipt are carefully examined. Besides borrowers are also required to take the prior approval of the IFC for making any changes in their capital structure including issue of bonus shares or reduction of capital, declaring dividends beyond the prescribed minimum limit, and for taking up any project or expansion. Such negative covenants are intended to ensure continued financial viability of the project and efficient use of capital employed.

e. Other goals: None.

Achievement of goals: Discussed under "Overall Evaluation of ICICI, IFC, IDBI and NSIC."

2. Selection of Borrower

a. What economic criteria are employed? Are the formal criteria and the actual ones the same? Encourage particular kinds of industries?

Exporters?
Import substitution?
Small and medium industries?
Use of domestic raw material?
Others?

Are the criteria determined by the Government? The ICI? AID? Jointly?

Formal Criteria:

Under the IFC Act (1948), IFC is authorized to (a) grant loans and/or subscribe to debentures in rupee currency payable for not more than 25 years, (b) grant loans in foreign currencies, (c) underwrite equity, preference or debenture issue, (d) subscribe to equity or preference capital, (e) guarantee deferred payments in respect of machinery imported from abroad or purchased in India, (f) guarantee loans raised from foreign banking or financial institutions in foreign currencies or loans raised from scheduled banks or state cooperative banks in India, and (g) guarantee loans riased by industrial concern which are repayable within a period not exceeding 25 years and are floated in the public market.

To be eligible for IFC assistance an industrial concern should be incorporated in India as a public limited company or co-operative society and be engaged in or proposed to engage in the manufacture, preservation or processing of goods, shipping, mining, hotel industry, generation or distribution of electricity or gas.

Under the Act, the IFC is not authorized to make an unsecured loan.

Economic and Actual Criteria:

The IFC appraises industrial projects for financial assistance as business risks. It examines such project in the light of various factors, including

(i) The relative industrial and national priority of the project in the economy of the country;

(ii) The quality of management and adequacy and competence of the technical and administrative personnel likely to be available for the completion and operation of the project;

(iii) The technical feasibility and financial and economic viability of the project;

(iv) The market for the products to be manufactured;

(v) The cost of the project and the financing arrangements thereof as also the financial contribution to be made by the promoters towards the cost of the project;

(vi) The debt-equity ratio: The IFC would not normally finance a project if debt-equity ratio exceeds two hundred (200) percent, although this ratio has been exceeded in certain priority industries such as fertilizer, petro-chemicals etc. For the computation of debt-equity ratio, only debts due after are considered;

(vii) Sources and availability of raw materials whether imported or indigenous;

(viii) Position regarding the past working results in case of an existing undertaking;

(ix) Profit-earning capacity of the project;

(x) Position regarding cash-flow projections during the construction period and subsequent operating years.

In regard to the IFC's encouragement of particular kinds of industries, its assistance policy has been integrated with the Five Year plans of Government of India and generally any project which has been granted an industrial license (under the Industrial Development & Regulation Act, 1951) is considered eligible for assistance by the IFC including those industries which have been de-licensed by the Government and when no industrial license is required. This policy was being broadly followed by IFC until the year 1965. In the last quarter of 1965, however, IFC decided, in consultation with

Government and the Planning Commission to formulate the following inter-se priorities. These priorities were considered necessary in view of the limitation of its resources vis-a-vis the heavy commitments already entered into by it:

(a) Projects which would make a significant contribution to increase food production; these include projects for the manufacture of fertilizers, agricultural machinery and other agro-based industries.

(b) Projects for the manufacture of special alloy steel for which the country is dependent on imports and which are essential for the machine building industry.

(c) Projects which are export-oriented and those which hold out prospects of earning additional foreign exchange.

(d) Projects for increasing the production of cement.

(e) Projects which would result in substitution of imports which would otherwise have to be continued.

In accordance with a decision taken by Government in August 1967, that industrial cooperatives viz. sugar, textile and jute, should continue to be financed by IFC, the IFC has been considering such applications on a priority basis. Similarly, IFC has recently been entrusted by the Central Government with the responsibility of granting loans (Rs. 50 million in 1968-69) to the jute industry (which is a substantial earner of foreign exchange and is in urgent need of modernization and diversification).

Therefore, broad priorities (which are in the nature of guidelines, and not rigid) for financing of industrial projects have been laid down by the Planning Commission in consultation with Government and financial institutions in the country. It is within the general framework of these priorities that IFC selects the projects for assistance.

b. Are research, surveys and/or promotional work undertaken to stimulate borrowing for particular purposes or do you simply process applications submitted to you? Is there a problem of equipment salesman and other promotors stimulating the wrong kind of application? If so, how is it dealt with?

In terms of its charter, IFC is expected to make medium and long term credit available to industrial concerns for the setting up of new industrial projects as also for the renovation, modernization, expansion or diversification of existing ones. To encourage prospective borrowers to avail themselves of the assistance offered by IFC and to apprise them of its policies and procedures IFC maintains close relations with the various chambers of commerce and industry in the country. Besides IFC has established three branches, one branch each at Bombay, Calcutta and Madras, apart from its Head Office at New Delhi, with a view to having closer contacts with its clientele in the various regions. Keeping the same purpose in view, meetings of the Board of Directors of IFC are also held occasionally at Bombay, Calcutta and Madras. IFC, however, has not undertaken any surveys or promotional work to stimulate its activities.

c. Are the technical and financial criteria and reviews appropriate? Effectively applied?

The technical and financial criteria applied by IFC have been evolved after careful consideration and in the light of the experience gained during the last 20 years of the IFC's operations. As mentioned earlier, in order that such criteria are effectively applied, arrangements exist for proper follow-up and supervision of assisted concerns, and further improvements are effected as may be dictated by experience.

d. What changes are appropriate at this stage or would IFC recommend in the process of selecting a borrower?

The eligibility of a borrower to have assistance from IFC is governed by the provisions of the Industrial Finance Corporation Act. Under this Act, the concerns eligible to get financial assistance from IFC are either public limited companies or cooperative societies incorporated and registered in India, engaged in or proposing to engage themselves in the manufacture, preservation or processing of goods, shipping, mining, hotel industry, generation or distribution of electricity or any other form of power. IFC is not authorized to finance sole proprietary concerns, partnership firms or private limited companies. No change in this regard is at present contemplated, or considered necessary by IFC.

INDUSTRIAL DEVELOPMENT BANK OF INDIA (IDBI)
(Responses are primarily from IDBI. Miss
contained in "overall Evaluation o
IDBI, and NSIC.")

A. Description of the Project

1. Country : India

2. Name of ICI : Industrial Development Bank of India (IDBI)

3. Class of ICI : Public

4. Date Established 1/ : June 5, 1958

5. Initial Assistance from AID : 2/

Loan No.	Date Loan Agreement Signed	$Amount (Million)	Kind (i.e. dollar, local currency)
88	July 29, 1958	34.933	Rupees

6. Does IDBI take equity participation? Yes

7. Capital structure of IDBI on July 29, 1958 (when first AID Loan was made)

	(Rs. in Million)
Authorized capital	250.0
Issues, subscribed and paid up 3/	25.0
Reserves & Surplus 4/	N.A.

1/ Refinance Corporation of India (RCI) was established on 5th June 1958. The first PL 480 loan was sanctioned to RCI in July 1958. On July 1, 1964, Industrial Development Bank of India was set up under IDBI Act which also took over the business of RCI.

2/ Only through the Central Government. No loan agreement exists between IDBI and AID.

3/ Rs. 25 Million was paid up by RBI (Rs. 10 million), LIC (Rs. 5 million) State Bank of India and 14 other scheduled banks (Rs. 10 million).

4/ Figures for Reserves & Surplus were not available.

8. Subsequent Assistance from AID: 2 /

Loan No.	Date L/A Signed	Amount (Millions of Dollars)	Kind
88 Supplement No. 1	June 30, 1964	13.33	Rupees
88 Supplement No. 2	November 25, 1965	40.00	Rupees
88 Amendment No. 1 to Supplement No. 2	November 25, 1965	18.67	Rupees
146 Amendment No. 1	March 23, 1967	63.33	Rupees
88 Amendment No. 3 to Supplement No. 2	May 27, 1968	(0.266)	Rupees

9. Capital structure of IDBI at the end of latest fiscal year

Capital structure on June 30, 1968:	(Rs. in Million)
Share Capital Authorized	500.00
Issued, subscribed & paid up (wholly-owned by the GOI)	200.00
Reserve and Surplus	60.78
RBI Loan	60.89
AID Rupee Loan (through GOI)	1,251.50
Total	1,573,17
AID Rupee loan as percentage of total borrowing	95.36

10. Status of AID $loan as of July 1, 1968: IDBI has no dollar loan assistance from AID.

11. Interest rate: a) average rate paid by IDBI.
b) average rate charged by IDBI.

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2 / Only through the Central Government. No loan agreement exists between IDBI and AID.

Please specify type of lender/borrower if differential rates are operative.

a) Average rate paid by IDBI for the year ending June 30, 1968: 4.7% 5 /

b) Average rate charged by IDBI for the year ending June 30, 1968: 6.9% 5 /

The rate of interest on borrowings from the Government of India is 5.5%. The rate of interest on borrowings from the Reserve Bank of India varies from 3% to 6%. The existing rate of interest on direct loans is 8% with a penalty charge of 1/2% for default. The rate of interest on loans made under IDBI's refinance schemes is less than 8%.

The present rate of interest for refinance loans are:

(i) Normal rate	:	6%
(ii) Concessional rate	:	5 1/2% provided the financial institution does not charge more than 8 1/4%
(iii) Special concessional rate for loans to small scale industries under the Credit Guarantee Scheme.	:	4 1/2% provided the financial institution does not charge more than 8 1/4%
(iv) Refinance of medium term Export Credits:	:	4 1/2% with the stipulation that the financial institution does not charge more than 6%.

12. a) Limits on size of loans and uses of loans.

Limits on sizes

Under the IDBI Act there are no minimum and maximum limits in respect of loans that may be granted to a single enterprise. Loans to a value of Rs. 2 million are normally made by State Financial Corporations. IDBI, therefore, would not normally consider a direct loan application of less than Rs. 2 million. There are however, no floors and ceilings in respect of refinance of export credits. Minimum limits in case of refinance of industrial loans are

5 / Figure for average rate of interest paid/charged by IDBI were supplied by the IDBI. IDBI, however, did not disclose the details of all the borrowings and loans with relative interest rates paid on each of the loans.

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Rs. 20,000 for small scale industrial concerns and Rs. 200,000 for others. The largest amount of any direct loan made by IDBI is Rs. 200 million.

Limits on Uses of Loans

Normally direct loans and refinance facilities are granted for acquisition of fixed assets, which at times may include margin money for working capital.

13. Formal criteria if any:

Aid imposes no formal criteria on loans by IDBI to borrowers; because AID has no loan agreements with IDBI. Although, in practice, it has not made any unsecured loans so far.

IDBI is more flexible on debt-equity ratio requirements than IFC. In case of one project IDBI made a loan when debt equity ratio was as high as 4:1.

14. Number of loans under AID assistance. Please divide the total number of such loans by amounts authorized to various sectors and/or other relevant categories.

IDBI has no dollar loans from AID. Rupee loans obtained from AID have been merged with other rupee funds and a pool formed to carry on IDBI's operation, hence it is not possible to indicate the number of sub-loans under AID's rupee loans.

15. Relations with the financial community and commercial banks.

IDBI maintains close relationship with other term-lending institutions and banks. IDBI has a close relationship with the financial community in India. As the apex institution in the area of development banking it also contributes to the financial resources of other development banks by subscribing to their equity, and bonds particularly State Financial Corporation. It also refinances term loans and export finance extended by banks and other term lending.

Periodic meetings of the chief executives of the financial institutions like the IDBI, LIC, ICICI and IFC are held under the auspices of the IDBI as the apex body in the field of industrial finance. At such meetings, views

are freely exchanged about the technical and financial viability of the new projects seeking joint assistance and also about the problems of the undertakings already financed. Other matters of common interest including matters of policy and procedure in the field of industrial finance are also discussed.

TABLE I
BREAKDOWN OF INDUSTRIAL LOANS REFINANCED BY INSTITUTION

(in millions of rupees)

	1967-68		1966-67		Amount outstanding as on June 30, 1968
	Amount sanctioned*	Amount disbursed	Amount sanctioned*	Amount disbursed	
Commercial banks	53 (52.5)	65 (60.2)	151 (72.7)	145 (74.4)	444 (68.9)
State co-operative banks	-	4 (3.7)	7 (3.4)	3 (1.5)	33 (5.1)
State financial Corporations	48 (47.5)	39 (36.1)	50 (23.9)	47 (24.1)	167 (26.0)
	101	108	208	195	644

*Cross sanctions.
Figures in brackets indicate percentages to the total.

16. Importance as lender relative to other services such as underwriter, guarantor, etc. The relative importance of IDBI's operations under the various categories of assistance is detailed in Table II.

ASSISTANCE SANCTIONED AND DISBURSED BY THE IDBI DURING THE TWO YEARS 1967-68 AND 1966-67 (JULY-JUNE)1/

(In Millions of Rupees)

	Assistance Sanctioned		Assistance Disbursed		Total since inception of IDBI in July 1964		Out-standing Commitments at the end of June 1968 2/	Assistance outstanding as on June 30,1968
	1967-68	1966-67	1967-68	1966-67	Sanctioned	Disbursed		
1. Direct loans to industrial concerns	171 (171)	244 (244)	180	207	934 (913)	586	328	574
2. Underwriting of shares debentures, etc. of industrial concerns	21 (19)	24 (22)	11	52	189 (179)	121	49	121
3. Refinance (including export credit)	104 (104)	216 (209)	111	199	801 (731)	743 3/	100 3/	646 3/
4. Rediscounting of bills 4/	124 (124)	71 (71)	106	61	219 (219)	188	06	167
Total of 1 to 4	421 (419)	555 (546)	408	519	2,413 (2,042)	1,638	482	1,508
5. Subscriptions to shares and bonds of financial institutions 5/	19 (19)	94 (94)	39	74	152 (152)	152	-	152
Total of 1 to 5	440 (438)	649 (640)	447	593	2,295 (2,194)	1,790	482	1,660
6. Guarantees for loans and deferred payments	-	87 (87)	63 6/	79 6/	351 (237)	186 6/	186	-

Note: (1) Figures within brackets indicate net effective sanctions i.e., gross sanctions minus sanctions which were subsequently cancelled.

(2) Effective sanctions minus (a) disbursements under loan, refinance and underwriting assistance and (b) shares and debentures taken up by the public in respect of underwriting assistance plus bills on hand in respect of rediscounting.

(3) Including refinance assistance sanctioned by the Refinance Corporation for Industry upto the end of August 1964.

(4) While sanctions/outstandings relate to face value of bills, disbursals are exclusive of discount.

(5) Excluding purchase of shares of the IFCI but inclusive of assistance to the ICICI.

(6) Relate to guarantees executed.

17, Description of the functions performed by IDBI and how these have changed if they have as the institution has matured:

Although IDBI's initial operations included only: a) direct assistance to industrial concerns in the form of loans, underwriting of shares/debentures and guarantees for loans and deferred payments, b) indirect assistance in the form of refinance of industrial loans granted by approved financial institutions and medium-term export credits and c) subscription to shares and bonds of other financial institutions, it has subsequently extended its operations to cover (i) rediscounting of bills/promissory notes arising out of sales of indigenous machinery on deferred payments basis/ hire-purchase or conditional sale or resale of motor vehicles (ii) direct finance to exporters of capital goods and engineering goods in participation with banks, and (iii) financial assistance to small scale industry.

B. Evaluation on Specific Points

1. Goals

(a) How much emphasis is placed on the mobilization of additional capital? From the Government? From the private sources? What is the relative emphasis on local currency vs. foreign exchange? Quantify this answer to the extent possible:

As already mentioned, IDBI's share capital of Rs 200 million is wholly subscribed by RBI. Further, as of June 30, 1968, it has borrowed Rs 1525 million from the Government of India (all AID loans are made through the Government of India)and Rs. 61 million from the RBI. IDBI has not gone to the market to raise funds. All the resources of IDBI are in Indian rupees.

(b) Is the main purpose to increase the supply of investment funds for industry in general or to supply additional funds on especially favorable terms for special high priority uses? In this connection, how do interest rates (and other terms) compare with those available from other sources, i.e. influence the pattern of investment and what affect does it actually have? Is any consideration given to the comparative advantage of industry, or specific industries? The main purpose of the establishment of IDBI was to form an "apex" development bank to coordinate and supplement the activities of other financial institutions providing term-finance to industry as well as to provide direct financial assistance to industrial units to bridge the gap between the supply of, and demand for, medium and long-term finance. Although the assistance provided by the specialized industrial financing institutions set up in

the country since independence has shown a steady increase, their likely contribution in providing term-finance to industry was considered to be inadequate in relation to the substantial investment outlays envisaged in the five-year plans, both in magnitude and range of financing. In view of the dimensions of the problem that rapid industrialization poses, an apex institution with substantial financial resources and considerable operational flexibility was considered necessary.

IDBI in its appraisal of a proposal pays particular attention to high priority industries such as fertilizers, alloy and special steel and cement; to the promotion of exports and to the development of small-scale and technical industries.

It should be noted that IDBI follows the policy of differential rates of interest (as indicated under question No. 11 of part A) for export credits and refinance assistance to industries. The rate of interest changed by commercial banks on direct lendings is usually in the range of 8.5-9.5%. In some cases, relaxation in other terms and conditions are also considered such as higher debt equity ratio.

(c) Does the project aim at helping to get a securities market started?

The project did not aim at getting a securities market started. A developed securities market has existed in India for many years. However, the IDBI has supplement the securities market. Since inception and up to June 30, 1968 the IDBI underwrote shares and debentures (including convertible notes) for Rs 179 million, involving 63 projects. The underwriting function was intended presumably to supplement the private capital market where the underwriting was less attractive to the private purchasers. Of the projects underwritten, 52 companies with issues involving IDBI's commitment of Rs 94 million of ordinary shares; Rs 25 million of preference shares; and Rs 13 million of debentures and convertible notes had been sold. Rs 65 million of equity shares, Rs 24 million of preference shares and Rs 13 million of debentures and convertible notes remained with the IDBI, representing 91 per cent, 95 per cent and 100 per cent, respectively of the amounts underwritten by it. IDBI has not so far sold any part of its investment which was acquired as a result of its underwriting operations.

Underwriting operations of IDBI and other financial institutions (ICICI, IFC, LIC, UTI, etc.) are of considerable assistance for raising money in the capital market. The fact that a financial

institution like IDBI has agreed to underwrite suggests that the project has been subjected to careful financial and technical scrutiny. This helps companies to mobilize financial assistance from other sources.

(d) Does the project aim at improving technical, managerial and financial practices of borrowing firms?

In general, what stress is placed on increasing the efficiency of use of capital? IDBI's contribution in providing assistance and increasing the efficiency of use of capital is essentially the same as outlined in the case of IFC.

(e) Other Goals:

In addition to the previous discussion the IDBI may also,
a) Undertake research and surveys for (i) evaluating or dealing with marketing or investments, and (ii) undertaking and carrying on techno-economic studies in connection with the development of industry;
b) Provide technical and administrative assistance to any industrial concern or any person for promotion, management or expansion of any industry; and
c) Plan, promote and develop industries to fill up gaps in the industrial structure.

In March 1965, IDBI set up "Development Assistance Fund." The fund is intended to assist with the prior approval of Government:
a) Projects which require assistance of substantial magnitude.
b) Projects which are potentially risky or low profit yielding or involve a long gestation period but which are of strategic importance to the Indian economy.
c) Projects which are essential for filling up the gaps in the industrial structure and which are not likely to obtain necessary funds from banks and other financial institutions in their normal course of business.

IDBI has not so far made much progress in accomplishing the above "other goals."

Achievement of Goals: Discussed in "Overall Evaluation of ICICI, IFC, IDBI and NSIC."

2. Section of Borrowers

a) What economic criteria are employed? Are the formal criteria and the actual ones the same? Encourage particular kinds of industries?
Exporters?
Import substitutes?
Small and medium industries?
Use of domestic raw material?
Others?
Are the criteria determined by the government? The ICI? AID? Jointly?

(1) Formal Criteria:

The IDBI Act (1964) gives the formal criteria for its activities. IDBI is authorized to finance all types of industrial concerns engaged in manufacture of or processing of goods, mining, transport, generation and distribution of power both in the public and private sectors. So far IDBI has restricted its operations to the financing of private sector enterprises. Under the Act IDBI is authorized to (a) subscribe to or purchasing stocks, shares, bonds or debentures of industrial undertakings; (b) grant loans and advances both in rupees and in foreign currencies to any industrial concern with the option to convert these amounts into stocks and shares of that concern; (c) underwrite the issue of shares or debentures; (d) guarantee deferred payments due from any industrial concern; (e) guarantee loans raised by industrial concern which are floated in the capital market; (f) guarantee loans raised by industrial concern from any scheduled bank, or state co-operative bank or the Industrial Finance Corporation or any State financial corporation or any other financial institution which may be notified by GOI in this behalf; (g) guarantee the obligations of any scheduled bank or State co-operative bank or the Industrial Finance Corporation, State Financial Corporation or any other financial institution which may be notified by the Government in this behalf arising out of or in connection with underwriting the issue of shares or debentures of any industrial concern; and (h) accept discounting or rediscounting bills of exchange and promissory notes of industrial concern.

(2) Economic & Actual Criteria

The criteria of IDBI for making loans are essentially the same as those described under IFC. In addition, however, the following should be noted:

(a) IDBI can make unsecured loans but under the IFC Act, IFC cannot make an unsecured loan. IDBI has not made any unsecured loans so far.

(b) IDBI is more flexible on debt-equity ratio than IFC. In case of one project IDBI made a loan when debt equity ratio was as high as four to one.

IDBI acts as an important tool to supplement and reinforce the Government policies regarding investment in the economy. At the same time, IDBI has enough operational flexibility to change its policies according to changing requirements. During the last two years IDBI has not considered it necessary to confine its attention only to those applications which satisfy the strict tests of Central Government priorities, but has also given favorable consideration to a much wider range of applications to contribute to a revival of economic activity on as wide a front as possible. IDBI's main endeavor now is to ensure, as far as possible, that no worthwhile project of medium or small scale size should be allowed to languish for in sufficiency of institutional support. It also gives special consideration to applications from geographical areas which are relatively less industrialized.

(b) Are research, surveys and/or promotional work undertaken to stimulate borrowing for particular purposes or do you simply process applications submitted? Is there a problem of equipment salesmen and other promoters stimulating the wrong kind of application? If so, how is it dealt with?

Under the IDBI act, IDBI can undertake promotional activities such as investment research and surveys to stimulate borrowings. In practice, however, IDBI has not yet undertaken any surveys or promotion work to stimulate borrowing. IDBI so far has no experience of promoters and equipment salesmen stimulating the wrong kind of applications.

(c) Are the technical and financial criteria and reviews appropriate? Effectively applied? The technical and financial criteria applied by IDBI has been evolved after careful consideration and in the light of the experience gained by other financial institutions, i.e., IFC, ICICI, LIC, etc. In order that such criteria are effectively applied, arrangements exist for proper follow-up and supervision of assisted concerns. Improvements are effected as may be required by experience.

(d) What changes are appropriate at this stage or would you recommend in the process of selecting a borrower? No changes in this area is at present contemplated or considered necessary, by IDBI. The following comments from IDBI's latest financial report should, however, be noted.

"In order to be of more active assistance in the generation of projects in different areas and particularly to be of greater help to the medium and small sectors of industry, the IDBI is improving its liaison with offices of banks and SFC's in a number of ways. It expects to have branch offices in the near future in different parts of the country and delegate to these some of the functions which are now discharged in Bombay."

The following are discussed under "Overall Evaluation of ICICI, IFC, IDBI, and NSIC:"

3. Management and Operational Policies

4. Specific AID relationships

(C) Overall Evaluation and Conclusions

NATIONAL SMALL INDUSTRIES CORPORATION (NSIC)

(Responses are primarily from ICICI. Mission comments are contained in "Overall Evaluation of ICICI, IFC, IDBI and NSIC.")

A. Description of the Project

1. Country : India

2. Name of ICI : National Small Industries Corporation (NSIC)

3. Class of ICI : Public

4. Date Established : February 11, 1955

5. Initial Assistance from AID:

Loan No.	Date Signed	$ Amount (Million)	Kind (i.e. Dollar Local Currency
386-A-039 (DLF-144)	April 10, 1961	10	Dollar

6. Does NSIC take equity participation? No

7. Capital Structure of NSIC as of April 10, 1961 (i.e. date when first AID loan was made

	(Millions of Rupees)
Share capital authorized, issued, subscribed and paid up	5.00
Reserves and Surplus	0.61

8. Subsequent Assistance from AID None

9. Capital Structure of NSIC at the end of latest financial year, i.e. March 31, 1968 An application for an increase in the paid-up capital is still pending with the Central Government. The Central Government plans to convert Rs. 30 million of its loans to equity:

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	(Millions of Rupees)
Authorized Capital	35.00
Issued	35.00
Subscribed and paid up	5.00
Reserve and surplus	22.63
GOI Loan	117.53
AID dollar loan	37.41
Kreditanstalt fur Wiederaufbau (KfW)	25.83
Total	208.40
AID dollar loan as percentage of total borrowing	20.69
AID dollar loan as percentage of total foreign currency borrowing	59.15

10. Status of AID Dollar loan as of July 1, 1968:

Loan No.	Amount Authorized (After) Deobligation)(000 dollars)	Commitments	Disbursements
386-A-039 (DLF-144)	8,765	8,765	8,765

11. Interest rates: (a) average rate paid by NSIC
(b) average rate charged by NSIC

Please specify type of lender/borrower if differential rates are operative.

Average rate paid by NSIC for the year ending March 31, 1968: 5.3% 1/
Average rate charged by NSIC for the year ending March 31, 1968: 6.5% 1/

NSIC's borrowings came from the Government of India and foreign credit agencies (AID and KfW). The rate of interest paid on these borrowings have varied from time to time, but on average this rate comes to about 5.33% per annum.

Similarly, the average rate charged by NSIC has varied from time to time. In the initial stages the rate of interest charged on NSIC's loans was 6% per annum with some concessions given to co-operative and ancilliary units. Presently, NSIC charges a uniform rate of 7% and concessions given to ancilliary units and co-operatives have been withdrawn. After taking into account the rate of interest charged on NSIC's earlier loans, the average rate of interest comes out to 6.5% per annum.

12. Limits on size or uses of loans

Limits on Size
No minimum limit is prescribed for renting capital equipment, but equipment rentals are granted for equipment valued at about Rs. 5,000. The range goes up to about Rs. 500,000 in some cases.

Use of Loans
Loans are made to small scale industrial units both existing and new, in the form of capital equipment under easy hire purchase terms. NSIC does not make any cash loans. A "small scale industry" is a company in which the total original investment in capital equipment did not exceed Rs. 750,000, excluding the investment in land and buildings.

1/ Figures for average rate of interest paid/charged by NSIC were supplied by NSIC. NSIC did not disclose the details of all the borrowings and loans with the relating interest rate paid/charged on each.

13. Formal criteria, if any

Formal criteria is assumed to mean the restrictions of lending and procurement which AID puts on NSIC. The laws and actual practices of NSIC are treated under Section 2, "Selection of Borrower".

The AID Loan Agreement requires that (a) all eligible items financed under a sub-loan utilizing $50,000 or more of AID funds must be of U.S. source and origin and limits procurement of eligible items costing below $50,000 to countries included in AID Geographic Code 899, (b) NSIC ship at least 50% of gross tonnage of all eligible items on vessels belonging to privately-owned U.S. flag commercial vessels but permits NSIC to ship the remainder on vessels belonging to countries included in Code 899, (c) NSIC obtain prior AID approval to make any sub-loan in excess of $50,000 to a single enterprise involving AID funds, and (d) prohibits making of any sub-loan for a period less than 3 years.

In August 1963 AID restricted the unutilized balance of the loan for financing procurement of goods and services of U.S. source and origin.

14. Number of loans under AID assistance. Please divide the total number of such loans by amounts authorized to various sectors and/or other relevant categories.

Under the AID loan, NSIC made 707 "subloans" (equipment rentals/sales) to various small scale industrial units. These subloans can be classified in the following major groups:

Name of Industry	No. of Industrial Units
Engineering	264
Chemical	62
Electrical Engineering	45
Pharmaceutical	30
Glass & Ceramics	21
Servicing	92
Miscellaneous	193
Total:	707

15. Relations to the financial community and commercial banks.

NSIC has no formal relationship with commercial banks and other financial institutions, but does keep in contact with them on an informal basis.

16. Importance as a lender relative to NSIC's other services such as underwriter, guarantor, etc.

NSIC does not undertake underwriting or guarantees.

17. Description of the function performed by NSIC and how these have changed, if they have, as the institution matured.

NSIC has four major business divisions: Marketing Division, Hire Purchase Division, Government Purchase Division and Prototype Production-Cum-Training Centre. NSIC used to have an Industrial Estate Division. The functions of these divisions are described below:

(i) The Marketing Division was initially started to help and promote the marketing of the products of the small scale units. This work was undertaken with the help of mobile marketing vans operating in the whole of the country being regionally controlled by the Regional Offices at Bombay, Calcutta, Madras and Delhi. The Marketing Division had also undertaken marketing of the products of certain locally centralized industries - such as pottery at Khurja, footwear at Agra, glass beads at Renigunta, hosiery at Calcutta and Ludhiana. With the help of NSIC the small scale units at these places grew rapidly, and were ultimately in a position to afford their own marketing channels. At this stage NSIC moved its activities elsewhere.

At the moment the Marketing Division is a coordinator between the Bharat Electronics Ltd. (BEL) and small scale radio manufacturers. It helps obtain a portion of the radio contracts of BEL to small scale units. NSIC has also undertaken the work of the distribution of scarce raw materials

to the small scale units in Delhi by obtaining these raw materials in large quantities. The Marketing Division is now planning to promote exports of products manufactured by small scale industrial units.

(ii) The main functions of the Hire-Purchase Division is to supply machinery and equipment on a hire-purchase basis. NSIC has, so far, supplied machinery to about 8,000 entrepreneurs costing about Rs. 350 million. The progress of the Hire-Purchase Division has been steady and there is a large demand from the small scale units for machinery and equipment from NSIC.

(iii) The Government Purchase Division's main function is that of the coordination of orders from bulk purchasers like the Central Government's purchasing organization, DGS&D, to small scale units. NSIC had compiled a directory of small scale units engaged in the various lines of industries. As a result the small scale units find it easier to sell their goods in bulk quantities to these institutions. This service is handled free of charge.

(iv) NSIC looks after the management of the three Prototype-Production-Cum-Training Centers (PTCs) at Rajkot (Gujarat), Okla (New Delhi) and Howrah (West Bengal) established with the help of American, German and Japanese Governments, respectively. The main functions of these PTCs is to train artisans/workers employed in the small scale units, to develop prototypes of the various machines and pass it on to the small scale units and undertake job orders in their workshops for the small scale units. As a result of the operation of these PTCs, NSIC also trains technical personnel for the small scale units.

The Industrial Estate Division had undertaken the job of the construction of Industrial Estates. It constructed two Industrial Estates at Okhla, New Delhi, and at Naini near Allahabad. Recently the construction of industrial estates has been taken up by the state governments and accordingly NSIC closed down this activity.

B. Evaluation on Specific Points

1. Goals

(a) How much emphasis is placed on the mobilization of additional capital? From the government? From private sources? What is the relative emphasis on local currency vs. foreign exchange? Quantify this answer to the extent possible.

NSIC being an organization wholly owned by the Central Government relies on the capital available from the Central Government and other sources approved by the Central Government. The latter includes certain loans taken by NSIC from foreign credit agencies, KfW of West Germany and AID. NSIC has not taken any steps to mobilize capital from private sources. On March 31, 1968 the amount of loans due from NSIC were Rs. 117.5 million in Indian Rupees, 4.94 million in dollars and 13.54 million in DM.

(b) Is the main purpose to increase the supply of investment funds for industry in general or to supply additional funds on especially favorable terms for special high priority uses? In this connection, how do interest rates (and other terms) compare with those available from other sources, i.e., how is interest rate policy used to try to influence the pattern of investment and what effect does it actually have? Is any consideration given to the comparative advantages of industry, or specific industries?

As already indicated the objective of NSIC is to promote and encourage the growth of small scale industries and to help existing units. NSIC has already supplied machinery worth 346.2 million Rs. to the new and existing units. The objective of NSIC is to extend the growth of small industries particularly in the rural areas with the necessary economic infrastructure, and also to encourage the growth of ancilliary units near and around big plants.

The interest rate charged by NSIC is considerably less than the interest charged by other commercial undertakings dealing with hire-purchase business and also by commercial banks and financial institutions. In this connection it may also be mentioned that NSIC caters to a special need for credit which is not normally serviced by commercial banks and other financial institutions. In other words, in the hire-purchase scheme NSIC issues the machinery to small scale units without insisting on any additional security or mortgage, and the entrepreneur is not required to furnish any guarantee. The machinery so issued continues to remain the property of NSIC. The ownership is transferred to the entrepreneur as soon as the last installment due is paid.

(c) Does the project aim at helping to get a securities market started?

NSIC has no dealings with the securities market.

(d) Does the project aim at improving technical, managerial and financial practices of borrowing firms? In general, what stress is placed on increasing the efficiency of the use of capital?

Even after the delivery of machines NSIC continues to maintain liaison with the entrepreneur. NSIC's field staff makes periodical visits to the factory premises of the entrepreneur to ensure that the machines supplied under the scheme are being properly used. The services of the Director of Industries, the Development Commissioner's office and Small Industries Service Institutes are made available to the entrepreneur to cater for his needs for technical expertise, raw materials and power. NSIC also offers to train skilled or semi-skilled laborers for small scale units whether or not the units are participating in the hire-purchase scheme. This training is given by the three

Prototype Production and Training Centers run by the NSIC and is given free. The workers provided for training are paid a stipend of Rs. 50/- plus housing facilities by the NSIC during the period of such training.

(e) Other goals? None.
Achievement of goals: Discussed in "Overall Evaluation of ICICI, IFC, IDBI and NSIC."

2. Selection of Borrower

(a) What economic criteria are employed? Are the formal criteria and the actual ones the same?

Encourage particular kinds of industries?
Exporters?
Import substitution?
Small and medium industries?
Use of domestic raw materials?
Other?

Are the criteria determined by the government? NSIC? AID? Jointly?

Formal Criteria:

As laid down in the Memorandum of Association with NSIC, industrial enterprises with capital assets of less than Rs. 750,000 are eligible for seeking the assistance offered by NSIC. The various forms of assistance are: (a) supplying machine and machine tools to small scale units on hire/purchase system, (b) securing contracts from GOI store purchase agencies for the benefit of small undertakings, (c) providing training facilities at the prototype production and training centers and (d) management of industrial estates.

Economic & Actual Criteria in appraising an application

Various steps involved in appraising an application are:

a) The application should be recommended by the Director of the Industries of the area in which the unit is located or is proposed to be located.

b) The application is studied by an Acceptance Committee consisting of the representatives of

(i) NSIC
(ii) Office of the Development Commissioner for Small Scale Industries
(iii) Office of Director General Technical Development
(iv) State Trading Corporation
(v) Chief Controller of Imports and Exports.

The Acceptance Committee considers the industry's future prospects, its economic viability and the availability of raw materials.

NSIC does not follow any rules regarding debt equity ratio and current ratio that the borrowing company should maintain. NSIC also considers applications regarding their potential for export, import substitution and use of domestic raw materials. The criteria is determined jointly by the NSIC and the Central Government.

(b) Are research, surveys and/or promotional work undertaken to stimulate borrowing for particular purposes or does NSIC simply process applications submitted? Is there a problem of equipment salesmen and other promoters stimulating the wrong kind of application? If so, how is it dealt with?

NSIC does not carry out any research in this field on its own but has access to all research or survey reports, carried out by the Central and State/Departments from time to time, particularly the surveys carried out by the Office of Development Commission. In this connection it may be mentioned that the Development Commissioner, Small Scale Industries,

/-Government

is a member of the Board of Directors of NSIC and therefore has close contact with its various operations.

(c) Are the technical and financial criteria and reviews appropriate? Effectively applied?

NSIC relies very heavily on the Director of Industries for review of technical and financial aspects of a project. It is difficult to say whether these criteria are effectively applied by the Directors of Industries. Various Directors of Industries might have different standards of evaluating the same project. However, NSIC's default rate does not exceed 5% which suggests that these criteria have been relatively proven over a period of time.

(d) What changes are appropriate at this stage, or would you recommend in the process of selecting a borrower?

The scope of NSIC's activities has been expanded by amending the definition of small scale industries to allow a larger number of units within its scope of activity. NSIC also wishes to extend its activities to medium-size industries, particularly in the area of modernization. This matter is presently under consideration by the Central Government.

The following are discussed under "Overall Evaluation of ICICI, IFC, IDBI and NSIC":

3. Management and Operational Policies

4. Specific AID Relationships

C. Overall Evaluation and Conclusions

PAKISTAN

INVESTMENT CORPORATION OF PAKISTAN
(ICP)

TO: AID/S TOAID A-225

FROM: USAID/Rawalpindi

SUBJECT: Spring Review on Intermediate Credit Instiutions
Investment Corporation of Pakistan

REFERENCE: A) AIDTO CIRC XA 25; AIDTO CIRC XA 564

NOTE: The cover page of the airgram is so badly smudged that this copy was necessary to insure readability. * * *

A. Description of Project

The Investment Corporation of Pakistan is a privately owned, government chartered corporation whose objectives are to broaden the ownership of corporate securities, to provide new mechanisms and instruments for giving companies better access to the markets for capital, and to engage in other activities aimed at expanding and increasing investor participation in the capital market in Pakistan. AID's involvement is limited to a technical assistance program described below in B.4. There are no AID funds committed, either loan or grant, other than a technical assistance agreement.

Financial Data

1. Country: Pakistan

2. Name: Investment Corporation of Pakistan

3. Class of ICI: Mixed

4. Date of establishment: February 22, 1966

5. Initial assistance from AID: The technical assistance has included 3 U.S. advisors, a library of financial books, and job training in the States for several ICI officers. No loans were requested.

6. Equity Participation: This ICI is an investment bank whose major business is underwriting participations in public offerings and private placements of stock.

7. Capital structure as of February 22, 1966 (in rupees/dollars):

Assets	(000,000's)	Liabilities	(000,000's)
Cash -	150/30	Govt. Loan -	100/20
		Paid-up Capital	50/10
	150/30		150/30

8. Subsequent Assistance from AID: None requested

9. Capital structure as of June 30, 1968 (in rupees/dollars):

Assets	(000,000's)	Liabilities	(000,000's)
Cash	78/15	Free Cash Balances	21/4
Receivables	1.7/.3	Operating Charges	5/1
Investments	23/4.6	Govt. Loan	110/22
Margin Loans	22/4.4	Paid-up Capital	50/10
U/W Securities	65/13	Reserves & Profits	4/1
Fixed Assets	.6/.1	Mutual Funds	70/14
Mutual Funds	70/14		
	262/52		262/52

10. Status of AID Loans: None requested.

11. Interest Rates:

Average paid to Govt - 5 1/2%

Average paid on free cash balances - 0%

Average charged on margin loans - 6 1/2%

Average charged on corporate debentures - 8 1/2%

Average charged on call money - 7 1/4%

ICP's operations are intended primarily as an underwriter and merchandizer of corporate securities. Ideally then except for securities representing reserves and temporarily idle cash, ICP has no desire to invest in a portfolio of securities. It was recognized in the beginning, however, that until a wider capital market could be developed, largely through ICP's efforts, ICP would have to carry in its portfolio the portions of capital issues which it was unable to sell. These "take-ups", as they are called, are regarded as marketable after being held for seasoning for a year or so. ICP does not make loans as such, but deals in corporate debentures both with the issuers and with secondary sellers and buyers. There are fixed limits on the size of equity or other security offerings which it might engage in as underwriter. Board regulations limit its own participation in the underwriting commitments in any single project to no more than 20 percent of ICP's paid-up capital. It has no formal criteria such as is normally associated with development lending institutions; however, it does engage in a very thorough examination of economic, financial and technical aspects of prospective underwritings and employs standards comparable to those associated with underwriting firms in the Western World. During the fiscal year ending June 30, 1968, ICP rejected 23 applications, for example, as a result of their investigations which showed poor operating record, weak management, uneconomic size of the unit, unsound financial plans, refinancing of existing loans, difficulties in organizing underwriting consortia, or the sponsor's unwillingness to accept the terms of underwriting, etc. Quoting from its 1968 Annual Report, "The main consideration governing the Corporation in its underwriting operations is the confidence that the company can be expected to generate among potential stockholders on the basis of conservatively assessed operating forecasts and its ability to offer dividends in accordance with prevalent expectations in regard to the rate of return on investments."

In the two years of its existence, ICP has assisted as syndicate manager in 23 different corporate financings, and as of December 31, 1968 had 31 applications pending for additional financings. These 23 underwritings during the two years were broken down by industry as follows:

Jute textiles	8
Cotton textiles	2
Paper	1
Sugar	6
Glass and ceramics	1
Chemicals and pharmaceuticals	1
Engineering and construction	2
Fuel and power	1
Synthetics and rayon	1

Concerning the environment in which it operates and its relation to the financial community, it must be recognized that ICP is the first effort in the NESA area to organize what has become common in the Western world, particularly in the U.S., i.e., an investment banking institution operating as an underwriter and also as a financial advisor to individual shareholders. Although a stock exchange did function and shares were offered to the general public prior to its existence, these were generally offerings by entrenched industrial groups who could raise capital without the services of an underwriter. ICP was thus formed to fill the gap between the financial requirements of upcoming new industries and the sources of funds. It operates at the margin by acting as a syndicate manager, forming syndicates with insurance companies, commercial and development banks and private investment companies, which agree to purchase portions of public offerings not sold to the public. It is the only organization performing this function of syndicate manager in Pakistan. It enjoys an excellent reputation within the financial community and has received firm support from Government and from insurance companies and commercial banks as well as other financial institutions.

In addition to its role as underwriter and syndicate manager, ICP has been very active in devising "equity-mindedness" programs to broaden the base of share ownership. This led to the establishment of the Investors Scheme (margin brokerage accounts) whereby an individual investor having made a deposit can obtain a loan from ICP, thus establishing an investment portfolio on which ICP continues to act as custodian, advisor and manager. The Investors Scheme is a continually expanding one (400 to 4000 accounts in 13 months). In addition, two separate and very successful mutual fund offerings have been made to the general public by ICP. It operates these as fund manager. Plans are that there will be additional mutual funds offered in the near future of both equity shares and debentures.

Substantial detail and financial data are available on ICP in NESA/CDF in AID/Washington via copies of the two Annual Reports thus far issued. In addition, there is on file in NESA/CDF made by the three U.S. advisors provided by AID to ICP substantial descriptive data on the company's operations contained in reports.

B. Evaluation on Specific Points

1. Goals

Description:

(a) ICP provides local currency only and does not deal in foreign exchange. Since ICP's function is that of an underwriter, under normal operating conditions it would not be necessary to have expanding resource as is the case of development loan institutions. However, in view of the fact

that ICP as well as other underwritings has had to temporarily take up substantial portions of underwritings for seasoning, they must seek additional resources until investor demand catches up with the supply of new issues. Therefore, in addition to the initial Rs. 10 crore* loan obtained from the Government of Pakistan, it will, before the end of fiscal 1969, obtain an additional Rs. 5 crore loan from the Government of Pakistan. Ideally, as the capital market develops and there are sufficient number of investors participating to permit the immediate sale of all underwritings, it would not be necessary for ICP to expand or maintain these loans which in effect now permit it to carry unsold portions of underwritings. At the time of its establishment, the paid-up capital of ICP amounting to Rs. 5 crore was subscribed to by 16 private institutions--six banks (including First National City Bank of New York) and ten insurance companies. Last year an additional private stockholder, Bank of America NT&SA of San Francisco, was added. Considering the ultimate desirable pattern of operations, it is not deemed necessary that ICP's paid-up capital base expand substantially.

(b) ICP provides funds for industry in general with little if any emphasis placed on "favorable terms for special priority uses." Its objective is to increase the development and sophistication of the capital market and public participation. Therefore it has tended to focus on companies with proven economic viability and projects with short gestation periods. However, it has also financed what might be called "unseasoned" ventures with growth potential as long as they have high caliber sponsors and a promising dividend paying capability. It will figure prominantly in the financing of three U.S.-Pakistan joint venture fertilizer plants, i.e., American Cyanamid - Adamjee, Dawood - Hercules and Kaiser - Hyesons. These and the 23 financings referred to in A above are in companies which are predominantly based on indigenous raw materials and emphasize import substitution, although some are export oriented.

(c) ICP was formed with the prime objective of getting a true securities market started in Pakistan and this remains its prime goal along with involvment in other related areas such as stock exchange expansion and reform, legislative reform, etc.

(d) In many of its projects, as a precondition to underwriting and often as a continuing condition, ICP has required various changes in managerial and financial practices. This applies particularly to the requirement of audited financial statements by recognized certified public accountants and the issuance of detailed periodic reports to shareholders. It has also been striving to obtain the adoption of rules relating to corporate disclosure and shareholder reports for all companies listed on the stock exchange, even though ICP may not be involved as an underwriter.

* 1 crore = 10 million

It has placed heavy emphasis on adequate managerial talent in the companies it finances, in some cases insisting on changes and additions in specific areas where it felt this was justified. It currently has a very high interest in increasing the caliber of industrial management throughout Pakistan and in discussions with the Mission and others is attempting to devise programs for improving the caliber and supply of industrial managers.

Achievement of Goals:

(a) Although progress has been hard-won, it is well recognized that ICP is effectively meeting its goals. Its accomplishments can be measured by general buoyancy in the stock market as compared to two years ago, growth in the Investors Scheme and success of the mutual funds which has brought new shareholders into the stock market, and by several legislative and other reforms associated with the capital market. There is every indication (in fact, research by the State Bank has so indicated) that funds generated by ICP in its underwriting activities have been additive and have not been a diversion of resources and savings from other uses.

(b) There have been no changes in basic goals or emphasis on particular goals although there have been introductions of new techniques such as the Investors Scheme and mutual funds. These have merely been ways of extending and implementing programs aimed at the achievement of its original goals.

(c) AID was instrumental in the establishment of ICP and worked closely with Government of Pakistan officials in its establishment. As is outlined in B.4. below, AID funds have been utilized only in the form of technical assistance to provide U.S. advisors and training in the U.S. for selected ICP staff members. In the Mission's view this support has played a big role in ICP's success.

(d) Since ICP deals solely in local currency and since, as explained above, the nature of its operation should eventually mean the leveling off of its resource requirements, there seems little need for funding from alternate sources. Some assistance has been rendered by World Bank, which provided training for one key staff member, and also by the United Nations, which provided one advisor on stock exchange organization, regulation, and reform for a three month period.

(e) ICP is the only organization of its kind in Pakistan, but it is hoped that its success will eventually lead to the establishment of other investment banking/underwriting establishments. The example of ICP--its establishment, goals and experience to date--should prove valuable to other countries and AID Missions for formulating similar programs.

2. Selection of Borrowers (Financings)

(a) The major criteria employed by ICP in the selection of financings is to underwrite, therefore to sell to the public, only those issues upon which the public can anticipate an early and stable rate of return via dividends, etc. In cases where long gestation periods are anticipated such as fertilizer projects, a package of various securities has been designed (including debentures, preferred and common stocks) which will provide a return for investors even during the period of gestation. ICP has dealt almost exclusively with medium and large industries with no particular reference to export potential; however, the projects to date have been primarily producing products for domestic consumption, i.e., import substitution, and are based predominantly on indigenous raw materials. The criteria used in selecting financing is determined solely by ICP. The primary criteria has been to select what might be termed blue chip ventures with sound financing, reputation and ability of the sponsors and managers, and early commencement of substantial returns to shareholders.

(b) Because of its more specialized nature as a financial institution, it is not the objective of ICP to preform the role of development bank in promoting or stimulating particular industries. Nevertheless, it is attuned to the broad development and industrialization objectives within Pakistan and to date its underwriting efforts have been channeled in directions which are compatible with existing development priorities. Indirectly it has assisted more specific development goals. In example, ICP's role in bringing about disinvestment of some of the portfolio holdings of the East Pakistan Industrial Development Corporation has freed funds within EPIDC to meet its more sharply defined development objectives.

(c) ICP has an effective and rigorous examination procedure in which not only the financial but also the technical aspects of projects are extensively reviewed. Where necessary, it also askes help from outside consultants and other institutions whose familiarity with similar problems and industries would be valuable in assessing viability of a particular project.

(d) Since ICP's primary role is that of a developer of the capital market rather than functioning as a development bank, there does not now appear to be any need to alter its selection procedures. Its major function is to increase the public's confidence in traded securities and the stock exchange. To meet this objective, the primary criteria employed is one of selecting financially sound companies rather than accepting somewhat riskier, development oriented projects.

3. Management and Operational Policies

(a) Since ICP is a young and expanding institution, its management organization has undergone substantial change and continuous expansion. As the direction and programs of ICP have become more defined, a more formal and clear-cut management organization has emerged. In addition to the creation of the position of Deputy Managing Director, Chiefs of Sections have been appointed for Administration, Investors Scheme, Operations, and Law Department. Since an institution like ICP is an innovation in Pakistan (and would be for most LDC's), it is extremely difficult to find adequate candidates for managerial and staff positions since there are essentially no other institutions which have similar operations which could provide experienced personnel. The emphasis is therefore on youth capable of learning new techniques.

(b) ICP has very rigid requirements regarding submission of certified financial data and detailed financial projections. ICP staff thoroughly reviews submitted data and makes its own analysis and projections. This frequently results in rejection of applications which supposedly are financially sound. Evidence that complete arrangements have been made for other short and long term financial requirements is made a condition of any underwriting agreement by ICP and other syndicate members.

(c) See 3. (b) above.

(d) ICP is prepared to counsel companies on questions of financial management where necessary. ICP Board representation is standard in all underwriting agreements. ICP does not provide assistance on technical or managerial problems; however, in several cases they have been instrumental in recommending and suggesting qualified advisors or consultants.

(e) ICP has been instrumental in introducing several measures aimed at correcting corporate management abuses and has been concerned with the potential conflicts of interest inherent in the management agency system under which most industrial firms in Pakistan are run. Corrective measures have often been a precondition to financing from ICP. As a result of this and its activities in introducing measures to correct malpractices on the stock exchange and improving management/stockholders relations, ICP must and does maintain a high degree of internal control to avoid conflict of interest problems.

(f) ICP, as may be noted in its Annual Reports, has been a profitable institution. This should not be the measure of its overall effectiveness since its primary objective is not profit making but capital market and institution building. It thus must engage in activities which are not necessarily profit oriented but are a reflection of its broader goals. The Investors Scheme, for example, is a break even proposition from the standpoint of ICP's earnings; however, it is a very successful and worthwhile program from the standpoint of ICP objectives.

4. Specific AID Relationships

(a) USAID's contribution has been limited to technical assistance under project No. 391-11-989-283. This program was begun in 1966 and is continuing through the end of fiscal year 1969. The program has had two aspects. One, the provision of U.S. advisors in specific areas related to investment banking. Under this program a legal/investment advisor has been provided for a total of 30 months beginning January 1967. In addition, a senior investment advisor and a marketing specialist were provided for periods of three and five months respectively during fiscal year 1968. The second aspect of the assistance program has consisted of sending 12 of the senior staff members of ICP to the U.S. for periods ranging from three to six months. While in the U.S. they have worked with investment houses, commercial banks, and other financial institutions, primarily in the New York area, as well as participating in short term academic courses provided by various institutions in New York. The Mission's assessment as of this date is that there is no longer a necessity for providing U.S. advisors except for short tours of three to six months in specialized areas.

(b) Not applicable

(c) Not applicable

(d) Not applicable

(e) Not applicable

(f) Not applicable.

TURKEY

TÜRKIYE SINAI KALKINMA BANKASI
(TSKB)

AIRGRAM

DEPARTMENT OF STATE

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TO - AID/W TOAID A-156 X

DATE SENT
March 27, 1969

FROM - ANKARA

SUBJECT - Spring Review on Intermediate Credit Institution (ICI's) PE No. 21

REFERENCE - (A) AIDTO CIRC A-25
(B) STATE 035101

1. USAID regrets the delay in its submission of materials for the Spring Review of ICI's. Because of critical shortages of staff time and an independent study now in progress we have had to limit our report on ICI's in Turkey to the principal institution in terms of volume and importance of intermediate lending.

2. This report deals only with Turk Sinai Kalkinma Bankasi (TSKB, sometimes known as IDB), Turkey's oldest and most active medium and long term credit bank. In process at the moment by a USAID contractor (Checchi Company) is a detiled study of the operations and structure of the Tourism Bank, another institution that can be classed as an intermediate credit bank, which, under general direction of the Ministry of Tourism, lends to private investors in Tourism. We expect a final report from the contractor about the middle of April and will forward it to you on receipt.

3. The Industrial Investment and Credit Bank is another ICI in Turkey which has received local currency assistance from AID. A dollar loan has been authorized to IICB but as yet no final agreement has been reached with the bank. We have been unable to devote the time necessary to provide you with a meaningful report on this bank. Because this bank is only three years old and has had no dollar loans and its lending of local currency is very slow, we have given priority to the TSKB. The American-Turkish Foreign Trade Bank, although primarily a

Enclosures:
ATTACHMENT A - Spring Review on Intermediate Credit Institution

PAGE 1 OF PAGES 17

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commercial lender of short term credit, has received a relatively small amount of LC through An AID loan to relend on medium terms. Because of its low profile it too was a low priority in this exercise.

4. The depth and scope of the information and opinions developed in this report is more limited than we would like. Pressures of day-to-day staff demands made it impossible to devote the concentrated time which would have been required for a more developed report.

KOMER

ATTACHMENT A

SPRING REVIEW ON INTERMEDIATE CREDIT INSTITUTION (ICI's) FE No. 21

A. Description of Project

1. Country - Turkey

2. Name of ICI - Türkiye Sinai Kalkinma Bankasi (TSKB)

3. Class of ICI - Private

4. Date Established - June 1950

5. Initial Assistance from AID:

Date	$ Amount	Kind (I.E. Dollar Loan, TC Grant, LC Loan)
12/4/50	$2,522,500 ($1 = TL 2.8)	LC Loan

6. Does the ICI take equity participation? Yes.

7. Capital structure of the ICI as of date specified in 5 above.

The TSKB's initial share capital was TL 12.5 million ($4.5 million) of which approximately 75% was subscribed by privately owned commercial banks, 15% by the Chamber of Commerce and Industry and the remainder by private interests. The above capital of the Bank was supplemented by a bond issue of TL 12.5 million purchased by the Central Bank of Turkey and a World Bank loan of $9.0 million, bringing total resources to TL 50.2 million.

8. Subsequent Assistance from AID:

AID has given substantial subsequent assistance to the TSKB over the years through dollar and local currency support. The local currency support came from: Industrial Export Working Capital Fund under P.L. 665 - Sec. 402, Marshall Plan Private Enterprise Fund, Capital Participation Fund and Marshall Plan Private Enterprise Fund under P.L. 480 Title I 104(f) funds. Following are U.S. inputs which include total releases and accumulated interest income to the TSKB as of the dates given.

Date	Amount	Kind
*1/ 1/66	$40,898,473.33 ($1 = TL 9)	IC Loan
*7/31/68	2,730,764.07 ($1 = TL 9)	IC Loan
12/15/59	10,000,000	Dollar Loan
11/18/64	5,000,000	Dollar Loan
5/18/68	7,500,000	Dollar Loan

9. Capital Structure of the ICI at end of latest fiscal year.

The TSKB fiscal year is concurrent with the calendar year. As of December 31, 1968 the Bank's capital was TL 65 million, more than one-half of which is subscribed by commercial banks, insurance companies and trade associations, 11.6% by the International Financing Corporation and the remainder by private interest. It should be noted that on February 24, 1969 at an extraordinary meeting of shareholders, a resolution to increase the Bank's share capital to

*) Consolidation of various earlier agreements. Details of original agreements available in AID/W from the International Loan Branch, Office of the COntroller.

TL. 110,500,000 was approved. This is to be accomplished by the issuance of TL 32,500,000 of TL 500 par value shares to be sold to the public and by the transferrence of TL 13 million from extraordinary reserves to share capital.

10. Status of AID Dollar Loans as of July 1, 1968

AID's first two dollar loans (DLF-11 and Loan 277-H-049) have been fully committed and disbursed. Loan 277-H-084 had recently been signed and the TSKB was in the process of fulfilling conditions precedent to disbursement. As of March 1969 the first one million dollars from Loan 277-H-084 has been obligated in a Letter of Commitment but has not been disbursed according to our information.

11. Interest Rates

The average interest rate paid by TSKB for LC is 5%, estimated. Average rate paid by TSKB for FX is 6½%, estimated. Average rate charged by TSKB for LC is 8%, plus 1% commitment fee, plus less than 1% transaction tax. Average rate charged by TSKB for FX is 9½% beginning during the second half of 1968. Prior to 1967 this rate was 8½%. Beginning in 1967 it was increased to 9%. All of the FX rates are plus one percent commitment fee.

The TSKB applies the above stated rates for medium and long term loans which are over three years. Most loans are from five to ten years including a grace period of one or two years. The TSKB also makes short term loans at the standard rate in Turkey of 10½%, plus 1% commitment fee, plus 1% transaction tax. Generally medium and long term loans are for capital investment and are not available for working capital borrowings.

12. Limits on Size or Uses of Loans

A. Lending Limits

The TSKB finances up to 60% of fixed assets in any one enterprise. The Bank's commitment to any one company is restricted to 15% of the equity of the Bank plus the outstanding balances of the Bank's quasi-equity loans. In 1967 this limit was calculated to be TL 70 million. The minimum size for LC loans is TL 250,000 and for FX loans $50,000.

B. Equity Participation

TSKB's participation in one company may not exceed 5% of the equity of the Bank plus the outstanding balance of quasi-equity loans. In 1967 this limit was calculated at TL 24 million. The Bank's interest in any one company may not exceed 25% of the share capital of the company concerned.

13. Formal Criteria

The TSKB has always maintained a set of formal lending criteria which are established by the Bank's Board of Directors. These criteria over the Bank's 18-year history, have been revised from time to time. AID/Washington will find detailed reference to these criteria in the DLF-11 loan paper, in AID Loan 277-H-049 loan paper, and in AID Loan 277-H-084 loan paper. As one of the conditions precedent of the most recent AID dollar loan to the Bank (Loan 084) a statement of loan criteria to be applied in the granting of sub-loans from Loan 084 was approved by the TSKB Board. AID/Washington will find complete documentation related to these loan criteria in the NESA/CDF loan files for Loan 084. The IBRD, IDA and IFC have also required the application of various criteria in the making of sub-loans from the funds they have lent the Bank. Information on these criteria is also available in AID/W from the Development Bank files of NESA/CDF. The various IBRD, IDA and IFC reports and recommendation papers on the TSKB should be referred to for this information.

14. Distribution of Loans by the TSKB

DISTRIBUTION OF LOANS (TL. million-percent)

MANUFACTURING INDUSTRY	1952-1957	%	1958-1962	%	1963-1967	%
2. CONSUMPTION GOODS INDUSTRY	78.3	54.9	102.1	32.0	236.1	26.1
1. Foods	23.3	16.3	62.4	19.6	46.8	5.3
2. Beverages	1.2	0.8	2.8	0.9	15.8	1.7
3. Textile and clothing	53.8	37.8	35.2	11.6	165.9	18.2
4. Printing	-	-	1.7	0.5	7.6	0.9

DISTRIBUTION OF LOANS (TL. million-percent)

MANUFACTURING INDUSTRY	1952-1957	%	1958-1962	%	1963-1967	%
II. INTERMEDIARY GOODS INDUSTRY	49.9	35.0	159.1	49.9	488.7	53.9
1. Forest products	4.6	3.2	12.4	3.9	21.2	2.5
2. Paper	1.2	0.9	5.6	1.8	9.4	1.0
3. Leather	0.5	0.3	1.8	0.6	1.3	0.1
4. Rubber	0.3	0.2	10.1	3.1	4.7	0.5
5. Plastics	-	-	-	-	30.5	3.4
6. Chemicals	10.1	7.1	37.8	11.9	110.9	12.2
7. Products other than metals	17.8	12.5	41.9	13.0	215.3	23.9
8. Iron, steel and metallurgical industry	15.4	10.8	47.1	14.8	92.0	10.1
9. Petroleum Products	-	-	2.4	0.8	3.4	0.4
III. INVESTMENT GOODS INDUSTRY	12.5	8.7	51.8	16.2	157.0	17.2
1. Metal products	3.4	3.4	32.2	10.1	93.8	10.3
2. Machinery	3.2	2.3	10.2	3.2	54.8	6.0
3. Production and repair of transport equipment	5.9	4.0	9.4	2.9	8.4	0.9
IV. OTHERS	2.0	1.4	6.0	1.9	25.7	2.8
TOTAL	142.7	100.0	319.0	100.0	907.5	100.0

The TSKB is the only ~~bank~~ development bank in Turkey/~~and is the only lender of significance of medium and long term funds.~~ of significance. The Bank's position is generally quite favorable as the demand for loans is much greater than the supply and the Bank can generally choose the best projects available. The TSKB is therefore an essential and important source ~~[illegible]~~ of medium and long term financing for the private sector. The Bank's overall reputation

is excellent and it is generally highly regarded in the local and international financial community.

The Bank, as stated above, does take equity participation and is an important factor in making foreign exchange credits and local currency financing available to the private sector. The TSKB has matured over its 18 years of existence but its general orientation and activities have been essentially the same from its establishment. Of late (last 3 to 5 years) the Bank has become active in the underwriting and guaranteeing of bonds and securities issues. Although the capital market in Turkey is small the TSKB is the dominant factor. It is estimated that from 30% to 50% of all capital market activities involve the TSKB.

B. Evaluation on Specific Points

1. Goals

(a) The TSKB is generally quite active in the mobilization of additional capital from all potential sources. Over the years the TSKB has regularly increased its share capital proportionate to its growth and has done so entirely with private sector ownership and support. The Bank also regularly obtains LC funds from the Government for lending in the private sector. In addition the Bank has received substantial support from the international lending agencies such as the IBRD, IDA, IFC, EIB and AID and occasionally from suppliers' credits provided by West European sources. In its earlier years, the TSKB's major resource for lending was LC funds with only a small amount of FX funds available. However, from 1964 on with the increased success of the TSKB in obtaining support from the abovementioned international lending institutions, the emphasis and thrust of the Bank's activity has been in making FX resources available to the private sector.

Loan Commitments

Years	Foreign currency (million $)	Local currency (million TL)	Total (million TL)
1950-1952	2.6	50.2	57.3
1953-1955	11.5	42.3	74.3
1956-1958	6.0	62.8	79.7
1959-1961	22.5	86.5	174.5
1962-1964	14.8	167.6	301.9
1965-1967	51.7	221.2	691.4
Total	109.1	630.6	1,379.1

(b) The TSKB attempts to coordinate its lending policies with those of the goals and objectives of the current Government development plan. The State Planning Organization consults regularly with the TSKB and as regards certain foreign exchange funds the SPO must approve a particular project as eligible for a loan in accordance with the criteria of the Government's development plan. In this sense the TSKB channels its resources to the sectors and industries given priority by the GOT. Interest rates are fixed and to our knowledge are not used as a mechanism by the Bank to influence the pattern of investment. The Bank, through the application of its criteria for the granting of loans, makes evaluation of both the economic and technical feasibility of the project and gives priority to those projects which have the potential to increase exports or create import substitution.

(c) While AID's support for the most part has not been directed towards supporting securities marketing, some of the LC funds made available have been earmarked for use by the TSKB in taking equity positions in private sector companies. It is the TSKB's policy, in turn, to sell the Bank's equity shares to the Turkish investing public when they become marketable. In addition the foreign exchange loans to the TSKB have indirectly helped in the development of the securities market by enabling private sector companies to obtain the necessary foreign exchange loans to import capital goods which, in turn, makes them attractive investment opportunities for the Turkish investor.

(d) The TSKB has also taken an active role in project preparation,

choice of technology, improvement in accounting and management practices as well as a role as consultants to private firms and Government departments. While it is difficult to quantify the value of this assistance TSKB, as one of the leading institutions supporting the private sector has made a very important contribution in this area.

Achievement of Goals

(a) The TSKB has generally done a good job in meeting its goals; however, it should be kept in mind that it is the only institution of its type in Turkey offering in most cases any of the above enunciated goals, and surely the only one with the full prospective outlined above. It may safely be said that the TSKB is a very important mechanism for the channelling of these resources into the private sector and that without it a high percentage of the resources might well be channelled into the public sector or less important investments.

(b) The TSKB has generally done an excellent job of maturing and expanding the emphasis of its operation in accordance with the receptiveness and climate in the Turkish economy. This has called for more of a maturing process and expansion of its goals than a shift in emphasis among them. It may be said that all the areas of the TSKB's operation need continued support and development in order to develop the capital markets required in an industrializing country with a growing private sector.

(c) As may be seen from the substantial support that AID has given the TSKB, we have accorded its role in Turkey one of high priority. We continue to believe that the role played by an institution like the TSKB is critical for the development of the private sector in the Turkish economy and that even with today's limited AID resources, the support of ICI's and in particular TSKB continues to be considered one of high priority.

(d) As has been mentioned above, the TSKB has been successful in achieving support for its goals from almost all of the major international lending institutions. The TSKB is actively investigating on a regular basis the possibility of obtaining support from commercial sources for its activities. At the present time, it appears that commercial sources of support in the current international market would tend to be excessive in cost, as may be seen from

from the lending rates available from the TSKB. Nonetheless, we are aware that the TSKB is presently investigating the possibility of utilizing investment guarantees in conjunction with private U.S. investment funds for support of its operation.

Since Turkey has probably already obtained the maximum amount of foreign suppliers' credits economically justifiable, it is unlikely that the Bank could actively pursue increasing this source of support for achieving its goals.

(e) It is difficult in a project as large and complex as the TSKB to go into an analysis and recommendations for the development of new goals and improvement for achieving what has been undertaken by the TSKB without going into much greater depth and analysis than called for by this report. However, generally it may be said that some greater emphasis on technical assistance to the Bank in its earliest stage of development would have been useful in giving it depth and greater precision in the application of economic and financial analysis. At present the TSKB is too matured an institution for such assistance to be effectively given or accepted. In the overall notwithstanding some mistakes and inefficiencies during the 18 year period of the Bank's existence, it can be rated as being a successful intermediate credit institution.

2. Selection of Borrowers

(a) The economic criteria employed by the TSKB are fully documented in AID/Washington. Reference should again be made to the development banking files in NESA/CDF, particularly for loans DLF-11, 049 and -084. In addition, most of the other international lending institutions' reports on the TSKB are on file in AID/Washington and the full perspective of the economic criteria applied by the TSKB may be best drawn from this source.

The Government is of influence in the guidance of the criteria used by the Bank through regular consultations by the executives of TSKB with the State Planning Organization. In addition as stated above, approval from the SPO must be obtained by prospective borrowers seeking $200,000 or more of FX before the TSKB may consider a loan application.

(b) The TSKB has from time to time undertaken sector and industry studies in conjunction with its evaluation of particular projects and in an effort to encourage investment in areas which are attractive and appear important for the development of the Turkish economy. This is an area of the TSKB's work which has developed over the past 10 years and it is expected will increase and the quality of it improve as more industry studies are undertaken by the Bank.

Because of reasonably good bank review and the State Planning Office review, pressures from salesmen or promoters which might stimulate the wrong type of application or the purchase of the wrong equipment is not a problem.

(c) It may be said that the technical and financial criteria applied and reviews undertaken by the TSKB are from fair to good. To a certain degree the comprehensiveness of review is influenced by the reputation and security available from the prospective borrower with a resulting diminution of the weight given technical and financial criteria, as AID might apply them. It is difficult to find fault with this approach of the TSKB as it is important that the backers of a particular project have the financial resources to extend further support to a project when unforeseen circumstances increase costs, so long as the project is basically sound. Another important factor is the limited number of fully qualified personnel to undertake these reviews available in Turkey.

(d) Again it is difficult to recommend specific changes in the manner in which the TSKB has been supported in the past. As suggested earlier managerial assistance in the first years after the Bank's establishment would have been useful. On the other hand the perspective of the financial community's sophistication at each stage in the institution's development and thus its receptiveness to new ideas and assistance must be considered.

3. Management and Operational Policies

(a) The TSKB is believed to have a good managerial organization which is appropriate for its operation and to date has been effective in achieving the goals of the Bank. As in all

developing countries the need for properly trained personnel exists and the selection of managerial talent is generally based on the development of TSKB employees and selection of proven individuals in the particular expertise which the Bank is seeking at any particular time. It is therefore difficult to set up criteria or recommendations beyond those already formally applied as regards the methods and selection of managerial personnel.

(b) The TSKB's overall experience with repayment has been good; defaults are kept to a minimum and loans are generally adequately secured by the borrower. The TSKB continues in close contact with the projects it supports and by undertaking periodic reviews by TSKB auditors requires that the borrower maintain adequate records and financial planning.

(c) In the area of balancing the requirements of security for loans with appraisal of the entrepreneurship and worthiness of a particular project much is still to be accomplished. However, because of the inadequacy of financial data and records available, it is difficult for the Bank to temper its requirements for security when granting a loan. Nonetheless, TSKB management is aware of the need to do this and has made allowances in the type of security required when an outstanding project is available to it. In this area it can only be hoped that a more favorable balancing will evolve with time and with the standardization of accounting and availability of reliable credit information.

(d) Assistance is generally required and is available from the TSKB for the borrower. This varies greatly from project to project and also on whether or not the TSKB has taken an equity position in the Company and the type of security that has been obtained for the loan. The effectiveness of this type of support is hard to evaluate without going into consideration of its effect[illegible] on a project by project basis. In the overall, it can be rated as varying from fair to good.

(e) To a certain degree there is a tendency to lend to established firms. However, the TSKB (when receiving proper security) has not been afraid to support new ventures which appear attractive. [illegible] The TSKB has a single lending rate for medium and long term loans with the result that interest rates do not create priorities. Therefore the borrowers own resources are not as a result freed for low priority projects.

As in most institutions of this type the TSKB has specific rules and regulations concerning loans to officers and principals of the Bank. To date no problem of this type or conflict of interest has come to our attention, however, we are not familiar with the details of the TSKB's implementation and solution to questions of conflict of interest.

(f) The TSKB has over the years been a profitable institution which reflects its general overall success and effectiveness.

4. Specific AID Relationships

(a) AID/s projects have not been necessarily directed to the specific areas reviewed above. The main objective of AID dollar loans has been to make available foreign exchange via an effective mechanism to the private sector. The LC funds have been used to meet various objectives, i.e., support equity investment by the TSKB and increase the amount of LC available to the private sector. Thus, in total it may be said that AID has effectively supported the overall goals of the bank discussed above.

(b) Our experience has proven that loan terms have met the objectives desired and have been suitable for our purpose. The changes in the various loan terms and conditions during the 18 year history of support of TSKB can be viewed as a response to changing factors in the changing political and economic situation in Turkey.

(c) The two step loan procedure has been a satisfactory mechanism in the AID/TSKB loan relationship. Although direct loans to the TSKB used during AID's earlier support of the bank could be viewed as having advantages over the two step procedures which has injected the GOT into AID's direct working relationship with the TSKB, the change to the two step loan was made to meet GOT requirements. Nevertheless, the working relationship with the TSKB continues to be satisfactory.

The need for local cost financing continues to exceed the amount of LC funds available. While the TSKB to date has had sufficient LC fund to support many projects additional funds are required to utilize its capacity and meet the needs of a growing private sector.

(d) It is apparent that tied procurement is restrictive and that only effective improvement would be its elimination. There is little doubt that it slows the flow of incoming goods by the long shipping time and U.S. source procurement is not always competitive pricewise even without consideration to higher shipping costs. Nonetheless, in the overall operation and implementation of the AID foreign exchange loans, it is not viewed as a major problem.

(e) As may be noted from the above evaluation, AID has not given the TSKB technical assistance support. In retrospect, such technical assistance might have been effectively used in the very early periods of AID support to the TSKB (between 1950 - 1955). At this time no technical assistance is contemplated nor do we believe it could be acceptable to or effectively utilized by the bank.

(f) We feel that the rate of utilization of the foreign exchange funds by TSKB is satisfactory. The only shortening of the pipeline which would be desirable would be the faster receipt of goods after the placement of a firm order. More rapid use of funds would only tend to shorten the loan processing time by the TSKB and lead to a more perfunctory application of the criteria of subloan evaluation.

(g) Not applicable.

C. <u>Overall Evaluation and Conclusions</u>

The scope, importance and application of economic and financial criteria in the selection of borrowers has been fully discussed above. Increasing the emphasis in the application of these criteria versus the stringent demands of loan security and financial reputation of borrowers is something that will only evolve with time.

As briefly noted previously ~~matrix~~ the standardization of accounting procedures and the availability of accurate financial information within the industrial community will be the key to the acceptance of these criteria as the important factors in the evaluation of the project versus security and individual reputation of borrowers. At this point in time we believe that the TSKB has matured and continues to mature in applying balancing of the application of economic and financial criteria versus security requirements for loans and that further pressure in this area would be counterproductive.

The interest rate structure, "going rate" is considered good and effective. It should be noted that the rates offered by the TSKB tend to be from 2 to 5 percentage points lower than those of most other developing countries (outside the NESA area).

The question of mobilization of capital has been adequately covered previously. We do not believe that the TSKB need exert any more effort in this area than it has already undertaken. The shift in emphasis from LC funds to FX funds over the 18 year history of the bank has been a favorable one, the TSKB being the only institution now making available FX loans to private sector borrowers.

The TSKB should be considered an example of one of AID's successful programs of support to an ICI.

However, it should be noted that assistance (technical assistance or otherwise) in managerial and organizational arrangements should be given in the early stages of the institutions establishment. Once the institution has solidified its managerial and organizational arrangements, efforts in these areas becomes unacceptable to them and preference for utilizing all the resources of assistance offered in making additional funds available becomes their sole objective.

The question of whether AID should increase the support offered ICIs in the future we believe must be considered on a country by country evaluation. In Turkey the TSKB is a demonstration of the success of an AID program and in particular of a program of support to an ICI. AID should continue to support the TSKB and if possible help in the development of additional ICIs, which appear to be an effective mechanism for making capital available to the private sector and at the same time infusing the application of economic, financial and technical analysis of projects of a more sophisticated nature.

In conclusion, we believe the TSKB may be viewed as a good example for other ICIs in early stages of their development. The TSKB has effectively increased its scope, broadened its goals, and tempered the various emphases of its operation to meet the changing climate and conditions for the support of the private sector within the Turkish economy. Unquestionably institutions must be viewed within the perspective of the climate in the country of operation and with this perspective in mind, the TSKB may be rated as a leading intermediate credit provider for the private sector.

KOSER

KOREA

EVALUATION AND CONCLUSIONS

KOREAN RECONSTRUCTION BANK
(KRB)

MEDIUM INDUSTRY BANK
(MIB)

KOREA DEVELOPMENT FINANCE CORPORATION
(KDFC)

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FROM - SEOUL

SUBJECT - Evaluation and Conclusions Concerning AID's Experience in Korea with Intermediate Credit Institutions

REFERENCE - AIDTO CIRC XA-25

I. Background of AID's Assistance to ICI's in Korea

After the years of Japanese occupation (1905-1945) and the disruptions and destruction of World War II and the Korean War, Korea's economy was largely characterized by widespread destruction, poverty, and a stagnant private sector. The government owned a major part of existing industry, while family-owned enterprises prevailed as the other most common form of business organization. Inflation was rampant and per capita income was low. The scarce private capital available was invested mainly in assets such as land and business inventories. While the Korean people were ambitious and had a generally good basic education, they were lacking in managerial experience.

It was in this environment that U.S. assistance to Intermediate Credit Institutions was initiated. As the U.S. began to assist in Korea's reconstruction, it became clear that substantial financial assistance was needed to rebuild the country's industry. The U.S. decided to direct its aid to Korea's small and medium industry through existing banking institutions as the most effective means of providing such assistance. This course was chosen because of the magnitude of the (counterpart) funds involved and because the U.S. had no institutions and few technicians available in Korea to administer the loans. And, by channeling loan money through Korea's existing banks, the U.S. would be helping to develop those institutions as an essential part of a viable Korean economy.

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PAGE 1 OF PAGES 5

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In 1950, two officials of the Federal Reserve Bank assisted the Korean Government in enacting legislation to establish a new and improved banking system, including the creation of the Korean Reconstruction Bank (KRB). Later, after the Korean Armistice, the U.S. began extensive aid to the KRB in the form of loans from counterpart funds for re-lending to local industry. Beginning in the early 1960's, the U.S. increased its aid by also providing dollar loans and technical assistance to the KRB and later to the Medium Industry Bank (MIB) and the Korea Development Finance Corporation (KDFC).

II. AID's Goals in Assisting Korea's ICI's

During the course of its assistance to Korea's ICI's, the U.S. has provided advisory services and training for various banking institutions, including the KRB, MIB, KDFC, and Korea Housing Bank (KHB). In addition, the U.S. has supplied a total of $45 million in development loans to three of these institutions, KRB, ($32 million), MIB, ($8 million), and KDFC ($5 million), plus a total of $90.4 million in loans and grants from counterpart funds.

AID's major goals in providing technical assistance, training, grants, and capital loans to Korea's ICI's can generally be described as:

1. To mobilize capital
2. To direct capital investment for economic development, preferably in the private sector.
3. To develop the ICI as an additional institution in the capital market.

In addition to these major objectives, there has also been, with the more recent loans, a secondary goal of promoting U.S. exports.

III. Contribution of ICI's to Korean Economy

One of the ways to help develop an economy is to build strong, efficient financial institutions dedicated to development and to financing numerous small projects essential to the growth of the economy, especially in the private sector. AID's assistance to Korea's ICI's has indeed encouraged this process greatly.

AID's emphasis upon adequate project appraisal has helped to develop the capability of Korea's ICI's to select projects offering the greatest return to business, in particular, and the economy, in general. For example, AID loan 489-A-007 for $5 million to the KRB is estimated to have had the following beneficial effects in its financing of forty-five individual projects (on an annual basis):

Net increase in U.S. raw material exports to Korea

	$1.5 million
Increase in taxes paid	$3.9 million
Increase in employment	5,370
Increase in production value	$22.4 million
Net foreign exchange earnings	$1.6 million
Net foreign exchange savings	$3.5 million

As further indicated by the A.T. Kearney & Company's advisors,* between 1963 and 1966, KRB-financed enterprises tripled production, quadrupled exports, and increased employment by about one-third.

Another way to measure the contribution of the ICI's to the Korean economy is in terms of Loans, Deposits and Capital Funds. During the past eight years the ICI's in Korea have shown a significant growth as indicated by the following (in billions of won):

	Loans	Deposits	Capital Funds
1960	15.8	.4	.3
1964	38.3	4.3	13.2
1968	92.8	40.5	34.3

In summary, AID's assistance to Korea's ICI's has generally been successful in channeling needed funds to an area of priority concern, and in helping local credit institutions made lasting improvements in their operations and in contributions to the growth of the private sector.

IV. General Conclusions

Based on AID's experience in assisting Korea's ICI's, there have been lessons learned and conclusions reached which can be applied elsewhere. These conclusions may be summarized as follows:

1. The ICI can be an effective instrument in channeling foreign capital to a less developed country. Korea's ICI's, for example, have been very useful in attracting U.S. and other foreign capital and then in sublending this money to Korean borrowers with worthwhile projects. The successful establishment and operation of ICI's has been quite important to Korea in providing the necessary "seed" money during the early stages of the country's development. Foreign loans to Korean ICI's now total $88,750,000. Further details are in the Country Assistance Paper for AID loan 489-H-051, Annex II A.

* Final Report of June 30, 1967, Tables VIII, p. 4, 5, 6.

2. Greater emphasis should be placed on raising domestic capital.

Except through the government, ICI's, particularly those in Korea, have been less successful in drawing savings out of the economy. Both AID and the host government should explore policy measures to make domestic investments in ICI's more attractive.

The KRB, for example, through December 31, 1967, had received only 2.9% (₩2.4 billion) of its funds in the form of savings deposits and 2.5% (₩2.1 billion) in debentures. The MIB, as of December 31, 1967, had total deposits of ₩15.6 billion or 58% of its total liabilities and net worth. (Further details on the KRB, are in the booklet, "KRB, Its Functions and Activities 1968".)

3. ICI's, with government backing or ownership, can often better encourage and utilize domestic savings. With the tax power the government can force some domestic savings that otherwise would not occur. These incremental savings can be invested through the ICI's in projects that are important to the country's development. For example, from 1954 through 1967, the KRB received from the ROKG 62 percent of all funds originated, consisting of ₩30.9 billion or 38 percent in loans plus ₩19.4 billion or 24 percent in paid-in capital. The remainder of the funds provided KRB was largely loans from counterpart funds. The MIB, on the other hand, which was set up in 1962 or much later than the KRB, has relied principally on savings deposits as a source of funds.

4. ICI's require substantial, outside assistance.
Consistent with the ICI's potential importance in a country's development, a great deal of financial, technical, and training assistance is needed.

a) Financial - Substantial financial assistance should be made available in the form of soft loans. The U.S. input in Korea has been $45 million in dollar loans plus $90.4 million in counterpart funds. Such aid should be judiciously administered so as to meet AID's and the host country's objectives.

b) Technical assistance - The continuing services of financial advisors from AID and other public or private organizations is essential to the development of the ICI's. Such technical assistance should be commensurate with the needs of the country as well as with the requirements of the ICI. This technical assistance could be financed either from an AID loan to the ICI,

or from an AID loan to the host government for a "package" of various types of technical assistance. Such advisory services should be primarily concerned with institutional development, and not just concerned with the implementation or operational procedures of approving AID sub-loans. For example, because the KRB has profited from the U.S. assistance, it now requires only limited and general guidance. The MIB, however, has been less successful and needs further technical assistance. (For more details, see USAID/K's recent PAR on the Improved Banking and Credit Administration Project.)

c) Training - Participant training should preferably involve not only academic instruction, but also seminars and on-the-job training with another ICI. The latter should take place in the same geographic area, where conditions are often more comparable and readily applicable. AID should also strive to train all levels of personnel, including senior management, in order to build a stronger foundation and superstructure for the ICI.

5. In reviewing the institutional development of an ICI, AID should look closely at the ICI's operating efficiency. AID ought to review continuously the ICI's activities from the standpoint of profitability and financial soundness, as well as the contribution to the development of the economy of the country. Specifically, more attention should be given to: (1) overdue and charge-off ratios; (2) internal expense ratios; and (3) the economic impact of the projects. Of course, it must be recognized that it will be easier to stress these points with ICI's that are not government controlled. (Further details are contained in A.T. Kearney & Co's final report of June 30, 1967, Appendix C, concerning miscellaneous ratios and measuring operations of the KRB; and Section VIII, for an assessment of the KRB's contribution to the Korean economy, capital structure, lending and guarantee activities, and administrative activities and operating results.)

Attached are statistical data on AID's assistance to KRB, MIB, and KDFC, as well as a PAR on AID's technical assistance project involving ICI's.

USAID/K is now preparing further substantive comments concerning AID's assistance to Korea's ICI's. These additional conclusions will be forwarded to AID/W within the next two weeks.

Enclosure: A/S

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INFORMATION FOR SPRING REVIEW ON ICI

A. Description of the Project

1. Country: Korea
2. Name of ICI: Korean Reconstruction Bank (KRB)
3. Class of ICI: Public
4. Date established: April 1, 1954
5. Initial Assistance from AID*:

Loan: 489-A-007
Date: 6/17/59 (authorized loan) Amount: $5,000,000
4/12/60 (signed agreement) Kind: U.S. dollar loan
Project: 489-26-920-618

*Includes dollar loans only.

6. Does the ICI take equity participation? Yes x No_____

7. Capital structure of the ICI as of 12/31/59:

KRB Capital Structure (In Millions of Won)

	1959-end
Paid-in Capital	197
Capital Surplus	-
Earned Surplus	141
Total:	338

8. Subsequent Assistance from AID*:

Loan	Date	$ Amount	Kind	Project
489-H-042	8/19/66	$12,000,000	U.S. dollar loan	489-26-920-662
489-H-052	5/17/68	15,000,000	" " "	489-26-920-667
Total:		$27,000,000	" " "	

*Includes dollar loans only.

9. Capital structure of the ICI at end of latest fiscal year (1968):

KRB Capital Structure (In Millions of Won)	1968-end
Paid-in Capital	19,918
Capital Surplus	1,498
Earned Surplus	6,577
Total:	27,993

10. Status of AID $ loans as of July 1, 1968:

Loan	Subloan Approved	Issued L/Com	Disbursed*
489-A-007	$5,148,743	$5,000,000	$4,285,038.15
489-H-042	8,975,337	6,000,000	-
489-H-052	-	-	-
Total:	$14,124,080	$11,000,000	$4,285,038.15

*Per W-224 (status of Loan Agreements) as 6/30/68. Includes loans (equivalent to $2,000) repayable in local currency.

11. Interest Rates:

Interest Paid by KRB	Interest Rates Per Annum (%)
AID Counterpart Fund	2
Other Government Fund	6-13
1st and 2nd AID Loans	5
KFW Loan	5
3rd AID Loan	6
Industrial Finance Debentures	5
Time Deposits	14.4-25.2
Other Deposits	1-12

11. Interest Rates: (Cont'd)

Rate of Interest on KRB Loans (%):

	At Present	To be amended and Effective Jan. 4, 1969
Capital Loans:		
"Basic" Industry Loans	7.5 p.a.*	12 p.a.**
Loans under 5 yrs.	12	
Between 5 to 10 yrs.	11	20
Over 10 yrs.	10	
1st and 2nd AID Loans	8	Not changed
KFW Loan (German)	8	"
3rd AID Loan	10	"
Operating Loans	18 (	18 for "Basic" Ind. 23 for Others.

*Electricity, coal mining, shipbuilding, marine transportation, public works and waterworks (applicable only to governmental fund loans.)

**Electricity, coal mining, shipbuilding and iron & steel industries.

Size of Foreign Exchange Subloans

AID: 489-A-007: Up to $500,000
489-H-042: $100,000 to $1,000,000)
489-H-052: $100,000 to $1,000,000)
No more than fifty percent of the AID loan funds may be used to finance subloans in excess of $500,000.

Other: KFW(German): Up to $200,000
KRB Loans other than Foreign Exchange:

Size of Each Loan

(1) Capital Loans;

Up to 65% of total project cost. (except foreign development loans)

(2) Operating Loans:

Up to 65% of working capital requirements per turn over period.

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Formal Criteria for KRB Loans

The priority KRB gives for financing has necessarily been in accordance with the development efforts of the Government as reflected in the successive Five-Year Economic Development Plans. KRB attaches priority to industrial projects in the following order:

(i) Those envisaged in the Five-Year Economic Development Plan.

(ii) Those complementing or supplementing Five-Year Plan Projects.

(iii) Non-Plan projects producing essential goods.

The eligible projects are further classified based on a balance-of-payments contribution criterion. The highest priority is accorded to export industrial projects, which are followed by import-substitute projects. The projects, whose production ensures a high proportion of domestic raw material use and high employment effect, are also given high priority.

From a legal point of view*, there is virtually no limitation on what projects KRB should support, as long as the projects contribute to the development of the essential industry and the needed funds are difficult to obtain from other financial institutions. In practice, however, there are fairly well drawn criteria as to types of industries to be supported, eligible size of projects, ratio of loan participation, mining industries and some limited projects in tertiary industry. Small enterprises are excluded, as they are supported by the Medium Industry Bank.

As practiced by any sound banking institution, KRB takes the following factors into consideration before making any loan:

a. National economic benefits.

b. Technical and financial soundness.

c. Profitability, and

d. Quality of management.

Once a decision is made to extend credit to a project, KRB supports the project on a full scale. KRB provides managerial and technical assistance, as the occasion requires. It also extends guarantees to client enterprises to facilitate their borrowing from other financial sources, when this is feasible. In addition, it occasionally provides working capital loans to ensure a full and successful operation of the projects supported.

* i.e., according to Korean legislative provisions.

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Summary of KRB Loans

(as of 12/31/68)

(In Mil. of Won)

Sector	Capital Loans		Operating Loans		Total	
	Number of Loans	Amount	Number of Loans	Amount	Number of Loans	Amount
Agri., Forestry & Fishery	1	70	2	621	3	691
Mining	201	2,871	16	1,611	217	4,482
Manufacturing	687	22,753	379	9,746	1,066	32,499
Construction	3	442	-	-	3	442
Electricity & Gas	131	17,042	4	1,615	135	18,657
Transportation & Warehouse	215	6,258	1	128	216	6,386
Services	52	3,256	1	12	53	3,268
Total:	1,290	52,692	403	13,733	1,693	66,425

KRB - Loans by Type

(As of Dec. 31, 1968)

Account Title	Total Outstanding Loan (In Thousands of Won)
Local Currency Loans	64,118,780
FX Loans	2,278,412
AID subloans	988,127
KFW subloans	1,290,285
Others	27,649
Total	66,424,841
Government Enterprise	29,872,729
Operating	3,888,726
Capital	25,984,003
Private Enterprise	36,552,112
Operating	9,844,073
Capital	26,708,039
Total:	66,424,841

AID Counterpart Assistance to KRB, MIB & KDFC

Unit: Won

	Counterpart Fund Loan	Counterpart Fund Grant	Total	Date ProAg Finalized
A. Korean Reconstruction Bank				
CY 1962	10,012,617,419	2,526,266,309	12,538,883,728	4/1/62
CY 1963	2,326,500,000	148,834,616	2,475,334,616	4/25/63
CY 1964	2,258,000,000	-	2,258,000,000	3/2/64
CY 1965	100,000,000	-	100,000,000	4/20/65
CY 1966	-	-	-	-
CY 1967	2,025,000,000	380,000,000	2,405,000,000	8/25/67
CY 1968	703,000,000	-	703,000,000	10/7/68
Total:	17,425,117,419	3,055,100,925	20,480,218,344	
B. Medium Industry Bank				
CY 1963	700,000,000	795,848,873	1,495,848,873	4/25/63
CY 1965	750,000,000	-	750,000,000	4/20/63
CY 1967	-	*500,000,000	500,000,000	4/25/63
Total:	1,450,000,000	1,295,848,873	2,745,848,873	
C. Korea Development Finance Corporation				
CY 1967	2,025,000,000	-	2,025,000,000	12/30/67

* Grant from AID to ROKG. However, repayment ROKG loans to MIB will not be returned to AID's counterpart account, but to the ROKG's own account.

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Position and Functions of the KRB

The KRB was established in 1954 as a government-owned, development bank to provide the financing needed for industrial and agricultural rehabilitation. The KRB, as a major source of long-term funds, grew rapidly and, as of June 30, 1968, accounted for 22% of all loans and 64% of all long-term loans made by all Korean financial institutions.

As of December 31, 1968, total outstanding loans amounted to 66.4 billion won, an increase of 14 billion won over the preceeding year-end. About 45% of the KRB's loans, as of December 31, 1968, were to Government enterprises; these were principally capital loans, which accounted for 80% of the loans to government enterprises. The remainder of the outstanding loans to private enterprise were also primarily in the form of capital loans, which accounted for 73% of such loans.

The KRB supplies the major portion of funds, both long-term and short-term, required by the government-owned enterprises. Approximately one third of all of its loans is to Korea Electric Company, a government-owned electric utility company.

The KRB is the largest single guarantor of local currency for guaranties issued by the Korean Exchange Bank on foreign loans. As of December 31, 1968, the total outstanding for all guaranties amounted to 147.2 billion won.

The KRB is generally regarded as the foremost long-term financing institution in Korea. It's management, in general, is considered capable and competent.

There have been several significant changes in the operations of the KRB since 1960, the date of the first AID loan to this ICI. These innovations are as follows: 1) the issuance of guaranties for both domestic and foreign exchange loans; 2) the increasing reliance upon equity investment; 3) the shift in source of funds from government loans to transfer-of-shares of government-owned enterprises to the KRB as paid-in-capital in lieu of government loans; and 4) sale of debentures as proposed in the 1969 operational program for the KRB.

Additional information on the background and functions of the KRB is found in:

a. Capital Assistance Papers for each of the aforementioned AID loans.

b. "Report and Recommendations on the Korean Reconstruction Bank", by Arthur I. Bloomfield, August 1960, p. 7 ff.

c. "The Banking System in Korea", The Bank of Korea, Nov. 1968, p. 11 ff. (copy attached).

d. Reports by A. T. Kearney & Co. on the KRB.

e. Seoul TOAID A-2348 of 10/7/68.

INFORMATION FOR SPRING REVIEW ON ICI

A. Description of the Project

1. Country: Korea 2. Name of ICI: Medium Industry Bank(MIB)

3. Class of ICI: Mixed 4. Date established: August 1, 1961

5. Initial Assistance from AID*:
   Loan: 489 - H-040
   Date: 6/13/66 (authorized loan) Amount: $5,000,000
   8/11/66 (signed agreement) Kind: U.S. dollar
   Project: 489-26-920-659

   *Note: Includes dollar loans only. Prior to authorization of the $5,000,000 loan in 1966, AID had provided a total of W2,246 million to the MIB (equivalent to approximately $8.3 million) in the form of grants (W796 million) and loans (W1,450 million) from counterpart funds.

6. Does the ICI take equity participation? Yes____ No_x__

7. Capital structure of the ICI as of 12/31/65:

	(In Million Won)
Paid-in Capital	810
Reserve	254
Profit	154
Total:	1,218

8. Subsequent Assistance from AID*:

Loan	Date	$ Amount	Kind	Remark
489-H-040	6/28/67	3,000,000	U.S. dollar	Increase over $5,000,000 Authorized 6/13/66.

*Includes dollar loan only.

9. Capital structure of the ICI at end of latest fiscal year (12/31/68):

	(In Million Won)
Paid-in Capital	1,760
Reserve	516
Profit	104
Total:	2,380

10. Status of AID $ loans as of July 1, 1968:

Loan	Subloans Approved	Issued L/Com	Disbursed*
489-H-040	$4,589,487	$3,103,000	$485,936

*Per W-224 (status of Loan Agreements) as of 6/30/68.

11. Interest Rates:

Interest Rates paid by MIB on Borrowings:	Interest Rate(%)
Borrowing from the Bank of Korea	3.50 to 26.00
Counterpart Fund	2.00
Gov't Loans	7.00 to 23.00
KFW Loan (German)	5.00
OECF Loans (Japan)	5.00
AID Loan	5.00

Interest Rates paid by MIB on Deposits:	Interest Rates(%)
Extra Deposits	1.00
Pass Book Deposits	1.80
Notice Deposits	5.00
New Household Deposits	12.00
Time Deposits--3 months or over	14.40
6 " "	19.20
1 to 2 years	25.20
National Savings Ass'n Deposits	25.20
Installment Savings Deposits	15.00
National Bond Deposits	5.00

Interest Rates charged by MIB:	Interest Rate(%)
Banking Fund Loans	2.00 to 28.00
Operation Fund Loans	18.00
Facility Fund Loans to Exporters	11.00
" " to Others	12.00
Cooperatives Business Fund Loans	12.00
AID Loans	8.00
KFW Loans (German)	8.00
OECF Loans (Japan)	8.00

Size of Subloan (foreign funds)

A.I.D. Loan 489-H-040:	Up to $200,000
KFW Loan (German) :	Up to $300,000
OECF Loan-1st (Japan):	Up to $300,000
OECF Loan-2nd (Japan):	Up to $200,000

Formal Criteria for MIB Loans

The MIB set up its lending policies as follows in accordance with the government's general policy for development of small and medium industies:

1) Small and medium entrepreneurs, who are engaged in the business of mining, manufacturing, and transportation, either with 200 employees (300 in the case of mining and transportation) or less, or with total assets of no more than 30 million Won, are eligible for MIB loans (except foreign funds, for which eligibility criteria are established incidental to implementation of governing loan agreement.)

2) Size of Loans:

Facility Fund

a) Export item manufacturer: Up to W10 million
b) Domestic item manufacturer: Up to W5 million

Operation Fund

a) Export item manufacturer: Up to W10 million
b) Domestic item manufacturer: Up to W5 million
c) Overdrafts & Commercial Bills Discount: Up to W5 million

Small & Medium Industry Cooperatives

a) Within the limit of 10 times paid-in capital

Local Gov't & non-profit organization

a) Up to W5 million

Other Natural & Juridical Person

a) Up to W 1 million

3) Priority is given in the following order:

a) Export industries
b) Import-substitute industries
c) Industries producing raw material necessary for export and import-substitute industries
d) Labor intensive industries
e) Development of machinery industry

Summary of MIB loans by number and amount and by industry
(as of 12/31/68)

(In million Won)

Industry	Number of Loans	Amount
Mining	153	453
Manufacturing	15,652	24,200
Transportation	239	354
Other	1,868	1,013
Total	17,912	26,020

AID Counterpart Assistance to KRB, MIB & KDFC

Unit: Won

	Counterpart Fund Loan	Counterpart Fund Grant	Total	Date ProAg Finalized
A. Korean Reconstruction Bank				
CY 1962	10,012,617,419	2,526,266,309	12,538,883,728	4/1/62
CY 1963	2,326,500,000	148,834,616	2,475,334,616	4/25/63
CY 1964	2,258,000,000	-	2,258,000,000	3/2/64
CY 1965	100,000,000	-	100,000,000	4/20/65
CY 1966	-	-	-	-
CY 1967	2,025,000,000	380,000,000	2,405,000,000	8/25/67
CY 1968	703,000,000	-	703,000,000	10/7/68
Total:	17,425,117,419	3,055,100,925	20,480,218,344	
B. Medium Industry Bank				
CY 1963	700,000,000	795,848,873	1,495,848,873	4/25/63
CY 1965	750,000,000	-	750,000,000	4/20/63
CY 1967	-	*500,000,000	500,000,000	4/25/63
Total:	1,450,000,000	1,295,848,873	2,745,848,873	
C. Korea Development Finance Corporation				
CY 1967	2,025,000,000	-	2,025,000,000	12/30/67

* Grant from AID to ROKG. However, repayment of ROKG loans to MIB will not be returned to AID's counterpart account, but to the ROKG's own account.

Background of Medium Industry Bank(MIB)

The MIB was established in accordance with the Medium Industry Bank Act of 1961 and began operations on August 1, 1961. The MIB was established to meet the financing requirements of private small and medium industries. The MIB Act of 1961 was amended on December 31, 1964, authorizing the MIB to introduce foreign development loans and to relend proceeds of the loans as long-term financing to private small and medium industry. The bank has its head office in Seoul and forty-one branch offices in twenty-three principal cities throughout Korea. The number of employees, as of September 30, 1968, was 2,191. As of November 31, 1968, the total loans and deposits of all banking institutions amounted to W347 billion and W422 billion, respectively. The MIB, as of same date, had total deposits of W23 billion and total loans of W25 billion.

Further details as to the organization, management, and functions of the Medium Industry Bank are contained in the capital assistance paper for AID loan 489-H-040, beginning on page five. Additional details are also contained in the booklet "The Banking System in Korea".

As of 1966, small and medium size businesses in Korea numbered about 25,000, making up 98.2% of the total number of enterprises, employing 60.7% of the total number of employees in the mining, manufacturing and transportation industries, and producing 46.6% of the total combined output of all mining, manufacturing, and transportation industries. The MIB, as of September 30, 1968, had loans outstanding to approximately18,000 different borrowers. The MIB is the primary source of long-term and working capital loans for small and medium size businesses in Korea, and has been designated by the ROKG as the principal institution to promote exports by these companies.

For additional information, note the Capital Assistance Paper for the AID loan to MIB and Seoul TOAID A-2348 of October 7, 1968.

INFORMATION FOR SPRING REVIEW ON ICI

A. Description of the Project

1. Country: Korea

2. Name of ICI: Korea Development Finance Corporation (KDFC)

3. Class of ICI: Private

4. Date Established: April 20, 1967

5. Initial Assistance from AID*:

   Loan : 489-H-051

   Date: 12/1/67 (authorized loan)
   1/31/68 (signed agreement)
   *Includes dollar loans only.

   Amount: $5,000,000
   Kind: U.S. dollar

   Project: 489-26-920-666

6. Does the ICI take equity participation: Yes x No____

7. Capital structure of the ICI as of 12/31/67:

   KDFC's Capital Structure

	At the end of 1967
Government Loan (Quasi-Equity)	W -
Paid in Capital	820,000,000
Retained Earnings	107,238,241
Total	W927,238,241

8. Subsequent Assistance from AID: AID provided on January 20, 1968, a total of W2,025 million to the KDFC in the form of a loan from counterpart funds.

9. Capital structure of the ICI at end of latest fiscal year (12/31/68):

   KDFC's Capital Structure

	At the end of 1968
Government Loan (Quasi-Equity)	W2,025,000,000
Paid in Capital	1,350,000,000
Retained Earnings	543,127,324
Total:	W3,918,127,324

10. Status of AID $loans as of July 1, 1968:

    Committed: None Disbursed: None

11. Interest Rates:

Interest Rates paid by KDFC	Interest Rate (%)
IBRD Loan	6.5
AID Loan	6.0
Government Loan (Local Currency)	4.0

Interest Rates charged by KDFC	Interest Rates (%)
Won Currency Loan	20.0
IBRD Loan	10.0
AID Loan	10.0
Government Loan	10.0 (Interim interest received on deposit of undisbursed balance of government loan.)

Size of Subloan

489-H-051: $50,000 to $1,875,000

Credit Policies & Criteria:

1) KDFC will give due regard to the Government's general economic plans and policies. Priority is given in the following order:

   a. Export industries.

   b. Import-substitute industries.

   c. Industries producing raw material necessary for production of export commodites and import-substitutes.

   d. Indigenous local industries which have special advantage in comparative costs and potential marketability in foreign markets.

   e. Participation or assistance in the turn-over of the Government-owned industries to private ownership.

2) KDFC will make investment decisions only on the basis of sound investment criteria and standards, and will provide financial assistance only to those projects which are financially and economically sound and technically feasible. Special attention will be given to the ability of management and the profitability of the enterprise.

3) KDFC will not provide financial assistance of less than the Won equivalent of $50,000. The maximum financial commitment in whatever form, including loan, share capital or guarantee or any combination thereof, that KDFC may make to any single enterprise will not exceed 15% of the total of KDFC's paid-in capital, free reserves and government loan of 1968.

4) KDFC will not commit to any single enterprise in the form of share capital more than 10% of KDFC's paid-in capital and free reserves. Also, the aggregate equity investment at any one time will not exceed the total of paid-in capital and free reserves.

Summary of KDFC Loans Outstanding by Industry

Industry	Number of Loans	Amount
Textile	2	W160,000,000

AID Counterpart Assistance to KRB, MIB & KDFC

Unit: Won

	Counterpart Fund Loan	Counterpart Fund Grant	Total	Date ProAg Finalized
A. Korean Reconstruction Bank				
CY 1962	10,012,617,419	2,526,266,309	12,538,883,728	4/1/62
CY 1963	2,326,500,000	148,834,616	2,475,334,616	4/25/63
CY 1964	2,258,000,000	-	2,258,000,000	3/2/64
CY 1965	100,000,000	-	100,000,000	4/20/65
CY 1966	-	-	-	-
CY 1967	2,025,000,000	380,000,000	2,405,000,000	8/25/67
CY 1968	703,000,000	-	703,000,000	10/7/68
Total:	17,425,117,419	3,055,100,925	20,480,218,344	
B. Medium Industry Bank				
CY 1963	700,000,000	795,848,873	1,495,848,873	4/25/63
CY 1965	750,000,000	-	750,000,000	4/20/63
CY 1967	-	*500,000,000	500,000,000	4/25/63
Total:	1,450,000,000	1,295,848,873	2,745,848,873	
C. Korea Development Finance Corporation				
CY 1967	2,025,000,000	-	2,025,000,000	12/30/67

* Grant from AID to ROKG. However, repayment of ROKG loans to MIB will not be returned to AID's counterpart account, but to the ROKG's own account.

Background of the Korea Development Finance Corporation (KDFC)

The KDFC was established in 1967 with the assistance of AID and the International Finance Corporation (IFC) of the World Bank. The KDFC was founded largely by private interests as a private development financial institution to assist in the development of sound productive private enterprises in Korea. This intermediate credit institution (ICI) is designed to achieve this goal by providing capital in the form of loans and equity investment and by furnishing managerial and technical assistance to private enterprises. The ROKG favored the formation of the KDFC as a supplement to the existing financial sources available to finance the Second and succeeding Five Year Plans.

At the present time, the principle sources of long-term capital for private enterprise in Korea are two banks, the Korean Reconstruction Bank (KRB) and Medium Industry Bank (MIB), which are both owned by the ROKG (KRB - 100%, MIB - 98%). While these banks have contributed significantly to the growth of the Korean economy, the capital needs of business continue to grow. The KDFC is expected initially to supplement the KRB and MIB as a source of long-term capital; however, the KDFC is expected gradually to become one of the major sources of long-term capital for private enterprises in Korea.

The IFC has continued to support KDFC by subscribing to its common stock. Additional assistance has been received from prominent banking firms located in the five leading trading countries (U.S., U.K., Japan, W. Germany, and Italy) represented on the KDFC's board of directors. The total capital and long-term loan funds provided KDFC from the above sources has amounted to $22,500,000.

The objectives, functions, and policies of the KDFC are further described in the Capital Assistance Paper for the AID loan to this ICI; Pro-Ag 588-8015 of December 31, 1967; a booklet entitled "The Banking System in Korea", published by the Bank of Korea (copy attached); a Project Appraisal Report recently submitted on the Improved Administration of Banking and Credit Project (489-15-750-588); and Seoul TOAID A-2348 of October 17, 1968.

LAOS

DEVELOPMENT BANK OF LAOS
(DBL)

DEPARTMENT OF STATE

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DATE REC'D.

TO - AID/W TOAID A- 138

DISTRIBUTION
ACTION

DATE SENT 2/11/69

FROM - VIENTIANE

INFO.

SUBJECT - Spring Review on Intermediate Credit Institution (ICI's)
PE No. 41

REFERENCE - AIDTO CIRC A - 45

A. Description of the Project:

Industry Development #439-11-290-074
Sub-Activity: Industry Loan Fund

1. Country Laos

2. Name of ICI - Development Bank of Laos (DBL).

3. Class of ICI: public X
private
mixed

4. Date established: See Below

Credit National Lao founded Oct. 8, 1956. Development Bank of Laos took over CNL Assets and Liabilities on July 10, 1967. DBL inaugurated Nov. 29, 1967.

OTHER AGENCY

5. Initial Assistance from A.I.D.:

Date	Amount	Kind (i.e. dollar loan, LC Loan, TC grant.
September 14, 1967	$380,000 (Kip 91,258,408)	Local Currency for Industry Loan Fund administered by DBL.

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PAGE 1 OF PAGES 13

DRAFTED BY	OFFICE	PHONE NO.	DATE	APPROVED BY:
Rodney M. Wilbur	AMI/IND	2418	2/7/69	DIR:CAMann

AID AND OTHER CLEARANCES
A D:ECCarlson
GPE:GAZimmerly

DIST:: OD/DD, AD/M, CON, GPE, AGR, AMI-3, CGR-3.

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AID-5-39 (9-62)

6. Does the ICI take equity participation? Yes X No _____ From RLG.

7. Capital structure of the ICI [illegible] as of 12/31/67.

Equity paid by RLG and National Bank of Laos	Kip	240	Million *	= 51%	= $ 1,000,000
Credit Received: RLG, France, US + Deposits (including deposits, Kip 5,300,000)		189	"	= 41%	= 787,500
Reserve		36	"	= 8%	= 150,000
Total	Kip	465	Million	100%	$ 1,937,500

*Total equity pledged by RLG and NBL = Kip 360,000,000.

8. Subsequent Assistance from A.I.D.:

Date	Amount	Kind
May 1968 to present	$ 4,800	Participant Training in Thailand 2 personnel
January 13, 1969	$ 202,000	Local Currency for 2 loans, Industry Loan Fund

9. Capital structure of the ICI at end of latest fiscal year:

12/31/68 statements not received at present writing. Additional Kip 20,000,000 transfer of Equity from RLG was made in 1968.

10. Status of A.I.D. $ loans as of July 1, 1968:

$ committed	$ disbursed
380,000	238,000 (Kip 57,000,000)

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11. Interest rates: average rate(s) paid by ICI 3 %

average rate(s) charged by ICI 11%

Specify type of lender/borrower if differential rates are operative.

Debit Interest:	RLG and French loans received at 2-1/2%; USAID interest average 3% of sub-loan disbursements; short-term credits received at 7%.
Credit Interest:	Loan ceiling to Customers 11% plus service charge 1%.

Limits on Size or Uses of Loans

a. Industry Loans

Size of industry loans is not prescribed specifically, but is controlled by USAID which controls the programming of forward funding based on estimated size of loans required to enable identified industrial projects, or recipients of sub-loans under program, to advance their activity.

Criteria include: requirement for RLG industrial authorization of the industry project; due registry of the company or individual requesting the loan for the purpose of the specific project; availability of equity funding for 1/3 of the total project costs (fixed capital and working capital); study by reputable group (usually USAID-financed technical services contract) that favorably recommends as to technical and financial feasibility of project; machinery specifications; agreement to buy U.S. Import Program (USIP) commodities to extent of 70% of loan total.

Following satisfaction of foregoing criteria, loan project is reviewed by DBL Technical Committee (composed of representatives of RLG, Ministry Finance, Plan, Ministry of Economy, National Bank of Laos, DBL and USAID and other interested RLG groups) and with favorable

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technical finding is submitted to Management Committee of DBL (composed of higher ranking officials of RLG entities in Technical Committee and representative of Director, USAID). When DBL Management Committee approves, Director USAID issues letter authorizing loan signature and agreement to pay first tranche of loan funds which will be used as partial payment (with borrowers equity) for purchase of USIP (CIP) Commodities for industrial project being undertaken.

Period	Number of Loans	Sector	Equipment	Total USAID Loan Commitment
9/67 - 2/69	3	Logging Industry	Heavy Logging Equipment	$582,000

b. Mechanized Farming Loan Projects

Size of loan is not specifically prescribed but is controlled by USAID as with Industry loans.

Criteria include: technical review and approval of the equipment requested; [illegible] visit to proposed agricultural project site(s) by team (composed of agricultural and equipment technicians and economists, supplied by U.N., USAID, RLG Ministries and DBL) to assure truth of statements as to land sites and validity of project proposal.

The immediate objective of this form of loan is to increase rice production in Laos so as to replace imports and save foreign exchange.

No loans have been issued yet because criteria and technical procedures require formalization by amendment to Project Agreement which is in process of accomplishment.

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Financial Environment

The DBL is the only financial institution in Laos set up to provide industrial loans of medium and long term. Although legally empowered to undertake agricultural loans, it has no field mechanism or Branches to enable close contact with agricultural activities, and has not entered this lending area in any volume. The USAID financed Agricultural Development Organization (ADO) has a going farm credit program that handles mainly production credits and financing of implements, pumps, etc. ADO does not now finance tractors, which is the reason for expanding the DBL Industry Loan Fund to include Mechanized Farming Loans with USAID financial support.

A long standing French credit for NF 5,000,000 (Kip 242.9 Million) from Caisse Centrale de Cooperation Economique (CCCE) had remaining on 31 December 1967, Kip 139.4 Million of outstanding sub-loans for repayment. Much of this had been applied to loans for utility or infrastructure type development. The predecessor to DBL (Credit National Lao) had committed most of its equity and loan funds (prior to its conversion to the DBL) to utilities and mixed enterprises. Therefore, the DBL must rely on new transfers of equity from RLG or National Bank and new or expanded deposit accounts to enable it to finance from its own account industrial activities. Therefore, its funding capabilities are not substantial and it is constrained to rely on other funding sources, domestic or foreign, such as USAID's Industry Loan Fund.

The DBL effort to attract deposits from the private sector is continuing in low key. The heavy reliance on gold by the Lao public (hoarding) is the principal detriment to increased savings and as a consequence, the insecure situation. Also the general public is not yet accustomed to the use of bank deposit accounts. For example, in mid-1967, the composition of the money supply was:

Currency in circulation	89.4 %	approximately
Private demand deposits	10.6 %	"
Private savings deposits	less than 1%	"

Therefore, the effort to attract deposits (particularly savings accounts) may be expected to be slow at least until present security problems have been solved.

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Further information may be obtained from an attachment to TOAID A-1161 dated 5/14/68 entitled "Position Paper on continuation of Small Industry Loan Fund within the Development Bank of Laos" by AMI/IND Financial and Investment Advisor.

D. Evaluation on specific points

1. Goal for Industrial finance through the Development Bank of Laos

The goal is to support the development of priority private sector industries and mechanized farming enterprises through intermediary of the DBL by controlled local currency lending designed to assure technical, financial and managerial feasibility of activities assisted; and to develop the capability of the Development Bank of Laos to serve as intermediary for development funds to private sector enterprises, and developing the capability of the DBL to undertake professional appraisal of loan applications, and effective supervision and control of loan projects.

Target 1: Provision of Counterpart local currency through the intermediary of the Development Bank of Laos, Special Fund - Industry Loan Fund, for the purpose of financing loans to approved industries or mechanized farming enterprises with the precondition that professional loan appraisal has been made of the technical, financial and managerial feasibility of the loan project.

Target 2: To support through the Development Loan Fund Special Fund - Industry Loan Fund the industrial targets selected by the USAID industrial development program.

Target 3: To develop the capability of the DBL to make professional technical and financial feasibility appraisals of industrial and mechanized farm loan applications.

Target 4: To assist the DBL in attaining the posture of an industrial financing intermediary that will merit the confidence and support of the international lending community.

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Discussion

(a) Emphasis on mobilization of additional capital.

The Industry Loan Fund mobilizes a certain amount of private capital by requiring equity contribution of between 30% and 40% of the total industrial project. This funding does not usually show up in the DBL accounting of the Industry Loan Fund because the industrialists keep their funds in the commercial bank of their choice (e.g. the Banque Laoviong, Vientiane). However, the effect is mobilization of capital.

Also Mission is attempting to induce the DBL to step up its campaign to attract savings deposits. A letter from USAID Director to the Minister of Finance (Chairman of DBL Board) in the Spring of 1968 proposed increases in credit interest on savings accounts as a means of attracting deposits. There has thus far been no response, in part because the present legal ceiling on credit interest is 7%, the discount rate of the National Bank of Laos.

Also Mission personnel have induced certain fraternal societies in Vientiane to place available funds in DBL savings accounts.

Mission will continue to assist as possible with DBL promotion of savings accounts.

(b) Are investment funds for priority industries on favorable terms?

Market interest rates range between 25% and 40% in Vientiane. Consequently only short term users can afford it. The USAID Industry Loan Fund is one of few available credit sources for industry and mechanized farming development. USAID programs its support of priority industries very carefully, coordinating with Plan Commission, Ministry of Agriculture, and DBL, and the private sector investors interested in the project under consideration.

Is consideration given to the comparative advantage of industries supported?

With the arrival of the Industrial Engineer and the closer scrutiny of industrial projects to be supported, an economic input will be required to assess the comparative advantage of industries (and products) to be developed.

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A position of Industrial Economist has been requested to work "in pair" with the Industrial Engineer. However, in the absence of this position, other economic analysis input will be solicited from other USAID staff resources.

(c) Does project contemplate securities market?

A securities market does not appear feasible within the foreseeable future.

(d) Does project aim at improving technical, managerial, and financial practices of borrowing firms?

Yes, this is built into the feasibility study for a project. However, implementation is extremely difficult because of the scarcity of qualified local personnel and the low educational level of the citizens.

Achievement of Goals:

(a) The project has just commenced implementation. Only three loans have been authorized which are in support of the logging industry, a critical gap on the advancement of the wood products industry. Therefore, it is too early to judge project achievement.

(b) Have developments caused a shift in emphasis among goals?

Not yet, because goals have recently been reformulated.

(c) Do AID's development strategies and Host Country objectives for the ICI (DBL) differ? Do the allocation of AID funds and human resources support the findings of this analysis?

USAID industrial development program is coordinated fully with the RLG, and the Industry Loan Fund is an implementation tool of the industry program. In this respect, the objectives are virtually identical. However, in the means of developing the DBL there is a slow response by the RLG to the proposal to raise credit interest ceilings. However, the RLG is also responsive to the stabilization program proposed by the International Monetary Fund (IMF) which limits the volume of loans based on deposits to 50% of the deposits in hand.

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(d) Prospect of achieving goals from alternate sources of funding.

Without assessing the prospect of success, it may be said that Mission has as a target the attraction of other donor support to the ICI (DBL). The Asian Development Bank is now commencing an economic development study of the Vientiane Plain, and will coordinate efforts with the DBL, which is providing a Counterpart Economist for the ADB Study Team. This may lead to ADB financial or technical support of DBL or its programs. The reputation as an Intermediary of the DBL will probably determine IBRD support or non-support of it.

(e) What guidance does USAID project provide DBL in goal selection?

USAID, Plan Commission and Ministry of National Economy selection of industrial targets will determine the industry loan projects to be financed through DBL. In due course when DBL loan funds become adequate to enable substantial lending programs, the lessons learned from the USAID Industry Loan Fund will, it is hoped, enable the DBL to adhere to development priorities and to apply sound loan appraisal procedures by adequate feasibility studies.

2. Selection of Borrowers

(a) What economic criteria are employed? Are the formal areas and actual ones the same?

The formal criteria emphasize primarily export producing industries and import saving industries. These priorities are directed to the reduction in the deficit in the Lao balance of payments.

This may be expected in the near future to require particular economic analysis to determine, in a choice of prospective industries, which of the two criteria (export or import substitution) provides greater achievement in the reduction of the deficit in Lao balance of payments.

A related criterion concerns to the use of domestic raw materials. This was followed in the decision to concentrate first on the development of wood products industries, which is underway.

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However, economic determination on a case by case basis will be needed in materials selection for the metal working industries which will be the area of concentration of the Industrial Engineer, newly arrived at Post.

The criteria are developed by coordination between USAID, Plan Commission and Ministry of National Economy.

(b) Research Surveys and promotional work by ICI (DBL).

DBL does not have adequate staff resources yet to undertake surveys.

USAID plans a number of studies of industrial feasibility over the next five years. The DBL will receive the benefit of these studies.

(c) Are the technical and financial criteria and reviews appropriate and effectively applied?

DBL allows USAID criteria to obtain for the Special Fund - Industry Loan Fund. Also USAID finances and arranges the technical and financial feasibility studies that are intended to assure the optimum chance of success for Industry Loan projects.

3. Management and operational policies

Re (a) and (b) No comment.

Does ICI (DBL) achieve adequate financial planning by its borrowers?

Thus far USAID financed technical support enables development of studies that prepare initial financial planning for Industry Loan projects. It is [illegible] that training for DBL personnel provided in Thailand by our Participant Training programs will create the capability in DBL to assure adequate financial planning on loan projects.

(c) Is balance between security (collateral) and stimulation of new activities satisfactory?

Probably not, because the tenuous domestic security situation requires adherence by DBL to their requirement for collateral for 200% of loan amount. Efforts to reduce collateral requirements have started in the mechanized farming loan program and may in due course be extended to industrial activities,

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(d) DBL assistance on borrower's technical and managerial problems?

DBL has inadequate staff resources to provide this. Mission provides such assistance to Industry Loan projects as staff resources permit.

(e) Who gets the Money? Established or new firms?

As financing 1/3 of loan project is required, loans usually go to established businessmen, who in three cases have associated together to form a new company for the loan project.

(f) Is the Institution profitable?

The DBL makes a profit because of the RLG granted equity infused. However, it is not yet a dynamic intermediary and lacks free resources in own account to undertake substantial loans on its own. Therefore, its main purpose in the foreseeable future will be as an intermediary to direct externally sourced funds to development activities in Laos.

4. Specific AID relationships

(a) USAID has contributed to many of items noted above. For the Industry Loan Fund, USAID provides staff resources as well as financial resources. The RLG on signing the Project Agreement established that the USAID financed Industry Loan Fund would operate under criteria acceptable to USAID.

(b) Have the terms of the Industry Loan Fund (ILF) Loan Agreement been suitable for achieving the desired impacts?

Generally, yes.

(c) Has the two step procedure worked satisfactorily?

The two-step procedure is not precisely descriptive of the system employed by the ILF. USAID, in fact, develops each loan project and issues funding to DBL in tranches about as needed for loan project use. Therefore the DBL does not have much discretion over application of funds.

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(d) Are problems related to tied-procurement requirements?

USAID requires that ILF loans be used 70% to finance U.S. sourced industrial or agricultural equipment. This tends to have a counter-inflationary effect through the application of local currency to the procurement of productive equipment, and the committing of free private money to industrial projects.

The tied-procurement requirement keeps loan applications within programmed funding levels.

The ILF is funded by U.S. Trust Funds. If the loan program were freed from the 70% tied-procurement requirement, it might expand greatly; but the drain on U.S. balance of payments would tend to increase in direct proportion.

(e) Is relation between AID loans and AID technical assistance satisfactory to the ICI (DBL)?

Yes. USAID provides technical assistance for each ILF loan.

(f) How can the pipeline be shortened? What gains or sacrifices from more rigid use of funds?

The criterion of careful loan appraisal and the loan pre-condition that feasibility studies be completed for each industrial loan, [illegible] an important objective of the ILF. The predecessor of DBL "frittered" away some of the initial capital in poorly prepared investment projects. It would be undesirable at present to change this criterion. However, speeding the appraisal process without sacrificing the quality of feasibility studies would be an acceptable means of increasing the pace of loan issuance.

(g) What is the relevance of AID assistance to public vs private ICI's?

The DBL is a public intermediary. Under the present uncertain security situation, it is believed unlikely that a private ICI would be able to find private financial support.

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Overall Evaluation and Conclusions

The DBL is an Intermediate Credit Institution that has all the legal authority required to perform as administrator of the USAID-financed Special Fund -- Industry Loan Fund. It provides a useful function in the administrative role as a channel for U.S. funds to private sector industrial and mechanized farming development.

It has not yet developed the staff resources to enable careful loan appraisal and the conduct of technical feasibility studies. With the help of USAID participant training, its staff will probably have developed the capability to perform financial feasibility studies in the foreseeable future. The table of organization authorizes Economist, Agronomist (or Agricultural Economist) and Engineering positions in a Technical Appraisal Branch. The Economist position is filled. If the two remaining positions are adequately filled, the DBL capability to perform technical feasibility studies will be greatly enhanced. Meanwhile, the procedural system is to rely on loan review by a Technical Committee which can draw upon other Ministries or foreign assistance groups (UN, USAID, etc.) for engineering and agricultural professional services. For the present, the DBL protection against poorly conceived projects is the requirement for 200% collateral security for loans issued. This does not assure selection of priority projects for development; but the priority selection for industries is now made by the Plan Commission and Ministry of National Economy, based on recommendations from several advisory and assistance groups.

It is hoped that the example of USAID-Industry Loan Fund loan appraisal procedures will be followed by the DBL in future years in application of their resources to develop loans.

The DBL has not had an opportunity to operate fully during the uncertain political and security situation that has obtained in Laos since its predecessor, the Credit Nationale Lao, was set up. If one were to assume a future situation of peace, law and order and relative financial stability, the DBL might have an opportunity to develop financial resources on its own account. For the time being, however, it may be expected to perform as a financial intermediary for the direction of development funds to productive private sector industrial and agricultural projects.

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SULLIVAN

PHILIPPINES

INDUSTRIAL GUARANTEE AND LOAN FUND
(IGLF)

AIRGRAM DEPARTMENT OF STATE

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TO - AID/Washington TOAID A - 123 X

DATE SENT 3/28/69

FROM - MANILA

SUBJECT - Spring Review on Intermediate Credit Institutions (ICI's) Industrial Guarantee and Loan Fund (IGLF)

REFERENCE - AIDTO CIRC HA-25, 1/4/69

A. Description of the Project

1. Country : Philippines

2. Name of ICI : Industrial Guarantee and Loan Fund

3. Class of ICI : Public

4. Date established : July 15, 1952

5. Initial Assistance from AID: Date : September 8, 1954

Amount: ₱10,000,000

6. ICI does not take equity participation.

7. Capital structure at time of formation: Only Counterpart Fund Deposit of ₱10,000,000.

8. Subsequent Assistance from AID:

Nov. 10, 1956	$5 million	Counterpart Fund Deposit
July 24, 1956	$6.7 million	Loan
July 15, 1957	$7.5 million	Loan
March 18, 1964	₱1.0 million	Loan

PAGE 1 OF PAGES 11

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CRSiewert/GJGrande: JMWhelton	DL/OID	475	3-25-69	Philip W. Ruppert, Manager, O

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9. Capital structure of ICI at end of latest fiscal year (Dec. 31, 1968):

Liabilities

Loan Accounts - ICAX 92-1, ICAX 92-2		
492-G-013		₱26,760,164.02
Reserve Accounts		1,610,827.19
		₱27,725,991.21
Networth		
ICA Counterpart Fund	₱20,000,000.00	
Surplus	7,393,626.32	27,393,626.32
		₱55,119,617.53

10.

	$ Committed	$ Disbursed
ICAX 92-1	$6,700,000	$6,700,000
ICAX 92-2	$7,500,000	$7,500,000

11. Interest rates:

Paid by IGLF to AID - 492-G-013 - 3/4%

ICAX 92-1, 92-2 - 3% if payment in dollars

4% if payment in local currency

Average rate charged by IGLF - 4-1/2% with 2% guarantee fee on amount of loan guaranteed.

Limits on Size or Uses of Loan

The Industrial Guaranty and Loan Fund (IGLF) was established in 1952 by agreement between the National Economic Council (NEC), Republic of the Philippines, and the USAID.

The Fund was created for the purpose of encouraging the establishment and/or expansion of economically-sound small and medium-sized industrial, mining and other enterprises in the Philippines that would contribute to the economic development of the country. (The working definition adopted by the Fund of a small and medium-sized venture varies from industry to industry but, generally it is one which has an average amount of assets within the category of the industry.) In 1955, the function of the IGLF was expanded to include the making of special time deposit loans to commercial banks. These funds were to be relent by the bank, in their entirety, to a borrower approved by IGLF.

The Fund has assets in the range of ₱56 million, and is maintained in a liquid position at all times. Excess funds are invested in Government obligations which are readily convertible into cash.

The Central Bank of the Philippines administers the program, as agent of AID/NEC, under an agreement signed on January 22, 1965. The Central Bank is paid for its services at the rate of 1/4 of 1 percent of the highest outstanding amount of special time deposits and guarantees for the period.

Loan applications are submitted to the Central Bank for initial review. Loans and guarantees are approved by an IGLF Review Committee. The Committee is composed of three members: one from the Central Bank; one from the Philippine National Economic Council; and one from USAID/Philippines. Each Committee member casts one vote. The Committee has the responsibility for evaluating applications and determining rates of interests to be charged. When feasible, project inspection is conducted by the Review Committee members or representatives and their observations used in the project analysis. It is also a responsibility of the Review Committee to coordinate the activities of the Fund with those of Philippine Government long-term lending agencies and with private financial institutions (including the Private Development Corporation of the Philippines). The object of such coordination shall be to insure that IGLF resources are channeled into broadly diversified projects that complement the economic development activities of other long-term lending agencies, public and private, with a view to avoiding excessive duplication of facilities and undue concentration and/or overdevelopment in certain industries.

Some of the guidelines used by the Review Committee in project analysis are:

The ratio of venture capital to long term financing should not be less than two to three. In other words, venture capital must not be less than 66-2/3 percent of the long term indebtedness of the enterprise. Working capital as such,

with one exception (special time deposits for operating capital needs are available only to industrial enterprises which have outstanding IGLF loans for plant expansion or improvement and are for a maximum period of one year) is never financed.

Intangibles do not fall within the area in which IGLF will provide assistance.

In the event that short-term financing is to be refinanced, its origin is carefully traced to assure the Committee that the money was originally used for the items listed under the types of expenditures which qualify for IGLF support.

In evaluating project worthiness the Review Committee gives prime consideration to the following factors:

Essentiality of the product, especially with respect to its dollar earning or saving capacity.

Availability in the Philippines of necessary raw material, labor, skills and technical capabilities.

Proposed scale of operations, managerial skill and financial resources of the borrower.

Number of jobs to be generated and location of project with regard to available labor, along with the sponsor's willingness to share potential benefits with workers through improved compensation and employment conditions.

Competitive position of project with regard to alternative sources of supply.

Possibility of existing idle capacity in the industry.

Since its inception IGLF has made about 200 loans, that amount in value to almost ₱125,000,000. Of the 200 loans made, 33 were guaranteed to the extent of from 30 to 80 percent of principal. Loans have generally been made to manufacturers rather than to service or financial institutions. All loans have been made to private sector enterprises and IGLF time deposits have been made with commercial and government banks. Loans have varied in size

from ₱8,000 to ₱5,000,000, but tend to average about ₱600,000.

The following are some general IGLF criteria:

(1) IGLF shall operate only with commercial, development and savings banks.

(2) Upon approval of a loan by the Review Committee, the Chairman of the NEC and the Director of USAID/Philippines must also concur.

(3) The full amount of any IGLF loan must be availed of by the industrial enterprise concerned after one year from the receipt of the notice of approval, i.e., by the industrial enterprise.

(4) Special Time Deposits will be made available for loan to finance the establishment, expansion and refinancing of small and medium size industrial and mining and other enterprises. Funds can be used for building costs, acquisition of plant sites, installation cost and, as previously mentioned, under specific circumstances, short-term needs working capital. No single IGLF loan may exceed 10 percent of the total assets of the IGLF, except upon approval of the Review Committee in extraordinary cases.

(5) Interest rates at which commercial banks relend special time deposit funds shall be approved by the IGLF. (presently 9%)

(6) Interest accrues from dates of funds releases by Central Bank.

(7) IGLF guaranties shall not exceed 80% of the loan applied for.

(8) IGLF will charge a guarantee fee of 2% of the amount guaranteed, to be paid by the Bank, not the borrower.

(9) Special time deposit funds will be loaned at 4-1/2%.

(10) Loans for which a guaranty is sought may not exceed ₱1,000,000, except in extraordinary and Review Committee approved circumstances.

(11) Total loans guaranteed shall not exceed 50% of the total assets of the IGLF.

IGLF loans have gone to the following industries in decreasing order of magnitude:

		Percent of Total Outstanding Loans as of 1966
(1)	Textiles	14.3%
(2)	Cement	13.3%
(3)	Plywood and Veneer	8.4%
(4)	Logging and lumber	8.0%
(5)	Chemical and allied products	6.4%
(6)	Food Products	42.0%
(7)	Aluminum and metal products	3.6%
(8)	Paper and paper products	3.18%
(9)	Plastic products	3.15%
(10)	Garments	2.44%

IGLF has made loans through more than twenty commercial banks, Philippine, U.S. and British. IGLF maintains its ties with the commercial banking sector through personal contacts and by distributing explanatory published material.

IGLF has never completely loaned out its funds and is now in an exceptionally liquid condition, despite the "tight" money situation. The reasons for this liquid situation are almost entirely attributable to some rather stringent requirements of a minimum of 40% of equity requirement, no financing of working capital, lack of public knowledge, to some extent delay and bureaucracy in the functioning of the IGLF and a few other factors. The fact is that the original "rules" of the IGLF were based on the classic method of doing business in the United States. Lending and financing practices here are distinctly different and it may become necessary to revise some of these rules to accommodate current business practices.

B. Evaluation on Specific Points

1. Goals

(a) IGLF is not trying to mobilize additional capital.

(b) The entire emphasis of IGLF is to provide funds for small and medium size industrial projects that the commercial banking system would not or cannot fund. Philippine commercial banks are, without exception, short term credit institutions. When approached with any loan request for a period of more than two years most simply decline, or they demand large amounts of collateral. The result is that the only concerns that are in a position to borrow are the ones with the strongest financial backing. IGLF does not try to exert great influence on commercial bank interest rates. The Fund's present policy is to loan to banks at 4-1/2%, with an additional charge of 2% if IGLF guarantees the loan. Banks then charge the borrower 9%. This rate is below the current Philippine market rate of 10 to 12%.

(c) IGLF is not involved in the marketing of securities.

(d) Relatively little emphasis is placed on improving technical, managerial or financial practices of either the banks receiving deposits or the ultimate borrower. IGLF does not have the staff needed to pursue these objectives, and it is felt that between the staffs of the intermediary Banks and the audit function of the Central Bank, adequate investigation and control should be available.

Achievement of Goals:

IGLF seems to be meeting its goals adequately. The number of loans made, the diversity of the loan portfolio, the degree of success of the funded projects and the continued smooth functioning of the fund all indicate success. The financial losses have been minimal. Indeed, too minimal in that the IGLF has turned a "profit" over expenses over the years.

IGLF does have one major problem, inertia. At present, IGLF has in excess of ₱12 million available for lending and there are few applicants. This has been a characteristic of IGLF in recent years. The fund is simply not loaned out enough. In addition, IGLF has a problem of cash

management. Large amounts of money that should be available for lending are often committed and "frozen" for long periods of time. In some cases funds that have been reserved for over 12 months are not utilized for the purpose for which they were set aside. For example, IGLF permits borrowers to draw down funds over a period of one year from the date of approval of the loan. As soon as a loan is approved an amount equal to the amount of the loan is set aside. In some instances IGLF has had reserves of this type amounting to a total of ₱6 - 8 million.

The reason for IGLF's inability to lend out completely and manage its funds closely is the fact that IGLF is managed on a "part time" basis. IGLF does have a small full-time staff, but this staff does not have the skills required for proper management. Dependence upon the intermediary banks for judgment and/or management of borrowers has not been successful.

This short-fall of IGLF might be overcome by reorganizing the management of the IGLF so that competent, full-time managers will be able to manage the organization funds. Whether this problem should be approached as a function of the Review Committee is open to some question. The present personnel is not equipped for the work and does not have the time to do the job if it were.

Despite deficiencies in management, IGLF is addressing and meeting most of the goals for which it was designed.

2. Selection of Borrowers

At present IGLF reviews projects in light of the Investment Priorities Plan developed by the Philippine Board of Investment. Briefly, IGLF places priority on loans to small and medium size industries that act as import substituters.

3. Management and Operational Policies

Management has been effective in the area of loan project selection. This is demonstrated by the variety of the loan portfolio, the number of loans made and by the very small number loan projects that have failed. About three guaranteed loans are failures but the Fund has not lost their entire investment. In total less than ₱600,000 has been so lost.

Management has been less effective in the day-to-day tasks of managing the Fund. Timely preparation of financial statements, preparation of review

material have all received inadequate attention. Cash management is a significant problem as described above.

Since IGLF makes deposits to banks for relending, the burden of financial evaluation, with the exception of loans with guarantees, falls on the correspondent commercial banks.

IGLF has earned about ₱6 million above all costs since its inception, despite its relatively low interest charges.

4. Specific AID Relationships

AID is directly involved in the review and approval or rejection of every loan application made to the IGLF. As a result AID has influenced the lending activities of the Fund. AID, the sole source - other than revenue - of IGLF funds, realized in 1962, when the original agreement creating IGLF expired, that IGLF should continue. Funds that were to be returned to AID were left with the IGLF.

IGLF operations have not been satisfactory to AID. IGLF interest rates are low enough to appeal to individual borrowers, but applications are not processed with satisfactory speed. The IGLF does not receive specific, technical assistance from AID, other than AID's reviewing of loan applications.

C. Overall Evaluation and Conclusions

The operations of the IGLF have on the whole been quite successful. The problems of the Fund are due to the fact that it is a passive institution. IGLF operates with a very small full-time staff and most of its important functions are undertaken by the Central Bank, National Economic Council and AID on a part-time basis. This was an intentional arrangement when the Fund was initiated. USAID is now prepared to propose payment of higher administrative fees to the Central Bank for the services they perform in connection with the IGLF program. This should encourage the building of stronger full-time management for the program.

Some of the original assumptions on which the Fund was based was - (1) that the Philippines had a sophisticated commercial banking system, (2) that the primary problem of the banking system was the lack of funds for long-term projects of relatively greater economic impact, (3) that if the

funds were made available to banks for projects of this type the banks would eagerly utilize these funds, (4) that being sophisticated, the commercial banks could be counted upon to assume the primary role of feasibility evaluation.

There was no major desire to influence investment in areas of greater meaning to economic development by offering funds at lower interest rates. Indeed, there has been a continuing increase in such rates over the years to avoid the implication of "subsidized" credit. IGLF funds, though loaned to banks at 4-1/2% are released to borrowers at 9% at present. This rate is lower than the current market rate of 10 - 12%, but the difference is not great.

The fact that almost 200 loans have been made by IGLF supports most of these assumptions. The inability of IGLF to loan out its funds completely has been blamed on a number of factors. These include:

(1) lack of salesmanship - on part of IGLF.

(2) inability of the private sector to develop enough loan projects that meet IGLF criteria.

(3) commercial bank ignorance of either the existence or the functioning of the IGLF.

(4) the unwillingness of commercial banks to utilize IGLF funds because the banks are only able to earn 4-1/2% on standard time deposited and 2-1/2% on time deposits with guarantees. As long as banks have funds of their own they are unwilling to use IGLF funds.

With the exception of the possibility of lack of salesmanship on the part of IGLF, the other factors all would indicate that the Philippine commercial banking sector is not as sophisticated as one would hope.

One final area of difficulty encountered by the IGLF, in the area of guaranteed loans, again due to lack of staff, is the inability of the Fund to spot projects that are in danger of failing. When IGLF-guaranteed projects do fail the Fund is forced to let itself be guided by the correspondent commercial banks. In some instances banks have been something less than ethical in these circumstances. Notwithstanding charter authority to do refinancing and to make guarantees, both of these functions have been limited if not

abandoned by the IGLF in the past several years. The refinancing, because there is not enough money in the Philippines to refinance the characteristic program of Philippine entrepreneurs. They invest a minimum equity which often does not meet IGLF requirements and finance capital construction with short term loans. When money becomes tight -- as is now the case in contrast to the time the IGLF loan was made -- the loans are difficult or impossible to renew except at punitive rates far above the prime rates. The guarantees have been diminished significantly. The banks have kept the "good" loans for themselves and have insisted on guarantees for marginal loans. This is not all undesirable, of course, as this is what the IGLF was set up to do. But the practice has been that a Bank with a guaranteed loan virtually abandons supervision of the borrower and there have been several cases where assets have disappeared and the Bank simply comes to the IGLF for reimbursement under the guarantee.

There is no reason why refinancing and guaranteeing cannot be resumed as these situations can be corrected but for the time being, even at the risk of reduced lending activity, some of the more reprehensible features of Bank practices should be arbitrarily delimited.

WILLIAMS

PHILIPPINES

PRIVATE DEVELOPMENT CORPORATION OF THE PHILIPPINES
(PDCP)

AIDGRAM

DEPARTMENT OF STATE

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3/21/69

FROM - MANILA

SUBJECT - Spring Review on Intermediate Credit Institutions (ICI's)
Private Development Corporation of the Philippines
Project No. 492-44-920-188; Loan No. 492-B-014

REFERENCE - AIDTO CIRC A-25, 1/4/69

A. Description of the Project

1. Country : Philippines

2. Name of ICI : Private Development Corporation of the Philippines

3. Class of ICI : Private

4. Date established : February, 1963

5. Initial Assistance from AID: Date - February 15, 1963

Amount - ₱27,500,000

Kind - Local Currency

6. Does the ICI take equity participation? Yes.

7. Capital Structure at time of formation: (Line of Credit)

Debt - IBRD $15,000,000
Long Term Debt - AID . . . . . ₱27,500,000
Stockholders Equity . . . . . ₱17,571,607 (paid in)

PAGE 1 OF PAGES

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C.Siewert/GJGrande	DL/OID	475	3-19-69	Philip W. Rupert, Manager

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8. Subsequent Assistance from AID: None

9. Capital Structure as of December 1968:

Liabilities -	Current liabilities	₱ 6,155,006.00	
	AID loans payable	27,500,000.00	
	IBRD loans payable	78,207,496.64	
	Other loans payable	1,200,000.00	
	Deferred credits	872,696.79	₱113,935,199.49
Assets -	Capital Stock	₱ 25,000,000.00	
	Retained Earnings	11,194,035.46	36,194,035.46
TOTAL			₱150,129,234.95

10. AID Loan Status: ₱ Committed - ₱27,500,000

₱ Disbursed - ₱27,500,000

11. Interest Rates:

Average rate(s) paid by ICI - AID Loan - 1/2%

IBRD Loans 5-1/2 - 6%

Average rates charged by ICI - Project Loans - 8-3/10 - 12%

Temporary placements - 7 - 11-4/5%

Limits on Size or Uses of Loans

The Corporation may not incur, assume or guarantee any debt if at the time or as a result thereof the total amount of debt incurred, assumed and guaranteed by the Corporation and then outstanding would exceed an amount equal to three times the aggregate of (1) the paid-in unimpaired capital, surplus and reserves of the Corporation, and (2) that amount of the AID loan which at the time is outstanding but not due for payment.

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The maximum investment or commitment that the Corporation may make to any one business entity may not exceed amount equal to 15 percent of paid-in unimpaired capital, surplus and reserves of the Corporation and the amount of the AID loan not due and payable.

The Corporation makes commitments or investments including loans, share participation, agreements to sponsor or underwrite shares or securities, guarantees, counter guarantees, other arrangements for securing the payment of loans, obligations or any other kinds of indebtedness.

The Corporation was established under the Philippine Corporation Law for the purpose of assisting in the creation, expansion and modernization of private productive enterprises in the Philippines by extending medium and long-term loans, underwriting shares and securities, guaranteeing loans, and providing managerial and technical assistance. It has an authorized and paid-up capital of ₱25 million; in addition the PDCP has raised substantial amounts from bilateral and multilateral agencies.

At present the Private Development Corporation of the Philippines has a Loan Receivable account of ₱101,435,779.22. Loans outstanding were made to 57 business entities that engage in a variety of business activities ranging from public utilities to a distillery. The life of loans has varied from 4 to 12 years. Loan amounts have ranged from a minimum of ₱27,300 to a maximum of ₱9,700,000. PDCP has tended to concentrate its lending activities in the areas of public utilities and manufacturing facilities.

It is generally acknowledged that there are only two long-term lending institutions in the Philippines -- the Development Bank of the Philippines and the Private Development Corporation of the Philippines. The Development Bank of the Philippines suffers from both political interference and a chronic lack of funds. So, in spite of the limited funds available to PDCP it is regarded by many as the only local source of long-term funds for the general private sector.

Other than PDCP, the three major private financial institutions are BANCOM Development Corporation, House of Investments and CCP Securities who do not have large funds and operate primarily in the money market or as investment bankers.

PDCP enjoys an excellent reputation, both with the general public and with the banking community. The Corporation has been operating at a profit and its shareholders and directors include some of the most highly regarded businessmen in the Philippines. Total retained earnings increased from ₱8.9 million to ₱11.3 in 1968 over 1967.

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While PDCP can operate in a number of areas, it has over the past five years restricted itself to a very few activities. Most of the Corporation's funds have been loaned out at a satisfactory rate. But loans have tended to go to larger, more financially stable business entities. There has also been a tendency of relending to borrowers who have earlier demonstrated success. These characteristics are observable in the Corporation loan portfolio. Only 57 businesses now have loans. Some corporations have received as many as four separate loans. One public utility has received releases of funds totalling ₱16.5 million. A second utility has received loans totalling ₱13.3 million. Combined these two utilities have received almost 30 percent of the loan funds made available by the company.

The power industry in the Philippines is characterized by numerous private franchises of varying sizes, in monopoly positions, relatively risk free and operating with old equipment. USAID/Philippines has been critical of what it regards as PDCP's continued support to small and inefficient power companies in funding equipment for obsolete systems rather than to promote a rationalization of this sector.

Other than lending funds PDCP has a guarantor liability for $7.3 million of dollar guarantee. Guarantee fees contributed ₱224,651.17 to total 1968 revenue of ₱14,039,399.29. Total loans receivable as of December 31, 1968 amounted to ₱101.8 million. A total of ₱570,000 was in the form of Equity Investments. In addition about ₱44.5 million was in short-term paper or investments.

PDCP's guarantee operations were initiated in 1966 and were issued to cover foreign exchange obligations of its clients. Theoretically, it applied the same criteria to guarantee as it does for loans.

PDCP's equity investments as noted above have been extremely limited. Various reasons have been ascribed for this. Apart from the custom of Philippine corporations to restrict ownership, some sections of the business community felt that when PDCP was first getting under way it put pressure in clients to obtain equity or options in connection with its few operations. Sensing a resistance to these tactics, PDCP seems now to have become overly cautious in seeking equity. Again it is not too agreeable to accepting the risks associated in equity transactions but looks to the expected profitability and marketability of any equity investments it considers.

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B. Evaluation on Specific Points

1. Goals

a. A great deal of emphasis is placed on raising additional capital. The IBRD, which originally loaned PDCP $15,000,000 in September, 1966, made a second loan of $25,000,000. The IBRD may be asked to make a third loan. Recently (March 5, 1969) the ADB approved a $5 million loan to the PDCP. The loan will carry interest at the ADB's lending rate prevalent at the time of crediting the loan account and is to be repaid within 12 years, including a grace period of not more than two years. After some discussion with the GOP this loan was guaranteed by the PNB on the same basis as the IBRD loans. PDCP is now proposing to raise up to ₱25,000,000 by eventually issuing additional capital stock. PDCP has also discounted loans with the Development Bank of the Philippines. As a long term measure, PDCP has begun to establish connections with a number of sources abroad such as KFW, and bilateral government sources in the U.K., Germany and Japan.

b. PDCP interest rate seems to vary with the degree of risk that the loan carries. For example, ₱13.3 million has been loaned at 8-3/4 percent to Manila Electric Company -- the largest public utility in the Philippines, and a borrower with a well established credit rating. Republic Cement, one of the most efficient and profitable cement companies in the Philippines, was loaned ₱7.1 million at 8-3/4 percent. Atlantic Gulf and Pacific, Luzon Stevedoring Corporation and Lepanto Consolidated Mines -- all financially very secure firms -- have been able to borrow at 8-3/4 percent or less. The highest rates have generally been charged for longer term loans to firms lacking financial strength.

c. While PDCP was designed to help strengthen the security market as previously reported, activity in this area has been limited.

d. PDCP has provided limited technical, managerial and financial advice to borrowing firms.

Achievement of Goals:

In spite of the shortfall from which PDCP suffers -- management conservatism and strong profit orientation -- the Corporation is tightly run and

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serves a major need of the Philippine economy, long-term financing. Their goals of export promotion and public utility development have been well met. The Philippines has a serious unfavorable trade imbalance and there is a need to strengthen public utilities. With increasing experience perhaps PDCP lending activities could swing more to borrowers who are less firmly established.

2. Selection of borrowers

The primary criteria in selecting borrowers appears to be the bankability-feasibility of the project. The loan portfolio points to no formal project evaluation criteria. There is no formal focus on corporate size or use of domestic raw materials. Corporate press releases do speak of export promotion activities. PDCP claims to have made loans totalling ₱52.6 million to export industries generating $42.56 million in annual foreign exchange earnings.

PDCP has a large, well paid staff. An objective of management is to earn dividends for the Corporation's stockholders. Projects reviewed by the PDCP staff are thoroughly evaluated using both technical and financial criteria. The professional staff increased from 27 in 1966 to a reported 43 in 1968. The largest addition was for "project development"; approximately 10 professionals are at present concerned with project appraisal. During this period there has been no significant change in the level of PDCP's financing operations. The staff is young (average age 32 years) and reportedly reasonably well qualified. The management recognizes the need for further training to improve their skills.

A change that might be appropriate for PDCP would be to broaden the scope of the Corporation and lessen the profit orientation. Broader scope would involve expansion of investment banking activities including stock purchasing and underwriting, and providing advice to developing corporations. It would also involve a moving away from lending to certain large favored business entities that could secure financing elsewhere.

3. Management and operational policies

The present form of management seems to be appropriate and effective.

There has been a problem of AID review of certain projects that fall within categories outlined in the PDCP-AID Loan Agreement. AID approval

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must be solicited if projects are of a certain size or if they propose loans to corporations that have already received considerable assistance from PDCP. In the past projects have been presented to AID only after PDCP has completed its review of the project and management is on record as having approved the project. Any response from AID short of complete approval tends to be received less than enthusiastically by PDCP management.

4. Specific AID relationships

a. AID participates in the activities of PDCP only in a very limited way. AID acts as an advisor whenever called upon. AID also must approve loans of certain size in relation to its net worth plus the value of the AID loan. PDCP has discouraged AID from involving itself any more deeply in the business of the Corporation. The PDCP-AID Loan Agreement provided AID with very few controls over the Corporation. AID has expressed dissatisfaction with the manner of PDCP's financing of power projects particularly and other projects; and urging that the Corporation had not done enough to assist new and promising ventures. PDCP has taken little notice of its views.

b. One improvement in the original Loan Agreement might have been a provision for including a representative of USAID/Philippines on the Board of Directors of PDCP. By providing such an insider role the Loan Agreement might have better enabled AID to influence the policies of PDCP.

c. The need for local financing today is great and AID's investment in PDCP helps meet this need.

d. In the Philippines AID assistance has gone to both public and private ICI's. Both have served a useful function. The public institution appears to be undermanaged while the private ICI manages with great caution. Of the two, the public ICI, lacking the profit motive of the private ICI, seems to better serve the needs of the economy.

C. Overall Evaluation and Conclusions

The formation of the Private Development Corporation of the Philippines was made possible by an AID loan of ₱27,500,000. The structure, organization and focus of PDCP were in large part determined by AID. AID helped negotiate

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for the initial IBRD loan and AID stipulated that ₱25,000,000 in equity capital had to be raised locally. The organization of PDCP as a profit motivated institution was intentional and AID helped to design the organization.

In light of what was expected of it, PDCP's recent performance has been disappointing. Its business during the past two years has levelled off and it appears to be not growing. The limited investment in equities has been a major disappointment and it has made little contribution to the capital market.

Further, PDCP has not displayed sufficient (in AID's opinion) initiative, drive or imagination in looking for and developing new business. It is ultra conservative and has a restricted view in providing risk capital. This factor is important in its failure to develop diverse forms of financial instruments. While these attributes do not make for a robust, healthy and viable institution the majority of the domestic owners of PDCP are not dissatisfied with its performance and seem to have accepted and even encouraged a limited role for it and a cautious approach to any form of financial innovations. It has been moderately successful as a conservative long-term lending institution, with its financing based on improving appraisal criteria and standards. Its portfolio has to be judged good quality because it is based on the secure power sector and a group of first rate Filipino corporations.

When PDCP was organized AID provided itself with only limited devices for influencing the activities of the Corporation. In its early years of operation as is the case today, the PDCP managed its funds efficiently, made modest overtures into various types of financial ventures and was able to make a case for itself as an assist to the economic development of the Philippines. In light of that performance USAID/Philippines interfered little in the activities of the Corporation.

Today and in the past year the money market is much tighter than it was at the time the PDCP loan was made. This fact has resulted in the PDCP devoting itself to lending primarily to well established borrowers rather than to developing industries as was originally intended. Although AID is the largest lender to PDCP, the existing loan agreement gives it very little review authority on projects under PDCP considerations for loans. We have made recommendations -- in light of our limited role -- and these have in fact been rejected. The USAID for its part is not attempting to dictate policy or strategy to the Corporation. But as a development agency,

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we would like to consult in detail with the Board as it works out development strategies and policies. We would be willing to explore possibilities for helping in the preparation of programs and projects. We would like to assist in adding to the managerial skills in the administration of policy and the execution of projects. In all of these and other aspirations for the Corporation to achieve its original destiny we are estopped by the terms of the loan agreement.

If the USAID had this loan to make over again, it would make it mandatory that USAID participate in significant PDCP project development and approvals.

WILLIAMS

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VIETNAM

INDUSTRIAL DEVELOPMENT CENTER
(IDC)

and

VIETNAM DEVELOPMENT BANK
(SOFIDIV)

AIRGRAM

DEPARTMENT OF STATE

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STRIBUTION
ACTION

INFO.

TO – AID/W TOAID A 1633

DATE SENT March 24, 1969

FROM – SAIGON

SUBJECT – Spring Review on Intermediate Credit Institutions(ICI's)

REFERENCE – AIDTO CIRC A25 dtd 1/4/69 (PE-21)

1. This message consists of three parts. First, the Mission's background and evaluation statement directed to the major points noted in CIRC A25, section II-A, to be covered in the Spring Review on Intermediate Credit Institutions. Second, a descriptive paper outlining the organization and functions of the GVN Industrial Development Center (IDC), and, finally, a similar descriptive paper on the Vietnam Development Bank (SOFIDIV). PAR's covering USAID's technical assistance in this field are currently being prepared and will be pouched shortly, one each on the IDC and SOFIDIV.

PART I

Background Information on ICI's:

2. In Vietnam there have been no U.S. loans of the type featured in the referenced airgram. The only financial assistance indirectly related to the subject has been the $10 million grant to the GVN for industrial reconstruction, with the IDC as the Agency handling disbursement. A Grant Agreement to the level of $10 million between GVN and USG, termed USAID grant accompanying PA 8217, was signed by USAID Director and GVN Minister of National Economy and issued June 29, 1968. This activity is not that of a typical ICI, for such funding is not made available to the ICI on a direct basis.

3. Given USAID's minimal role in furthering ICI activity in Vietnam, Part I of this message is addressed largely to the subjects discussed under "Purpose of the Review," Section II-A of CIRC A-25. Items listed in the check

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PAGE 1 OF 1

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list of CIRC A-25, Section III have little application to the Vietnam situation but are covered as appropriate in the Part I narrative.

4. At this time in Vietnam two institutions might be termed ICI's - namely the Industrial Development Center (GVN agency) and SOFIDIV (Vietnam Development Bank). (SOFIDIV is a private organization but 50% of its shares are owned by Credit Commerciale, a GVN-owned commercial bank.)

5. This U.S. grant assistance grew out of the two major VC offensives, in early 1968, which inflicted approximately 40-50 million U.S. dollars in damage to the industrial and commercial sectors and displaced and made thousands of workers jobless. To reconstruct damaged plants and stimulate industry, the USAID, VN Ministry of National Economy, and the Industrial Development Center coordinated efforts to produce a Reconstruction Loan Program.

6. The program is designed to assist damaged industry, the private sector in particular, to return to the January, 1968, level of production. To accomplish this end, the GVN granted VN$1 billion from national revenues to the Industrial Development Center for loans to cover plant reconstruction and purchase of foreign machinery, spare parts, and raw materials. Under the Reconstruction Fund, IDC will disburse piasters as long term, low interest loans. The U.S., through USAID, provided $10 million in grant assistance (from FY 1968*funds) which is to finance the replacement of damaged or destroyed equipment and spare parts - of U.S. origin - to be used for reconstruction. The equivalent cost in piasters will be repaid by borrowers to IDC to pay for such U.S. items procured under Commercial Import Program procedures.

7. On both the Reconstruction Fund and the USAID Grant, loan criteria, pre-loan economic analysis and loan repayment plans are the exclusive responsibility of IDC. The interest rate on such loans ranges from 3% to 4% per annum.

8. Technical services of USAID/IND advisors in selecting equipment, checking proformas and deliveries against specifications, as well as assisting in the installation and start-up, are an additional U.S. contribution to this recovery effort.

9. The amount, $10 million, is covered by one Letter of Commitment in favor of Crocker Citizens National Bank of San Francisco. The grant's administering agency is IDC whose function is to receive all loan applications from enterprises damaged during Viet Cong attacks in early 1968. The grant agreement was designed to cover replacement of damaged or destroyed machinery or equipment, spare parts, and some raw materials. After technical and financial evaluation, and if the loan request is in order, IDC recommends the loan request approval to the Board of Administration of the GVN Reconstruction Fund, composed of the Ministers of Finance and National Economy, and Assistant Minister for Industry, who have authority to approve such loans. USAID's function is licensing concurrence under customary CIP procedures. This entails examining import license applications covering the procurement.

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* CIP

10. After loans are approved, the relative import license applications under the U.S. Grant are processed through IDC to commercial banks, to National Bank of Vietnam, to Directorate of Commercial Aid, then to USAID Industry technicians and Commodity analysts; and finally the licenses are returned to the commercial bank to open the required letter of credit covering U.S. procurement under PA 8217.

11. U.S. procurement under 23 approved loans to January 31, 1969, would total $6,304,683. Pending applications indicate possible additional U.S. procurement of $420,000. Six letters of credit have been opened as of February 6, 1969. Payment under letters of credit opened under PA 8217 will possibly start from July, 1969. PA 8217 was pouched to AID/W by Transmittal Memo of July 2, 1968.

Evaluation:

12. IDC is functioning well in handling loan requests for reconstruction and rehabilitation projects. IDC continues to handle customary applications covering new or expanding industrial enterprises in the private sector. In doing so it supplies technical advice and guidance as well as finance counseling. Since loanable funds are limited, IDC's loan activities on new ventures are somewhat restricted.

13. SOFIDIV faces the same problem and has had practically no loan activity since February, 1968. Its functions can be considered as dormant for the time being, although potential projects are studied and discussed with the private sector. Otherwise, up to the attack period last year, SOFIDIV had been making excellent progress

14. Both institutions have as long-term goals the development of an industrial sector, mostly private, in Vietnam. The war and poor security have seriously interfered with significant progress toward those goals. IDC's shorter-term goal of assisting war-damaged plants is being realized, though not in the amount and at the speed hoped for. Each institution has the structure and a basic experience to enable it to move into any post-war or secure situation.

15. Currently, both institutions are short on qualified personnel due to the general mobilization. Their management and personnel are adequate under present circumstances provided that certain key personnel are not drafted, but for the future it is quite apparent both institutions will need to recruit and train more qualified people.

16. A request for future AID funding may be anticipated once South Vietnam ceases to be at war. An application was submitted to the Mission May 28, 1968, by the Minister of National Economy, requesting a loan of U.S. $10 million, to be utilized by IDC for its development lending activities. In view of the then pending USAID grant for reconstruction and the unsettled war situation, the application was placed in abeyance. Should peace occur, the application can then be given consideration.

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17. As to alternative sources of finance, assistance granted through the National Bank of Vietnam in the form of piaster loans is necessarily limited. As to assistance elsewhere, there are potential sources for post-war development but nothing specific has developed at this time. The Asian Development Bank plans to send a technical assistance team to Vietnam shortly to study, evaluate, and make recommendations as to what can be done for IDC and SOFIDIV. The team is expected to examine and appraise all facets of IDC's and SOFIDIV's management and operational procedures.

18. Evaluation of the Reconstruction Grant:

A. When the $10 million U.S. contribution was originally made, it was thought that it would hardly suffice in face of the $40 to $50 million estimate of damage. Therefore, the grant was restricted to replacement of damaged equipment and not to expansion of existing facilities. Events have proven that original planning did not take into consideration the extent to which plant owners would go to keep their doors open while awaiting arrival of imported equipment. The grant was not signed until June 29, 1968. The first loan contract between a company and the IDC was September 13 for $311,000. The latest was signed January 11, 1969 for some $590,000. In between one was signed in October for $44,000, one in November for $450,000, and the largest in December for $3,000,000. At least four months elapse between signing of the loan contract and the arrival of the ordered equipment. In the interim, since TET 1968, the factory owners reevaluated their needs, decided what equipment could be repaired or rebuilt using locally available materials and spare parts, and changed their production lines to conform with existing and rebuilt equipment.

Arrangements were made by some companies for special bank loans (a group of Chinese banks in Saigon pooled resources to lend VINATEXCO a sizable amount). This money was used to procure with GVN foreign exchange. Additionally, plants have been able to borrow from the GVN VN$ one billion fund which it contributed to IDC and thus purchase GVN foreign exchange for imports. Using those funds, importers have been exempted from most formal procedures being subject only to price checks by the DCE. Thus, the initial emergency situation has been somewhat relieved by self-help measures and access to local financing. Nevertheless, it is obvious that there is still a substantial need for replacement equipment, at least to the extent of the six million dollars in applications. The disappointing aspect is that to date less than $200,000 in letters of credit have been opened.

B. What have been delaying factors and what lessons can be learned? First, the IDC set up rather stringent requirements for minimum capitalization of the borrowers and for the conversion of proprietorships into corporations. Second, importers found it difficult to obtain necessary proforma invoices on much of the replacement equipment. Third, the U.S. Grant Agreement required quotations on a CIF basis which posed particular problems for importers trying to purchase insurance policies in Saigon on U.S. commodities. One U.S. supplier declined to quote insurance rates, because of lack of familiarity with insurance rates and practices. Fourth, USAID technicians counseled with IDC and the plant owners

with respect to the necessity for designated equipment and the specifications. Last, there is the inevitable delay in meeting the usual CIP requirements regarding licenses and OSB reviews. The OSB requirements were waived for replacement of items originally purchased in the U.S. but not for replacement of items originally non-U.S. in origin.

One is tempted to say offhand that most of the CIP regulations should have been waived in the Grant Agreement, thus speeding up the process. However, given the experience of the CIP program in Vietnam, it was probably good judgment not to have done so. The requirement ~~EE~~ for CIF quotations rather than C&F quotations seems to have been an unnecessary delaying factor. Likewise, the strict IBC requirements with respect to capitalization and incorporation have contributed to unnecessary delays. At the same time IBC did free its one billion piaster fund from many of the usual procedural restrictions and the companies have taken good advantage of this.

C. For other USAID missions the following might be considered if it is necessary to establish an emergency fund for rehabilitation of business or plants after a catastrophe:

1. To the extent that existing plant is being replaced or spare parts are being ordered, there would seem to be enough inherent protection to permit liberalizing of a great number of the usual procedural safeguards by permitting proprietory procurement, and waiving OSB requirements.

2. The local credit institution must also liberalize its procedures and treat the situation as an unusual one, not as part of its normal loan process, and it certainly shouldn't add steps or requirements!

3. There should be a joint loan committee or a joint technical committee that would enable the USAID and the local credit institution to process and approve applications in a timely manner with a minimum of paper shuffling.

4. It seems that no matter how great the initial damage estimates, the ingenuity of plant owners will often times change an apparently catastrophic situation into a lesser emergency. Any loan or grant agreement entered into by USAID should thus contain sufficient flexibility so that funds are not frozen into unalterable uses.

Conclusion:

Overall this reconstruction grant to IBC was effective: it bolstered the confidence of the local business community and it certainly provided a source of funds, though not a rapid one, to which they knew they could turn. It did not preclude the private banking sector from making its contribution and it helped to establish within the IBC a valuable body of experience that will be useful in its normal operations.

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Part II - Institutional Descriptions

THE INDUSTRIAL DEVELOPMENT CENTER (IDC)

A. ESTABLISHMENT:

Under GVN Decree No. 478/KT of November 16, 1957, IDC was established as an autonomous public agency, endowed with legal status, responsible for promoting the growth of industry through both financial and technical assistance. IDC actually has a triple role, that of an Industrial Credit Institution, a Productivity Organization, and an Investment Intelligence Body.

Its terms of reference qualify IDC as a development finance company or a development bank.

The staff is presently 101, including engineering, financial, economic, and development specialists.

	Executives and Technicians	Clerical	Total
Financial and Credit	9	15	24
Economic	7	8	15
Engineering	18	9	27
Trust Department	4	6	10
Administration and operations	2	23	25
	40	61	101

B. FUNCTIONS:

Credit and Investment Department

This department serves two basic functions. The Industrial Credit Service is charged with the responsibility of sound management of loanable funds, which includes the screening, analysis, and granting of medium term industrial loans to the private sector to assist investors in purchasing machinery and equipment. Loans may be granted up to seven years, and in some cases, longer.

The prevailing interest rate is presently 6.5% per annum. There has been some thought given to increasing the rate, but in an endeavor to really help prospective industrialists, and as a GVN-owned agency, it has been considered best to keep the rate low. Some loans were granted from 1963 to 1965 at 3% and 4%, plus a commission of 1%. The average rate 1965 through 1967 was 5% plus a commission of 1.5%. Now the practice is a minimum rate of 6.5% and no commission. No loans are being made at a higher rate. This compares to the commercial bank rates of 7% to 8% per annum which are almost exclusively for short term borrowings of up to 180 days.

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The second function is that of acquainting domestic and foreign entrepreneurs with investment procedures and providing them with current information and data on the economic climate and prevailing financial conditions. IDC is the Secretariat of the GVN Investment Commission and is responsible for receiving applications for investment privileges and following up on the performance of approved enterprises.

Credit Assistance

Since 1958, industrial credit disbursed by IDC has been VN$ 2,745,220,000, which accounts for almost 3% of the depreciated value of the capital stock of private industrial investment; however, at factor cost, this ratio is almost double:

		1967	
- Total capital stock (private sector) at depreciated value	VN$	78	billion
- Total capital stock at factor cost	VN$	40	billion
- IDC contribution	VN$	2.7	billion

The Industrial Development Center has loaned a large portion of its funds for the purpose of financing the importation of industrial equipment.

In future years, IDC's credit assistance is expected to increase. In 1963, IDC approved VN$ 0.3 million for industrial credit. This jumped to VN$ 497.3 million in 1966 and to VN$ 916.3 million in 1967. The forecast for 1968 was VN$ 1 billion, based upon estimated demand and availability of funds. The Spring 1968 VC offensive curtailed activity and financing was only VN$ 334.7. The IDC estimate for 1969 is again VN$ 1 billion of which loan disbursements for January and February are estimated at VN$ 200 million. An IDC forecast made in 1967 of 1972 requirements was VN$ 1.3 billion, which was a figure based almost solely upon the increased rate of demand yearly beginning in 1963. Such an estimate was made supposedly without consideration as to whether the hostilities would continue as is, or cease altogether. There is good reason to believe that once hostilities cease, the demand for industrial credit could rise substantially. The figures herein are based solely upon the present funds available to IDC, without considering possible other sources.

Within the framework of its original objectives, the IDC tries to augment the Government's development program.

It has been in the past, and it will be a policy in the future, for IDC to give financial, technical, and managerial help to those sectors of the economy which contribute most to the country's efficient allocation of its scarce resources. The sectors receiving the major portion of loans from IDC have been, firstly, the wood, paper and leather industries; secondly, textiles; thirdly, water, power and transport, followed by pharmaceuticals and chemicals. Factors involved cover a) the need for the product, b) does it conserve foreign exchange, c) ability of the borrower to repay, and d) its contribution to the economy, both in terms of price and potential profit to contribute to the GVN income by means of taxes and duties.

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Economic Studies Department

This department has two service areas. First, the Industrial Study and Economic Research Service provides industrialists with data concerning economic policy and planning in Vietnam, also administrative procedures and information on investment opportunities.

Second, the Industrial Statistics and Information Service is charged with keeping domestic and foreign investment circles abreast of all aspects of investment activities. It also fills a most vital function as liaison between potential foreign investors and local entrepreneurs.

Productivity Department

This department's Project Advisory Service prepares project studies available to interested investors, and may also assist investors in analyzing their own project needs. Such assistance may include a preliminary market study, technical studies, plant site choice, composition of capital structure, and advice on project implementation.

The Management Advisory Service offers specific technical assistance in such areas as production techniques, marketing, business organization, financial, and accounting techniques. It also disseminates technical knowledge by publishing various business guides and manuals, scheduling and offering training courses and seminars, producing appropriate slides and films, also maintaining a technical library service.

Comment: It would appear from the departmental functions described above (as outlined by IDC) that there may be some overlapping. The Mission has not gone into the internal management of IDC and is unable to comment in this regard.

Trust Department

This department serves the GVN in managing the government interest in confiscated enterprises. It also acts as representative of the GVN in certain enterprises in which the government has made an equity investment.

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Description of the Capitalization of IDC:

A. Equity

Capital

- French Government: NF 341,000	$VN	6,000,000
- ICA: $US 5,679,877.80 @ 35:1		198,795,723
- USOM:		87,654,384
	$VN	292,450,107
- Retained Earnings	$VN	95,261,237

B. Long-Term Liabilities

- Ministry of Finance (GVN)	$VN	270,000,000
- National Bank of Vietnam		1,039,021,419

C. Total (Equity + LT Liabilities) $VN 1,696,507,163

NOTES:

1. Capital: IDC's capital was contributed by:

- French Government: Date: October 17, 1957
  Amount: 341,000 NF (equivalent to $VN 6,000,000)
  Purpose: Purchase of French textile equipment

- U.S. Government:

On June 17, 1958, Sub-Project Agreement No. 1 was signed to provide funds for IDC and set out terms covering its loan activities. Under those terms the amounts of $US 6,000,000 and $VN 99,750,000 to be financed by USAID (then ICA and USOM, respectively) as contribution by the cooperating country to the capital of the IDC.

In accordance with the terms of the Sub-Project Agreement No. 1, the following amounts were transferred to the IDC:

- by ICA: $US 5,679,877,80 @ 35:1	=	$VN 198,795,723
- by USOM:		87,654,384
Total		$VN 286,450,107

The dollar transfer was made in five installments while the piaster one was made in six. The last dollar transfer was made on July [illegible] 1961, and the last piaster transfer on October [illegible]

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2. Retained Earnings: The IDC's Retained Earnings as of December 31, 1967, amounted to $VN 95,261,237. This amount is the accumulated Net Income from 1958 to 1967 after deducting bad debts which amounted to $VN 15,000,000. (1968 figures are not yet available.)

3. Long-Term Liabilities: The VN Government is the only creditor. However, the debts can be broken down as follows:

a. Ministry of Finance:

*First Loan: $VN 200,000,000

- Date of Loan: 1956
- Terms: Maturity - 12 years and 2 year grace
  Interest Rate: 1% per year

* This loan was actually negotiated by the Quoc Gia Doanh Te Cuoc (National Investment Fund) which IDC took over upon its establishment in November, 1957.

Second Loan: $VN 200,000,000

- Date of Loan: August 29, 1967
- Terms: Maturity - 15 years including 5 year grace
  Interest Rate: 3% per year (subject to be revised)
  Repayment Schedule: 10 annual installments, first payment in 1972
- Outstanding Amount: $VN 200,000,000

b. National Bank of Vietnam:

First Loan: $VN 460,000,000

- Date of Loan: 1962
- Terms: Repayment Schedule: Annually upon recovery from 5/7 Surtax loans
  Interest Rate: 0.5% per year up to Sept. 1, 1967
  3% per year from Sept. 1, 1967 onwards
  (rate subject to revision)
- Outstanding amount: $VN 417,021,419

Second Loan: $VN 400,000,000

- Date of Loan: July 28, 1966
- Terms: Maturity - 5 years
  Interest Rate: 2% per year up to Sept. 1, 1967
  3% per year from Sept. 1, 1967 onwards
  (rate subject to revision)
- Outstanding Amount: $VN 400,000,000

c. Refinancing Fund:

First refinancing:

- Original Amount: $VN 150,000,000
- Date: December 29, 1967
- Terms: Maturity - 5 years
  Interest Rate: 3% p.a. (rate subject to revision)
- Outstanding Amount: $VN 150,000,000

- Project: Cogido Paper Co.

Second refinancing:

- Original Amount: $VN 72,000,000
- Date: December 26, 1967
- Terms: Maturity - 3 years
  Interest Rate: 3% p.a. (rate subject to revision)
- Outstanding Amount: $VN 72,000,000

- Project: Visyfasa Textile Co.

Part III - VIETNAM DEVELOPMENT BANK

(Formerly Societe Financiere pour le Developpement de l'Industrie au Vietnam - SOFIDIV)

Address: No. 3 Vo Di Ngay Street, Saigon

Director General: Mr. Tu Ngoc Dinh (also on Board of Directors)

Board of Directors: (presently 17 - to be reduced in near future)

Shares Bank - Ind.

17,670		Nguyen Vo Dien - Director General Credit Commercial du Vietnam
3,000	10	Nguyen Thanh Lap - President Vietnam Ngang Hang
	10	Nguyen Ngoc Phat - Director Vietnam Ngang Hang
3,000	10	Tran Van Lam - President Industrial & Commercial Bank of Vietnam
	10	Ho Quang Phat - Director Industrial & Commercial Bank of Vietnam
2,000		Raymond Bravard - Director Banque Francaise de l'Asie
2,000		Andre Amathieu - Director Banque Franco-Chinoise
2,000		Andre Trottier - Director Banque National pour le Commerce et l'Industrie
1,000		David C. Porter - Manager The Chartered Bank
500		R. C. Beauclerk - Manager Hong Kong & Shanghai Banking Corporation
1,000		Albert Chao - Director Bank of China
1,000		Tchao Phe King - Director Bank of Communications
	10	Dinh Quang Chieu - Director American Trading Company
	10	Nguyen Hun Hanh - (former Governor, National Bank of Vietnam)
	10	Pham Kim Ngoc - Director General Saigon Investment Co.

Other Shares

1,460		Saigon Bank
300		Hong Cong Thuong Ngan Hang
34,930	70	
70		PAID-UP
35,000		VN$ 350,000,000 (12 banks plus 7 individuals)

A. ESTABLISHMENT:

A private company (stock corporation) established November 22, 1961, in compliance with the law of July 24, 1867. The new name, Vietnam Development Bank, was approved by the Extraordinary General Assembly on September 26, 1967.

B. CAPITALIZATION:

A consortium of 10 commercial banks was formed in order to undertake the risks of industrial financing. Original Authorized Capital was VN$ 200,000,000

divided into 20,000 shares of VN$10,000 each. Subscriptions were paid-up as follows: 25% by November 22, 1961; 25% by January 31, 1964; and the remaining 50% by August 31, 1966.

On September 26, 1967, capital was increased to VN$350 million by issuing 15,000 additional shares. These were fully subscribed and paid-up by the original shareholders, with allocations also made to two additional banks, Saigon Bank and Nong Cong Thuong Ngan Hang. In addition to the 12 banking shareholders, there are 7 individual shareholders, all bankers, with the exception of Mr. Chieu who is a former Director of Industrial Development Center (IDC).

C. ORGANIZATION:

Vietnam Development Bank is administered by an Administrative Council (Board of Directors) who are elected annually by the General Assembly of Shareholders. Presently, there are 17 Directors, however it is contemplated to reduce this number by from 5 to 9 in the near future (Meeting scheduled February 1968).

Management is vested in a Director General appointed by the Board who is given all necessary powers. Operating staff as of December 31, 1967 was 14.

D. FUNCTION:

The basic purpose of the bank is to contribute to the establishment and development of industrial enterprises within the private sector of the economy by providing financial and/or technical assistance.

As a development bank it may extend medium or long term loans at a present interest rate of 7½% per annum. It may also function as an investment company by taking an equity position in the creation and development of industrial enterprises.

Policies include the desire to:

a) Encourage private enterprise specifically in fields of industry which will contribute most to the economic development of Vietnam.

b) Assist particularly those industries which will produce goods currently being imported in order to conserve foreign exchange.

c) Provide technical assistance to promote efficiency in industrial production and industrial management and introduce new techniques in all phases of industrial development.

d) Stimulate foreign participation in new or expanding enterprises.

e) Earn a profit sufficient to keep reserves and to pay dividends to shareholders.

E. PROJECT IMPLEMENTATION:

1) Submission of Project

The applican submits to the bank his project for the establishment, expansion or modernization of an industrial enterprise and furnishes information concerning the technical, economic, commercial and financial aspects of the project.

2) File

With the assistance of technicians of the bank, the applicant makes up a file consisting of a questionnaire covering the following areas:

- Location of the plant.
- Raw materials, power, water, transport.
- Manpower and know how.
- Market Study: Sales estimates, distribution, possible competition.
- Soundness of the project with regard to the economy of the country and to its balance of payments.
- Financing of the project: own capital, long term and short term loans.
- Feasibility of the project: Ratios of feasibility, annual cash flows.
- Management.
- Conditions of financial assistance.

3) Consideration of the File by the Director

The whole file is submitted for the consideration of the Director who, if the project is deemed interesting, will submit his report and his recommendations to the Administrative Council of the Bank.

4) Decision of the Administrative Council

The Administrative Council decides by a majority of 2/3 of the registered capital.

F. FINANCIAL RESOURCES:

Since August 1966 the Company has increased its financial resources:

a) By increasing the registered capital;

b) By obtaining long term loans from the government at an interest rate of 3% and refinancing by the Banque National du Vietnam.

The present structure of the financial resources of the Company is as follows

1. Own Capital

Authorized capital (entirely paid-up): VN$ 350 million

2. Government Loans

1st Government Loan (Contract dated March 24, 1967): VN$200 million
2nd Government Loan (Contract dated August 30, 1967): VN$200 million

3. Refinancing by Banque National

Already granted: VN$ 242 million
Under negotiation: VN$ 95 million

BUNKER