**THE WORLD BANK GROUP ARCHIVES**

**PUBLIC DISCLOSURE AUTHORIZED**

Folder Title: Mathew, P M. - Articles and Speeches (1971)

Folder ID: 1652173

Fonds: Records of Office of External Affairs (WB IBRD/IDA EXT)

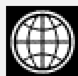
Digitized: February 12, 2014

To cite materials from this archival folder, please follow the following format:
[Descriptive name of item], [Folder Title], Folder ID [Folder ID], World Bank Group Archives, Washington, D.C., United States.

The records in this folder were created or received by The World Bank in the course of its business.

The records that were created by the staff of The World Bank are subject to the Bank's copyright.

Please refer to http://www.worldbank.org/terms-of-use-earchives for full copyright terms of use and disclaimers.



THE WORLD BANK
Washington, D.C.

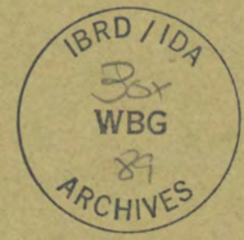
© 2012 International Bank for Reconstruction and Development / International Development Association or
The World Bank
1818 H Street NW
Washington DC 20433
Telephone: 202-473-1000
Internet: www.worldbank.org

**PUBLIC DISCLOSURE AUTHORIZED**

Mathew, P.M. - Articles and speeches (1971)

The World Bank Group
Archives
1652173
A1992-007 Other #: 12 212057B
Mathew, P M. - Articles and Speeches (1971)

DECLASSIFIED
WBG Archives



# UMBC economic review

UMBC Economic Review is published by the United Malayan Banking Corporation Bhd., 42, Jalan Mountbatten, Kuala Lumpur.

APR 23 1971

# TENTH ANNIVERSARY SPECIAL ISSUE

CONTENTS

| | PAGE |
|---|---|
| 1. FOREIGN INVESTMENT IN MALAYSIA: EXPERIENCE AND PROSPECTS *by V. Kanapathy, Economic Adviser, United Malayan Banking Corporation Bhd., Kuala Lumpur* | 1 |
| 2. OBJECTIVES AND STRATEGIES FOR DEVELOPMENT *by Harry G. Johnson, Professor of Economics, University of Chicago, and London School of Economics and Political Science* | 23 |
| 3. DEVELOPMENT FINANCE COMPANIES: AN APPRAISAL *by P. M. Mathew, Deputy Director, Development Finance Companies Department, International Bank for Reconstruction and Development, Washington, D.C.* | 27 |
| 4. CURRENT EXPERIMENTS IN BUDGETARY ORGANISATION *by Lady Ursula Hicks, Linacre College, Oxford University* | 30 |
| 5. THE IMPORTANCE OF A SOUND PROGRAMME STRUCTURE FOR THE PPB SYSTEM IN MALAYSIA *by Ramon Navaratnam, Deputy Secretary, Economic Division, The Treasury, Kuala Lumpur* | 42 |
| 6. THE LONG AND THE SHORT AND BRITISH INTEREST RATES *by A. A. Walters, Professor of Economics, London School of Economics and Political Science* | 50 |
| 7. ECONOMIC PROSPECTS FOR AUSTRALIA AND ITS NEIGHBOURS *by Professor Sir John Crawford, Vice-Chancellor, Australian National University* | 53 |
| 8. U.S. POLICY: CHANGES AND IMPLICATIONS *by Eli Ginzberg, A. Barton Hepburn Professor of Economics and Director, Conservation of Human Resources, Columbia University, New York* | 64 |
| 9. STATISTICS | 68 |

Vol. VI, No. 2, 1970. (KDN 4722)

# DEVELOPMENT FINANCE COMPANIES: AN APPRAISAL

*by*
P. M. MATHEW

*Deputy Director,*
*Development Finance Companies Department,*
*International Bank for Reconstruction and Development,*
*Washington, D.C.*

Among the myths and misconceptions that clutter the development field, one of the more common is the notion that poor countries are too poor to save anything.

One often hears the remark: "Oh, if only those countries could pull themselves together, sacrifice more, then we wouldn't have to give them all that foreign aid."

The fact of the matter is that — contrary to this prevailing myth — poor countries mobilize most of their own investment capital. As the recent Pearson Commission study noted, domestic savings financed 85% of total investment in the last decade. This, of course, is an extremely impressive achievement because a high savings rate obtained at low levels of income means a heavy sacrifice indeed.

In fact, great efforts are being made to increase savings despite formidable obstacles. Some poor countries have achieved very high rates of capital formation by any standard — more than 20% of gross national product. Equally significant, the average savings and investment rates in low-income countries during the 1960's compared very favorably with the historical investment rates of about 10% in Europe and the United States in the last century, although they were lower than the current rates in industrial countries.

This encouraging performance is due partly to the growing willingness of individuals to put aside income, usually through taxes, which could otherwise be spent on consumption. It is also partly attributable to the ability of governments to collect revenues and to increasing opportunities for profitable investment. Another reason is the steady growth of banking and other financial institutions.

One such institution, which deserves a lot more attention and credit than it normally receives, is the Development Finance Company (DFC). It does just what its name suggests — helps finance development. And in a variety of ways. A DFC may be government-owned or privately owned, or mixed. It can play a crucial catalytic role in mobilizing capital for industrial and commercial development by providing loan or equity finance, by underwriting security issues, by serving as a financial intermediary between local and foreign businessmen and by providing locally established companies with managerial and technical advice. In addition, DFCs can often perform a useful institutional function by helping nurture capital markets within their own countries.

Since entering this field in 1950 by helping establish the Industrial Development Bank of Turkey and the Development Bank of Ethiopia, the World Bank and its affiliate, the International Development Association, have lent a total of more than (US) $1 billion to 29 development finance companies in member countries. The International Finance Corporation, another affiliate of the World Bank, has made equity investments in 20 development finance companies and loans to two. During fiscal 1970, the Bank Group lent (US) $226 million to finance companies in 12 countries and to one regional development finance company. This represented a record in terms of the value of commitments, the number of companies assisted and the number of new countries to which loans and credits were made.

In a sense, this performance reflects several significant recent changes in the Bank Group's overall policy toward DFCs. For example, in June 1968, the Bank, whose policy once prohibited lending to government-controlled development bank, decided it would lend to such institutions provided their management was sound and autonomous in day-to-day decision-making. Another policy change subsequently affected the scope of operations of institutions financed by the Bank Group. Formerly, DFCs were eligible for Bank Group assistance only if they were devoted primarily to manufacturing. Now they may be multi-purpose companies, financing tourism, housing and other productive activities, in addition to industry.

These developments indicate the new, increased flexibility that the Bank Group is anxious to provide in its relations with DFCs. They reflect the importance which the Group sees in institutions that can mobilize capital, allocate it for productive purposes, promote investment and act generally as intermediaries in the investment process. Development banks presently associated with the Bank Group are now committing the equivalent of about (US) $590 million annually in loans, investments, etc. These in turn contribute to a total investment estimated at about (US) $1,200 million.

The central objective of the Bank Group in pursuing this new flexibility is not merely to find retail outlets for allocating external finance and technical assistance but to help build effective investment institutions in developing countries. Thus, the Group encourages development banks to actively mobilize domestic capital, to underwrite securities, to subscribe to equities, to sell from their portfolios in order to broaden ownership of enterprises, to identify and promote investment opportunities and to assist entrepreneurs in formulating and carrying out investment proposals.

Much progress has been made. But much remains to be done. Development banks, in the main, still act primarily by responding to investment opportunities presented to them by their clients. They do not do enough in identifying and promoting projects on their own initiative. It is to help stimulate this initiative, and broaden its scope, that the Bank Group has undertaken an expanded program of assistance. For instance, the plan for gross Bank and IDA commitments to development banks in the 1969-73 period calls for an outlay two to three times greater than the (US) $483 million in the preceding five-year period. To help achieve this objective, the number of development banks associated with the Group will grow to perhaps twice the number of 28 in 1969.

Several basic factors influence the Bank Group's deliberations and lending decisions in this field — the opportunities for productive investment, the need for the company, its policy orientation, and its management.

In looking at a request for help in establishing a new DFC or in reorganizing an existing one, the basic requirements are that the creation of the company be a matter of relatively high economic priority in the member country concerned. In other words, there must be a clearly defined institutional gap in the capital market which a DFC will be able to fill, partly or fully.

The Group also seek to be satisfied with the policy orientation of the company it is financing. Such an orientation entails, among other things, a description of the sectors the company proposes to invest in, the kinds of investment and other operations it plans to undertake, its conception of prudent debt limits and profit distribution.

Since satisfactory management is of fundamental importance to the success of a DFC, the Bank Group will not invest unless this basic requirement is fulfilled or unless arrangements have been made to provide management with an experienced adviser or senior staff.

Some recent examples of the Bank Group's participation in this field indicate the scope of operations. A (US) $5 million credit to the Societe Congolaise de Financement du Development (SOCOFIDE) in the Congo is particularly

interesting because it illustrates the Bank Group's willingness to promote new DFCs. SOCOFIDE is a new type enterprise in the Congo, charged with financing productive business ventures as well as promoting Congolese enterprises. Finance for the new firm came from IDA, from the Bank's other affiliate, the International Finance Corporation, from local investors, the Congolese Government and financial institutions in Belgium, France, the Federal Republic of Germany, Italy, Japan and the United States. The Bank took the initiative in organizing the company and found its first manager.

A recent (US) $20 million credit to the Industrial Development Bank of Pakistan is one of the first Bank Group lending operations for a DFC with majority government ownership. The credit will help the Pakistani Bank provide finance mainly to medium-sized firms. Benefits to industrial and commercial development in East Pakistan, hitherto a relatively poor region compared with West Pakistan, will receive emphasis.

Generally, the Bank seeks not to be simply a one-time lender but rather a continuing provider of capital. It therefore stresses establishment of a close relationship. For reasons of prudence, the Bank will lend at any one time the amount which (together with other available funds) the company needs, within the limits of sound borrowing policy, to meet the expected demand for capital for a limited period, usually about two years. Where the amount involved is large and where the company has a wider range of freedom in using the Bank's loan, a shorter period is sometimes preferred. The result of this policy has been to keep development finance companies coming back to the Bank at relatively frequent intervals, thus strengthening working relationships.

The effort and the resources which the World Bank Group has devoted to the promotion and financing of development finance companies and to providing them with a wide range of technical assistance have had an important and pervasive impact on our member countries.

We are convinced that there will be an increasing demand for effective development finance companies and we are prepared to intensify our efforts to help create them where needed, improve their operation and increase their impact.