Folder Title: Rosen, Martin - Articles and Speeches (1962 - 1969)

Folder ID: 1654538

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

Digitized: August 30, 2013

ROSEN, MARTIN (1962 - 1965)

RETURN TO ARCHIVES IN MC C3-120

ISN # 130346 ACC# A1992-007

BOX # 16

NUS LOCATION 475-4-5

ROSEN

To the Chamber of Commerce, New Delhi

LUNCHEON SPEECH

of

Mr. ~~xxxxx~~ Martin Rosen

25. 3. 62.

Mr. Chairman, Ladies and Gentlemen:

It is a great pleasure to be here and I am very pleased to have this opportunity of meeting with you and speaking and discussing the common problems with you. I must first start by apologising. I know you expected to have Mr. Roy as your Speaker and I am substituting with a great deal of apprehension. I remember a speech I made not very long ago where I did not know that I was a substitute speaker until prior to the introduction, the Secretary was asked to read the Minutes of the previous meeting and the Minutes of the previous meeting reported ~~xxxx~~ the distress of the group that the speaker who had been planned for the next meeting was not able to come and that they had found it necessary to arrange at the last moment to have a substitute speaker, but that they hoped to have a much better programme the next time.

I thank you, Mr. Chairman, for dispensing with reading the Minutes of the previous meeting.

You have heard from the Chairman something about the functions of the International Finance Corporation and its history and I would like to spend this occasion in discussing the role of the I.F.C. and its possible contribution to the industrial development of India and of the role generally of international private financial investment in the future development of India. Before, I come to this, however, Mr. Chairman, I think it only proper, as a visitor, to say what I think all the visitors to your country feel when they come here, and that is a sense of appreciation and of gratitude to India for the magnificent effort it is making in achieving the improvement in the standards of living of its people, in achieving the progress towards economic development of the country.

The record which you achieved during the second plan is a mafnificent record, and I think the record which will be achieved during this plan will be one which the rest of the world will continue to look to with a great deal of pride in what you have been able to achieve. I think that the congratulations are to be extended to India and to you here, to the private sector, for your contribution in this achievement. The contribution which you made in the second plan was an outstanding achievement and I am more than confident that the contribution which you will make in the next plan, in the current plan, as well as in future plans will be an equally outstanding achievement.

I have paid the tribute to the private sector but I do not want to minimise in any way the importance of the Government's role in what is being done. During this past week I have had the opportunity to meet with the Ministers and Secretaries and the officials of the Government, and as an outsider I would say that I am impressed with the understanding, the facility, the appreciation of the problems, the flexibility for adapting to the needs that they will develop in the future. We, in the I.F.C. hope and expect that we will be able to participate in the further economic development of India, in the development of the industrial sector, in the contributions of the private industrial progress. I do not intend to say very much about our past record. The I.F.C. was created as you said, Mr. Chairman, about five years ago as an affiliate of the World Bank, because we felt that industrial development ~~xxxxxxxx~~ was not a very basic area in the whole problem of economic progress, and we felt that the industrial development should be done, in our opinion a very considerable part in the prifate sector, but wherever there was private industrial development we wished to be able to do what we could to contribute to the support of that. We are an organisation which has money contributed by Governments but which is limited in its operation to make financial investments in private industrial undertakings. So far we have done very little in

India and I hope that that record will be a much greater one in the future. Part of the reason that we have done little in India is, I think, part of the reason arises from the purposes and the procedures that we ~~find~~ found it necessary to follow in the past; part of it, I think arises from certain fundamental factors which I would also like to talk about a bit.

3 purposes of IFC

We look upon our operations as accomplishing three purposes. One purpose is to make additional financial resources available for private industrial investment. The second purpose is to help develop the capital markets in the ~~country~~ member countries in which we are operating, and the third purpose is to help develop the international flow of private capital to make additional resources available for private industrial expansion.

We are ready in any sound project to make an investment, if it will serve to accomplish these goals, or some of these goals. We require, however, because of the kind of organisation that we are, that three basic tests should be satisfied.

The first test is one which arises from the fact that we are an international organisation and that our emphasis is devoted towards economic development. That first test says that our contributions shall be limited to investment projects which are of high economic priority and are of importance to the economic development of the country. That is the test, where, as I sometimes put it, we put on our hat of the international organisation of the development-minded person.

The second test is the test that we have to meet because we are bankers, as well as an international organisation. This is the test which requires that whatever projects we finance, whatever projects we participate in, should be projects which are soundly conceived, properly analysed, well-planned, with an adequate market for the output of the goods, projects which will be profitable, projects, in fact, which satisfy the normal investment banking criteria that the banker wishes to be certain of.

The third test that we have is the test that there is not available adequate private capital to provide the finance that is needed.

Any financial assistance that we make needs to meet these three tests. Now, as far as the first test is concerned in India, I think there is not very much difficulty in finding very many industrial projects which are of high priority. There is the plan, there are numerous projects which fit within the plan. To find projects which satisfy the priority test, is I think relatively easy.

The third test, the test of their not being available adequate private capital to meet the finances required, is also a test which is not very difficult to satisfy. This is not very difficult because, in fact, we are able to provide foreign exchange and with the foreign exchange shortage, many of the worth-while projects cannot go ahead because the exchange is not available.

The second test is also a test which I think can be satisfied by numerous projects here.

The question then may come up as to why is it that the I.F.C. has in fact not done very many projects in India? I said the I.F.C's role in India is rather limited. The World Bank has financed many Indian projects. The total amount of loans made by the World Bank to India are over or around 850 million dollars, or I think about 1/7th of the total amount of lendings made in ~~the~~ its history since the World Bank has been established have been loans to India. The International Development Association which is another affiliate of the World Bank and an affiliate which is intended to provide finance for useful projects on easy repayment terms, has made, I think, something like 50 million dollars in credits to India, or about half the credits extended so far by the International Development Association, which has just begun operating, have gone to India. The record of the I.F.C. has nothing like this to sister organisations. In fact we have only two projects which are on our books today for investments in India. The total amount of money is quite small. In terms of the percentage of our commitments, I think we have something like only 3 per cent of our commitments in India.

The purpose of my visit here was to try to find out what the reasons for this have been and to see in what ways we might be able ~~to do~~ to play a larger role in India. I came because I had found that in most countries it is necessary to adapt the pattern of the International Finance Corporation's activities to the particular needs of the country. In some countries, in some primitive countries, where there is very little technical skill available, little managerial ability available, little entrepreneurial ability available, our role is one of finding projects and promoting projects. That is certainly not the role to be played here. The number of good projects to be financed is very large. The record of Indian managerial technical entrepreneurial skill is one of the outstanding ones in the world. You, and your associates in the business financial community, are universally recognised throughout the world as the pillars of the communities in the other countries. So it is certainly not this question. This is not the role.

In other countries, the role has been that of providing equity money in order to provide a satisfactory equity base against which loans could be made. There have been a number of countries here, particularly in Latin America, where the project would be able to borrow the funds needed except ~~xikk~~ that the banker lending those funds was unwilling to lend unless an additional amount of equity was raised. In most of these countries, there was not a sufficiently developed capital market to permit that extra equity to be raised within the country, and the role which we play in that case is providing an equity investment which will make it possible to raise the additional loan capital. This, too, is not the need in India.

Here you have an active capital market. Some of my friends in Government have said it is sometimes too active. You have not too much difficulty in selling shares. The ability to raise equity to provide a satisfactory equity base, is certainly present through the capital market. That at least I can say that I feel that the general pattern of equity ..data....is one which in the interests of the investor coming into the transaction, should call for a greater amount of equity, that the general pattern of dead equity ratios of 2 : 1 is one which makes me as a banker, thinking of making a transaction in the company, have doubt about the transaction until the equity position is strengthened. But certainly you have adequate capital market to provide the extra equity that is needed to make possible the borrowings desirable. So this is not that role.

When I arrived I found that a role which thought for us was the role of putting in additional loan money in order to make available additional foreign exchange to help meet the foreign exchange problem. The more discussions we had and the more we considered the the problem, the more it became clear to me that that role by itself was not a key role. The reason why I feel that role is not a key-role, because our own resources are relatively small. As the Chairman has said, we have a capital of 100 million dollars. At present we have uncommitted funds of 60 million dollars. We have 61 members countries in which we are supposed to operate. We obviously do not parcel out the amount <u>pro rata</u> among each of the countries, but nevertheless it is clear that the amount of foreign exchange we could bring into India even if we gave a further large proportion of our total available resources to investments in India, would be relatively unimportant in terms of the size of community needs and in terms of the future contribution that foreign private capital should make in India.

After I had been here a bit, my conclusion was that the important thing for India's private industry was to try to raise foreign financial investment and that the role which we hope to be able to exercise was one of being a catalyst, to help to bring the foreign financial investor into making investments in Indian companies. You have companies with long and excellent histories. You have companies with names widely known throughout the world. You have many of the attributes which would make investment in Indian companies attractive to foreign investors. You have an economy which has been growing at a considerable rate. You have an industry which has been growing at quite a good rate. This past year of course, the industrial growth was 8 per cent, but the year before, it was higher, and if the plan is realised the rate of industrial growth will be in the neighbourhood of 10 or 12 pe per cent. This is a growth opportunity which is of interest to the foreign investor.

So far the foreign investment which has been attracted into India has been obviously of the joint venture type. It has been what I call industrial investment, rather than financial investment. Industrial investment has of course advantages and it is a very desirable thing, but industrial investment is of prime importance in a country which does not have technology and which needs to bring in foreign management, foreign skills, foreign know-how. This is not the prime problem here. Here the problem is permanent in certain processes of course, certain patterns. Primarily, it is a question of bringing in capital. In consideration of the developments which we see likely to happen in the future of India, it became clear to me at least that the problem of capital was going to be arising in the future as well as the problem of foreign exchange. I believe the emphasis on foreign exchange, on the foreign exchange position, on the foreign exchange availabilities, on the foreign exchange balance, is a very understandable emphasis because of the present agricultural foreign exchange position. But I believe also that it is important to look towards the future and in looking towards the future to see what the needs are going to be five or even ten years from now. What the directions of expansion are going to be five to ten years from now and to do actions which will be directed not only towards meeting today's problems and to-day's needs, but towards meeting the needs of five or ten years. I believe that the present apparent liquidity of the capital market, ability of industry to raise the funds that are required, is a liquidity which will be less apparent as industrial expansion grows, and that in the future there will be a problem of capital, there will be a need to attempt to attract foreign capital ~~mmxprdmr mmxprdmrxtpxjmxmxmm/mtmxxmm~~ in order to have capital, as well as to attract foreign capital in order to have foreign exchange.

The advantage of the foreign financial investment as contrasted to foreign industrial investment in the country, is that it brings in capital as well as exchange. The industrial investor is making available foreign exchange but this is usually geared to particular imports of equipment or particular licensing arrangements or to a particular know-how agreement, and in fact the capital that comes in is already ear-marked to that project rather than making available additional capital available to meet the capital needs of the country.

Coming to this conclusion of the matter of looking at foreign financial investments, I came to the consideration of the question as to whether the international finance corporation could help in any way in helping to attract financial investment.

We, first of all, had to look, ~~mk/tjm xmmmpmxmjmxmmxxmm~~ ~~mkx~~ at the reason why, as we, as financial investors had made relatively few investments in India, and it is only honest to say that one of the reasons is that it is very complicated to make an investment in India. We are operating in 60 countries. We have done transactions in ~~60 mmmmtrimm~~ a large number of these 60. In other countries when we negotiate a transaction, we negotiate with the industrial partner. An agreement is reached between us ~~and~~ on what both of us agree are fair terms; and although we bankers wear a double hat, we have the hat of the international organisation interest in economic development. So we do not try to negotiate the most favourable terms for us. We try in fact to negotiate the most favourable terms for the project. So we reach an agreement with the industrial partner and we conclude the agreement.. In India there is another step involved. After negotiating the agreement with the partner, we then turn and negotiate the same agreement with the Government. It has been necessary to get the terms of the investment, each of the conditions agreed by Government. I am not critical of this. I understand the reasons why Government has felt that this was a procedure that should be followed and I do not wish to criticise it in any way, and I am not criticising this procedure. But I am only pointing out its complexity. It ~~may mak~~ meant, in fact, that these transactions involved multi-partite negotiations. Usually the negotiation has involved a foreign industrial group who is comimg into the project, the local industrial group, perhaps a local financial group who is going to do an under-writing for the transaction, ourselves, and then the Government, and as we see at most negotiations, whenever four or five parties are all trying to reach agreement together, it becomes a complicated agreement.

We have been talking with the officials in the Government during our stay here to see whether this procedure might be simplified and I think we have found a very sympathetic understanding of the problem and of the desirability to accelerate the possibility of reaching agreements on the part of the officials with whom we have been discussing this matter.

What we are intending to do is to reach an agreement on general terms and conditions which the Government agrees will be appropriate and after we have reached the agreement on that general outline, we will be able to negotiate for specific transactions with the industrial group involved, with the assurance that as long as agreement is reached, if it is within the general outline Government will agree with the conclusion. This is I think a very valuable change and is a very valuable procedure and we were delighted that Government officials have proposed this procedure.

In my opinion this kind of procedure will greatly help other investments being made in India. I have discussed with many groups, both in Europe and in the United States, the experiences they have had in investigating in India and in each case this question of the need of double negotiations has arisen.

~~We xexx~~
So, we feel that we have now a base for being able to carry on individual transactions. We will feel we will be able to negotiate agreements promptly, and that we will be able to carry this forward much more easily.

We will try in each of these transactions to attempt to interest other financial investors into coming into the transactions. There is, of course, very great advantage, if we can find financial investors who would be willing to ~~join~~ join in the transaction because that would be the expression of the financial community, the world, of continued confidence in the future of the enterprise involved and of India as such.

Finally, we have talked about a different type of transaction and one which I hope we will be able to develop in the future. This is a transaction in which we would assist an Indian company which is trying to float an issue of shares or ~~to~~ of convertible debentures to float ~~x~~ an issue in one of the important capital markets of the world - in Zurich, Frankfurt, London, New York, Amsterdam, wherever it may be. We believe, and we are working on similar transactions in other countries which reinforce this believe. We believe that the opportunities of selling shares or convertible bonds or convertible debentures in a well known successful company, in the stock exchanges of the world, is an opportunity which ought to be very carefully investigated. We also have found that the I.F.C. is able to assist in ~~pix~~ the placing of such an issue by willing to give a stand-by committment to the underwriters ~~x~~ who are planning to put ~~it~~ out the issue. What we will do at the time the issue is proposed, we will enter into an agreement with the bankers who are selling the issue in which we agree to take a portion of the issue if it is not placed successfully. Numerous bankers in Europe and in New York with whom I have talked, have indicated that with this kind of support there will be many issues that they ~~xThey~~ will be willing to consider, which otherwise they might not be able to afford to take the risk of trying.

We have not talked specifically of Indian issues with any of these bankers because up to this time that possibility had not appeared, but I believe that as a result of the conversations that I have had during this visit here, this is a possibility which should be investigated for the future. I think this is a possibility which if successful should be of great importance to India.

I will not try to talk Mr. Chairman about the difficulty of inducing the financial investor to make an investment. The industrial investor comes into a transaction for many reasons other than the return on capital which he is going to make. The financial investor looks upon this as an investment and there are many problems in inducing the investor to come in. These problems exist in any country and they exist of course in a country undergoing a rapid developmental effort, a country which has a balance of payment problem. I cannot be too optimistic of how soon we will be able to get financial investors to be willing to make a sizeable financial investment in India. But I do believe that this is an important possibility in the future and one in which every effort should be made.

I will say that the investor will be looking ~~at~~ among ~~manx~~ other things, at the soundness of the investment and in this case he will be certainly looking at the competitive nature of the production involved to see whether in fact, over a long run that company, and the product it is producing, will be competitive in an international market.

This is only the last comment I want to make. I believe, for this group - the private industrial, commercial entrepreneurs of the country - it is very essential that in your investments every effort be made to think of the need for ~~xx~~ the ability of that investment being competitive internationally in the future. You need this if the investment is to be sound; you need this certainly if the financial investor is going to enter into the transaction. We as a financial investor, will not come into a company whose product can be sold in the country, but is sold at 40 or 50 or 60 per cent higher price than competitive world production.

We think that that is building problems for the future. I know the view of the need of the comp titive nature of Indian industry is one which is widely shared. So I will not belabour this point.

Mr. Chairman, I would be delighted to have the opportunity to answer any questions or enter into any discussion.

I want before doing this, merely to close by saying again that the record of development, the record of progress, by India and of the private sector is a record of which you all should be very proud. This is a record which ~~should sax~~ the outside observer, coming to see is very much impressed.

(Questions & Answers)

Questions and Answers

Q. No.1.- Is it possible for the foreign investor from Europe and America to give loans to Indian companies who need foreign exchange for their expansion programmes, say at a fixed rate of 7 or 8 or 9 per cent which in my opinion would be a sort of debenture stock, which you can float or sell to bankers or investors there, and which will ~~xxaxa will~~ be available to entrepreneurs here at this end at a much cheaper manner, because if it was debenture stock, it would be taxable here.

Answer: This is a question which I think is very properly put by any industrialist thinking of the financial resources of additional capital. I wish I could answer, Yes, but I am afraid the answer has to be no. I do not believe that any Indian company will be able to raise any substantial amount of capital at a fixed return basis from financial investors. I have tried this for many companies and we recently, about two years ago, participated in a transaction which involved one of the outstanding Japanese ~~still~~ steel companies. After a great deal of work by the investment bankers concerned, who spent approximately 10 months trying to ~~xxx~~ sell the debentures, and supported by a world bank loan to the same company, they were finally able to raise 4½ million dollars at an 8 per cent interest rate. This ~~is~~ has demonstrated the difficulty of selling fixed interest debentures stock. The reason for this is very clear: that the investor who is making a financial investment is usually, as far as the United States is concerned, in a tax bracket which makes a fixed interest rate return of no interest to him whatsoever. He is able to buy good equity tax exempt bonds which yield 4, 4½ per cent and if he is in the 50 per cent tax bracket, as any corporate investor is, that would be equivalent to a 9 per cent return with no foreign exchange risk, no international security risk, no ~~xxrix~~ uncertainty. If he is an individual investor that would be equivalent to a 12 per cent return. So that the fixed interest is not attractive. What he is interested in is the possibility of capital gains, of appreciation and only the sale of equities or more likely I believe the sale of convertible debentures as a possibility at this time.

Q. No.2 .- What would be the minimum size of a capital of a company whose proposals the ICICI has sponsored?

Answer.- We do not have any fixed maximum or minimum. But we feel that smaller transactions can best be handled through intermediary institutions. We work very closely with ICICI. We have had some discussions with I.F.C., India. We feel that transactions of the smaller size ~~and~~ can more effectively be handled through local institutions than trying to deal with a board and with lawyers and with engineers, who are a few thousands of miles away. The size of the transactions that we have talked about here, would involve investments of new expansion or of new projects, which would be in the neighbourhood of say, 10 million dollars or so, which we would put up apart. We have done smaller transactions in India. I think we did a transaction of £600,000, ~~pounds.~~ Frankly, I would say, I would not want to do that again.

Q. No.3 : You have rightly pointed out the need for attracting foreign capital. Do you have any suggestions whereby it can be more attractive?

Answer.- I have. But I am afraid that would take much longer than the Chairman would allow me. I know you have a 3 o'clock session planned. Let me say in very brief answer to this, that the foreign investor , who is coming in on ~~xx~~ a financial investment needs to be satisfied on three things. He needs to be satisfied about the future of the country in which the investment is being made. He needs to be satisfied about the future of the company in which he is making the investment. He needs to be satisfied about the promptability of this particular investment as compared with the thousands of alternative opportunities available to him. Now each of these points get expanded at some length, but I I think these cover the headings of what the problems are.

Q. No.4 .- You were referring to convertible debenture issues. Does that take account of the State company law which prevents the issue of capital other than to existing shareholders as a supplrmentary share issue?

ANSWER .- I recognise this problem. There are some countries in which this kind of issue is not possible at all. I believe in India this sort of an issue could be fitted in. It might be done by getting an agreement from shareholders, or by offering rights to shareholders, and then buying those rights from the shareholders in order to have a pool of rights which could make the convertibility. Let me say, in my opinion, and we have examined this, in India there are solutions to this problem. I do not recommend the ~~xxxx xerxixxix~~ convertible debenture as the normal ~~(?)~~ (?) wrap for investment. But for the needy Indian company, which is in a position to sell securities in London, or in New York, or Frankfurt, at this time, it will be easier to make a beginning with a convertible debenture which has ~~x~~ fixed ~~xaturn~~ re-payment terms and is ~~dxxxxxxxxxxd~~ denominated in foreign exchange in pounds or marks or in dollars and which is con-vertible into shares in the company. I would not recommend this as a general pattern for financing in all cases but I have tried to describe the one piece of paper which I think is more likely to be able to attract the foreign investor.

Q. No.5.- What would be the minimum rate of interest at which these debenture stock would be sold at in the present pattern of the economic conditions?

ANSWER.- This is difficult to answer. It would depend on the company, on the conversion rate and a number of factors. All I can say is, I believe it would be possible to get convertible; If any paper can be sold at a rate which is a tolerably acceptable rate ,it would have to be a convertible debenture. ~~Rxbxxxx~~ Debentures are sold at rates of of 6½ per cent, with convertible features, but I would not wish to answer that. It would depend on the company, the conversion price, the conversion period, and of course on the estimate of the market on the future of the country.

LUNCHEON SPEECH

Mr. Martin Rosen

March 25, 1962

Mr. Chairman, Ladies and Gentlemen:

It is a great pleasure to be here and I am very pleased to have this opportunity of meeting with you and speaking and discussing the common problems with you. I must first start by apologizing. I know you expected to have Mr. Roy as your Speaker and I am substituting with a great deal of apprehension. I remember a speech I made not very long ago where I did not know that I was a substitute speaker until prior to the introduction, the Secretary was asked to read the Minutes of the previous meeting and the Minutes of the previous meeting reported the distress of the group that the speaker who had been planned for the next meeting was not able to come and that they had found it necessary to arrange at the last moment to have a substitute speaker, but that they hoped to have a much better program the next time.

I thank you, Mr. Chairman, for dispensing with reading the Minutes of the previous meeting.

You have heard from the Chairman something about the functions of the International Finance Corporation and its history and I would like to spend this occasion in discussing the role of the IFC and its possible contribution to the industrial development of India and of the role generally of international private financial investment in the future development of India. Before I come to this, however, Mr. Chairman, I think it only proper, as a visitor, to say what I think all the visitors to your country feel when they come here, and that is a sense of appreciation and of gratitude to India for the magnificent effort it is making in achieving the improvement in the standards of living of its people, in achieving the progress towards economic development of the country.

The record which you achieved during the second plan is a magnificent record, and I think the record which will be achieved during this plan will be one which the rest of the world will continue to look to with a great deal of pride in what you have been able to achieve. I think that the congratulations are to be extended to India and to you here, to the private sector, for your contribution in this achievement. The contribution which you will make in the next plan, in the current plan, as well as in future plans will be an equally outstanding achievement.

I have paid the tribute to the private sector but I do not want to minimize in any way the importance of the Government's role in what is being done. During this past week I have had the opportunity to meet with the Ministers and Secretaries and the officials of the Government, and as an outsider I would say that I am impressed with the understanding, the facility, the appreciation of the problems, the flexibility for adapting to the needs that they will develop in the future. We, in the IFC hope and expect that we will be able to participate in the further economic development of India, in the development of the industrial sector, in the contributions of the private industrial progress. I do not intend to say very much about our past record. The IFC was created as you said, Mr. Chairman, about five years ago as an affiliate of the World Bank, because we felt that industrial development was not a very basic area in the whole problem of economic progress, and we felt that the industrial development should be done, in our opinion a very considerable part in the private sector, but wherever there was private industrial development we wished to be able to do what we could to contribute to the support of that. We are an organization which has money contributed by Governments but which is limited in its operation to make financial investments in private industrial undertakings. So far we have done very little in India and I hope that that record will be a much greater one in the future. Part of the reason that we have done little in India is, I think, part of the reason arises from the purposes and the procedures that we found it necessary to follow in the past; part of it, I think arises from certain fundamental factors which I would also like to talk about a bit.

We look upon our operations as accomplishing three purposes. One purpose is to make additional financial resources available for private industrial investment. The second purpose is to help develop the capital markets in the member countries in which we are operating, and the third purpose is to help develop the international flow of private capital to make additional resources available for private industrial expansion.

We are ready in any sound project to make an investment, if it will serve to accomplish these goals, or some of these goals. We require, however, because of the kind of organization that we are, that three basic tests should be satisfied.

The first test is one which arises from the fact that we are an international organization and that our emphasis is devoted towards economic development. That first test says that our contributions shall be limited to investment projects which are of high economic priority and are of importance to the economic development of the country. That is the test, where, as I sometimes put it, we put on our hat of the international organization of the development-minded person.

The second test is the test that we have to meet because we are bankers, as well as an international organization. This is the test which requires that whatever projects we finance, whatever projects we participate in, should be projects which are soundly conceived, properly analyzed, well-planned, with an adequate market for the output of the goods, projects which will be profitable, projects, in fact, which satisfy the normal investment banking criteria that the banker wishes to be certain of.

The third test that we have is the test that there is not available adequate private capital to provide the finance that is needed.

Any financial assistance that we make needs to meet these three tests. Now, as far as the first test is concerned in India, I think there is not very much difficulty in finding very many industrial projects which are of high priority. There is the Plan, there are numerous projects which fit within the Plan. To find projects which satisfy the priority test, is I think relatively easy.

The third test, the test of there not being available adequate private capital to meet the finances required, is also a test which is not very difficult to satisfy. This is not very difficult because, in fact, we are able to provide foreign exchange and with the foreign exchange shortage, many of the worthwhile projects cannot go ahead because the exchange is not available.

The second test is also a test which I think can be satisfied by numerous projects here.

The question then may come up as to why is it that the IFC has in fact not done very many projects in India? I said the IFC's role in India is rather limited. The World Bank has financed many Indian projects. The total amount of loans made by the World Bank to India are over or around 850 million dollars, or I think about 1/7th of the total amount of lendings made in its history since the World Bank has been established have been loans to India. The International Development Association which is another affiliate of the World Bank and an affiliate which is intended to provide finance for useful projects on easy repayment terms, has made, I think, something like 50 million dollars in credits to India, or about half the credits extended so far by the International Development Association, which has just begun operating, have gone to India. The record of the IFC has nothing like this to sister organizations. In fact we have only two projects which are on our books today for investments in India. The total amount of money is quite small. In terms of the percentage of our commitments, I think we have something like only 3 percent of our commitments in India.

The purpose of my visit here was to try to find out what the reasons for this have been and to see in what ways we might be able to play a larger role in India. I came because I had found that in most countries it is necessary to adapt the pattern of the International Finance Corporation's activities to the particular needs of the country. In some countries, in some primitive countries, where there is very little technical skill available, little managerial ability available, little entrepreneurial ability available, our role is one of finding projects and promoting projects. That is certainly not the role to be played here. The number of good projects to be financed is very large. The record of Indian managerial technical entrepreneurial skill is one of the outstanding ones in the world. You, and your associates in the business financial community, are universally recognized throughout the world as the pillars of the communities in the other countries. So it is certainly not this question. This is not the role.

In other countries, the role has been that of providing equity money in order to provide a satisfactory equity base against which loans could be made. There have been a number of countries here, particularly in Latin America, where the project would be able to borrow the funds needed except that the banker lending those funds was unwilling to lend unless an additional amount of equity was raised. In most of these countries, there was not a sufficiently developed capital market to permit that extra equity to be raised within the country, and the role which we play in that case is providing an equity investment which will make it possible to raise the additional loan capital. This, too, is not the need in India. Here you have an active capital market. Some of my friends in Government have said it is sometimes too active. You have not too much difficulty in selling shares. The ability to raise equity to provide a satisfactory equity base, is certainly present through the capital market. That at least I can say tha t I feel that the general pattern of equity data is one which in the interests of the investor coming into the transaction, should call for a greater amount of equity, that the general pattern of dead equity ratio of 2:1 is one which makes me as a banker, thinking of making a transaction in the company, have doubt about the transaction until the equity position is strengthened. But certainly you have adequate capital market to provide the extra equity that is needed to make possible the borrowings desirable. So this is not that role.

When I arrived I found that a role which thought for us was the role of putting in additional loan money in order to make available additional foreign exchange to help meet the foreign exchange problem. The more discussions we had and the more we considered the problem, the more it became clear to me that that role by itself was not a key role. The reason why I feel that role is not a key role, because our own resources are relatively small. As the Chairman has said, we have a capital of 100 million dollars. At present we have uncommitted funds of 60 million dollars. We have 61 member countries in which we are supposed to operate. We obviously do not parcel out the amount _pro rata_ among each of the countries, but nevertheless it is clear that the amount of foreign exchange we could bring into India even if we gave a further large proportion of our total available resources to investments in India, would be relatively unimportant in terms of the size of community needs and in terms of the future contribution that foreign private capital should make in India.

After I had been here a bit, my conclusion was that the important thing for India's private industry was to try to raise foreign financial investment and that the role which we hope to be able to exercise was one of being a catalyst, to help to bring the foreign financial investor into making investments in Indian companies. You have companies with long and excellent histories. You have companies with names widely known throughout the world. You have many of the attributes which would make investment in Indian companies attractive to foreign investors, You have an economy which has been growing at a considerable rate. You have an industry which has been growing at quite a good rate. This past year of course, the industrial growth was 8 percent, but the year before, it was higher, and if the plan is realized the rate of industrial growth will be in the neighborhood of 10 or 12 percent. This is a growth opportunity which is of interest to the foreign investor.

So far the foreign investment which has been attracted into India has been obviously of the joint venture type. It has been what I call industrial investment, rather than financial investment. Industrial investment has of course advantages and it is a very desirable thing, but industrial investment is of prime importance in a country which does not have technology and which needs to bring in foreign management, foreign skills, foreign know-how. This is not the prime problem here. Here the problem is permanent in certain processes of course, certain patterns. Primarily, it is a question of bringing in capital. In consideration of the developments which we see likely to happen in the future of India, it became clear to me at least that the problem of capital was going to be arising in the future as well as the problem of foreign exchange. I believe the emphasis on foreign exchange, on the foreign exchange position, on the foreign exchange availabilities, on the foreign exchange balance, is a very understandable emphasis because of the present agricultural foreign exchange position. But I believe also that it is important to look towards the future and in looking towards the future to see what the needs are going to be five or even ten years from now. What the directions of expansion are going to be five to ten years from now and to do actions which will be directed not only towards meeting today's problems and today's needs, but towards meeting the needs of five or ten years. I believe that the present apparent liquidity of the capital market, ability of industry to raise the funds that are required, is a liquidity which will be less apparent as industrial expansion grows, and that in the future there will be a problem of capital, there will be a need to attempt to attract foreign capital in order to have capital, as well as to attract foreign capital in order to have foreign exchange.

The advantage of the foreign financial investment as contrasted to foreign industrial investment in the country, is that it brings in capital as well as exchange. The industrial investor is making available foreign exchange but this is usually geared to particular imports of equipment or particular licensing arrangements or to a particular know-how agreement, and in fact the capital that comes in is already ear-marked to that project rather than making additional capital available to meet the capital needs of the country.

Coming to this conclusion of the matter of looking at foreign financial investments, I came to the consideration of the question as to whether the international finance corporation could help in any way in helping to attract financial investment.

We, first of all, had to look at the reason why, as we, as financial investors had made relatively few investments in India, and it is only honest to say that one of the reasons is that is is very complicated to make an investment in India. We are operating in 60 countries. We have done transactions in a large number of these 60. In other countries when we negotiate a transaction, we negotiate with the industrial partner. An agreement is reached between us on what both of us agree are fair terms; and although we bankers wear a double hat, we have the hat of the international organization interest in economic development. So we donot try to negotiate the most favorable terms for us. We try in fact to negotiate the most favorable terms for the project/ So we reach an agreement with the industrial partner and we conclude the agreement. In India there is another step involved. After negotiating the agreement with the partner, we then turn and negotiate the same agreement with the Government.

It has been necessary to get the terms of the investment, each of the conditions agreed by Government. I am not critical of this. I understand the reasons why Government has felt that this was a procedure that should be followed and I do not wish to criticize it in any way, and I am not criticizing this procedure. But I am only pointing out its complexity. It meant, in fact, that these transactions involved multi-partite negotiations. Usually the negotiation has involved a foreign industrial group who is coming into the project, the local industrial group, perhaps a local financial group who is going to do an underwriting for the transaction, ourselves, and then the Government, and as we see at most negotiations, whenever four or five parties are all trying to reach agreement together, it becomes a complicated agreement.

We have been talking with the officials in the Government during our stay here to see whether this procudure might be simplified and I think we have found a very sympathetic understanding of the problem and of the desirability to accelerate the possibility of reaching agreements on the part of the officials with whom we have been discussing this matter.

What we are intending to do is to reach an agreement on general terms and conditions which the Government agrees will be appropriate and after we have reached the agreement on that general outline, we will be able to negotiate for specific transactions with the industrial group involved, with the assurance that as long as agreement is reached, if it is within the general outline Government will agree with the conclusion. This is I think a very valuable change and is a very valuable procedure and we were delighted that Government officials have proposed this procedure.

In my opinion this kind of procedure will greatly help other investments being made in India. I have discussed with many groups, both in Europe and in the United States, the experiences they have had in investigating in India and in each case this question of the need of double negotiations has arisen.

So, we feel that we have now a base for being able to carry on individual transactions. We will feel we will be able to negotiate agreements promptly, and that we will be able to carry this forward much more easily.

We will try in each of these transactions to attempt to interest other financial investors into coming into the transactions. There is, of course, very great advantage, if we can find financial investors who would be willing to join in the transaction because that would be the expression of the financial community, the world, of continued confidence in the future of the enterprise involved and of India as such.

Finally, we have talked about a different type of transaction and one which I hope we will be able to develop in the future. This is a transaction in which we would assist an Indian company which is trying to float an issue of shares or of convertible debentures to float an issue in one of the important capital markets of the world -- in Zurich, Frankfurt, London, New York, Amsterdam, wherever it may be. We believe, and we are working on similar transactions in other countries which reinforce this belief. We believe that the opportunities of selling shares or convertible bonds or convertible debentures in a well-known successful company, in the stock exchanges of the world, is an opportunity which ought to be very carefully investigated. We also have found that the IFC is able to assist in the placing of such an issue by willing to give a standby commitment to the underwriters who are planning to put out the issue. What we will do at the time the issue is proposed, we will enter into an agreement with the bankers who are selling the issue in which we agree to take a portion of the issue if it is not placed successfully. Numerous bankers in Europe and in New York with whom I have talked, have indicated that with this kind of support there will be many issues that they will be willing to consider, which otherwise they might not be able to afford to take the risk of trying.

We have not talked specifically of Indian issues with any of these bankers because up to this time that possibility had not appeared, but I believe that as a result of the conversations that I have had during this visit here, this is a possibility which should be investigated for the future. I think this is a possibility which if successful should be of great importance to India.

I will not try to talk Mr. Chairman about the difficulty of inducing the financial investor to make an investment. The industrial investor comes into a transaction for many reasons other than the return on capital which he is going to make. The financial investor looks upon this as an investment and there are many problems in inducing the investor to come in. These problems exist in any country and they exist of course in a country undergoing a rapid developmental effort, a country which has a balance of payment problem. I cannot be too optimistic of how soon we will be able to get financial investors to be willing to make a sizable financial investment in India. But I do believe that this is an important possibility in the future and one in which every effort should be made.

I will say that the investor will be looking among other things, at the soundness of the investment and in this case he will be certainly looking at the competitive nature of the production involved to see whether in fact, over a long run that company, and the product it is producing, will be competitive in an international market.

This is only the last comment I want to make. I believe, for this group -- the private industrial, commercial entrepreneurs of the country -- it is very essential that in your investments every effort be made to think of the need for the ability of that investment being competitive internationally in the future. You need this if the investment is to be sound; you need this certainly if the financial investor is going to enter into the transaction. We as a financial investor, will not come into a company whose product can be sold in the country, but is sold at 40 or 50 or 60 percent higher price than competitive world production.

We think that that is building problems for the future. I know the view of the need of the competitive nature of Indian industry is one which is widely shared. So I will not belabor this point.

Mr. Chairman, I would be delighted to have the opportunity to answer any questions or enter into any discussion.

I want before doing this, merely to close by saying again that the record of development, the record of progress, by India and of the private sector is a record of which you all should be very proud. This is a record which the outside observer, coming to see is very much impressed.

<u>Question 1</u> Is it possible for the foreign investor from Europe and America to give loans to Indian companies who need foreign exchange for their expansion programs, say at a fixed rate of 7 or 8 or 9 percent which in my opinion would be a sort of debenture stock, which you can float or sell to bankers or investors there, and which will be available to entrepreneurs here at this end at a much cheaper manner, because if it was debenture stock, it would be taxable here.

<u>Answer</u> This is a question which I think is very properly put by any industrialist thinking of the financial resources of additional capital. I wish I could answer Yes but I am afraid the answer has to be No. I do not believe that any Indian company will be able to raise any substantial amount of capital at a fixed return basis from financial investors. I have tried this for many companies and we recently, about two years ago, participated in a transaction which involved one of the outstanding Japanese steel companies. After a great deal of work by the investment bankers concerned, who spent approximately 10 months trying to sell the debentures, and supported by a world bank loan to the same company, they were finally able to raise 4½ million dollars at an 8 percent interest rate. This has demonstrated the difficulty of selling fixed interest debentures stock. The reason for this is very clear: that the investor who is making a

financial investment is usually, as far as the United States is concerned, in a tax bracket which makes a fixed interest rate return of no interest to him whatsoever. He is able to buy good equity tax exempt bonds which yield 4, 4½ percent and if he is in the 50 percent tax bracket, as any corporate investor is, that would be equivalent to a 9 percent return with no foreign exchange risk, no international security risk, no uncertainty. If he is an individual investor that would be equivalent to a 12 percent return. So that the fixed interest is not attractive. What he is interested in is the possibility of capital gains, of appreciation and only the sale of equities or more likely I believe the sale of convertible debentures as a possibility at this time.

Question 2 What would be the minimum size of a capital of a company whose proposals the ICICI has sponsored?

Answer We do not have any fixed maximum or minimum. But we feel that smaller transactions can best be handled through intermediary institutions. We work very closely with ICICI. We have had some discussions with IFC, India. We feel that transactions of the smaller size can more effectively be handled through local institutions than trying to deal with a board and with lawyers and with engineers, who are a few thousands of miles away. The size of the transactions that we have talked about here, would involve investments of new expansion or of new projects, which would be in the neighborhood of say, 10 million dollars or so, which we would put apart. We have done smaller transactions in India. I think we did a transaction of £600,000. Frankly, I would say, I would not want to do that again.

Question 3 You have rightly pointed out the need for attracting foreign capital. Do you have any suggestions whereby it can be more attractive?

Answer I have. But I am afraid that would take much longer than the Chairman would allow me. I know you have a 3 o'clock session planned. Let me say in very brief answer to this, that the foreign investor, who is coming in on a financial investment needs to be satisfied on three things. He needs to be satisfied about the future of the country in which the investment is being made. He needs to be satisfied about the future of the company in which he is making the investment. He needs to be satisfied about the promptability of this particular investment as compared with the thousands of alternative opportunities available to him. Now each of these points get expanded at some length, but I think these cover the headings of what the problems are.

Question 4 You were feferring to convertible debenture issues. Does that take account of the State company law which prevents the issue of capital other than to existing shareholders as a supplementary share issue?

Answer I recognize this problem. There are some countries in which this kind of issue is not possible at all. I ~~believe~~ in India this sort of an issue could be fitted in. It might be done by getting an agreement from shareholders, or by offering rights to shareholders, and then buying those rights from the shareholders in order to have a pool of rights which could make the convertibility. Let me say, in my opinion, and we have examined this, in India there are solutions to this problem. I do not recommend the convertible debenture as the normal wrap for investment. But for the needy Indian company, which is in a position to sell securities in London, or in New York, or Frankfurt, at this time, it will be easier to make a beginning with a convertible debenture which has fixed repayment terms and is denominated in foreign exchange in pounds or marks or in dollars and which is convertible into shares in the company. I would not recommend this as a general pattern for financing in all cases but I have tried to describe the one piece of paper which I think is more likely to be able to attract the foreign investor.

Question 5 What would be the minimum rate of interest at which these debenture stock would be sold at in the present pattern of the economic conditions?

Answer This is difficult to answer. It would depend on the company, on the conversion rate, and a number of factors. All I can say is, I believe it would be possible to get convertible. If any paper can be sold at a rate which is tolerably acceptable, it would have to be a convertible debenture. Debentures are sold at rates of $6\frac{1}{2}$ percent, with convertible features, but I would not wish to answer that. It would depend on the company, the conversion price, the conversion period, and of course on the estimate of the market or the future of the country.

June 25, 1962

CORPORACION FINANCIERA INTERNACIONAL

1818 H STREET, N.W., WASHINGTON 25, D. C. TELÉFONO: EXECUTIVE 3-6360

ALGUNAS DEFICIENCIAS EN LA GERENCIA
DE EMPRESAS EN LOS PAISES INSUFICIENTEMENTE
DESARROLLADOS Y LA FORMA DE REMEDIARLAS

Por
Martin M. Rosen

Entre las principales causas del fracaso de nuevos proyectos industriales en los países menos desarrollados figura la administración inadecuada. En este resumen -- que comienza en la siguiente página -- de una disertación dada recientemente por el Sr. Martin M. Rosen, Vicepresidente Ejecutivo de la Corporación Financiera Internacional (CFI), en el Instituto de Desarrollo Económico del Banco Mundial, se describen algunos ejemplos específicos de diferentes clases de deficiencias en la gerencia de empresas y los remedios necesarios para superarlas.

La CFI es una institución internacional autónoma de inversiones estrechamente vinculada al Banco Mundial, del que es entidad filial. Ahora bien, sus operaciones son distintas ya que la Corporación trata exclusivamente con empresas privadas. Realiza inversiones en empresas productivas -- principalmente industriales -- de los países miembros de las regiones menos desarrolladas con el fin de facilitarles parte del capital necesarios para iniciar o ampliar operaciones que tengan repercusiones importantes en el crecimiento económico.

En septiembre de 1961 se enmendó la Carta de la CFI a fin de que pudiera efectuar inversiones en acciones de capital. Con la facultad para invertir en acciones así como para conceder préstamos, la CFI tiene mayor flexibilidad de financiamiento para atender las distintas necesidades de las empresas privadas en los países menos desarrollados y para

El Sr. Martin M. Rosen es Vicepresidente Ejecutivo de la Corporación Financiera Internacional.

ayudar directamente al desarrollo de mercados de capitales en esos países, suscribiendo emisiones de acciones antes de ofrecerlas al público. Más recientemente, la CFI ha establecido un Departamento de Servicios de Bancos de Fomento, que proporciona asistencia técnica para el establecimiento de nuevos bancos de fomento, de propiedad privada, así como asesoramiento y ayuda a los bancos existentes.

La CFI ha invertido hasta el 31 de diciembre de 1962 más de 80 millones de dólares en 23 países y no solamente ha complementado cantidades mucho mayores de capital, local y extranjero, de negocios privados, sino que además ha estimulado la participación en ellos de otras importantes inversiones privadas. Esencialmente, la CFI ha sido siempre una institución de inversiones más bien que de préstamos, juzgando los proyectos por sí mismos como inversiones para capitales privados.7

/A continuación figura un resumen de la disertación del Sr. Rosen:7

El problema al que voy a referirme es el de la gerencia de empresas privadas en los países en vías de desarrollo. Algo de lo que se dice sobre el problema de la dirección de industrias privadas puede aplicarse asimismo a la gerencia de las empresas del sector público. Casi siempre que se aborda el problema del éxito o fracaso industrial, se presume que la gerencia es el factor que determina el éxito o el fracaso de la empresa. Por gerencia se entiende la combinación de cualidades técnicas, administrativas y comerciales que conjuntamente determinan si una empresa ha de tener éxito o no. Así, pues, la gerencia significa mucho más que la simple organización administrativa de una empresa. Definida en esos amplios términos -- como creo que debe ser -- la gerencia es indudablemente el factor fundamental que determina el éxito o el fracaso de las inversiones en empresas industriales.

El éxito de una empresa industrial depende de diversos elementos. Uno de ellos, por supuesto, es el de obtener capital suficiente para la inversión en condiciones convenientes. Otro es el problema de conseguir la mano de obra necesaria, y de calidad y experiencia apropiadas. Y otro es efectuar los estudios adecuados antes de decidir sobre la inversión. Por estudios adecuados quiero decir los que cubran no sólo los aspectos de ingeniería del problema, sino también los comerciales. Por último, existe el problema de llegar a acuerdos apropiados con el Gobierno a fin de determinar si el proyecto contará con el apoyo o la oposición de aquél. El estudio y la consideración efectiva de estos problemas por anticipado, y después el establecimiento y el funcionamiento eficaz del proyecto, tomando en cuenta esos problemas, son los factores que distinguen una buena gerencia de otra condenada al fracaso.

Ahora voy a explicar brevemente como hemos considerado nosotros que se puede obtener una buena gerencia y como debe ser organizada. Nosotros, en la Corporación Financiera Internacional, hemos tenido ocasión de examinar muchos proyectos industriales diferentes en numerosos países. Conocemos a fondo los proyectos en los que hemos efectuado nuestras propias inversiones, y hemos examinado tal vez un centenar o más de otros proyectos en los que hemos decidido no realizar inversiones. Al examinar esos proyectos, hemos observado siempre que hay dos elementos clave que determinan el éxito de los mismos. Estos dos elementos son los controles contables y la capacidad de la gerencia.

El problema del control contable inadecuado ha existido en todos los proyectos que nos han causado dificultades. En la mayoría de los casos, el problema de la contabilidad se ha planteado porque la compañía comenzó por ser una empresa familiar muy pequeña, en la que el principal miembro de la familia encargado de la empresa conocía todos los detalles de la misma. Después creció y se desarrolló hasta que resultó demasiado grande para que una persona, o dos o tres hermanos, o un padre y un hijo, conocieran todos los detalles del negocio.

Permítaseme que les explique lo que ocurrió en uno de nuestros proyectos, en el que vimos por anticipado que el problema de la contabilidad podría llegar a ser grave. Se trata de una compañía que fabrica equipos eléctricos para la industria automóvil. El fundador de la empresa tenía mucha experiencia en esta industria y comenzó fabricando, casi a mano, pequeñas piezas para motocicletas, bicicletas con motor y automóviles: generadores, distribuidores, limpiaparabrisas, etc. Su hijo cursó la carrera de ingeniero y después se incorporó al negocio.

A medida que crecía la industria automovilista del país en cuestión, el problema de esta empresa era el de crecer al mismo ritmo que dicha industria. Tenía la licencia exclusiva para suministrar equipos eléctricos destinados a varios tipos de automóviles. Para conservar dicha licencia exclusiva tenía que estar en condiciones de producir todo el material que fuese necesario, pues en caso contrario perdería la exclusiva. Por consiguiente, había que ampliar la empresa. La expansión suponía grandes costos financieros para ensanchar la fábrica existente y, lo que era más importante, para construir una nueva fábrica a alguna distancia de la primera, donde se podrían producir algunas piezas.

El hombre que fundó la compañía tiene ahora unos 60 años de edad. A su juicio, el problema de la contabilidad era muy sencillo, según me explicó un día. Sacó una pequeña libreta del bolsillo y dijo: "En esta página anoto todo el dinero que recibo y en esta otra página todo el que pago, y mientras la cifra en la primera página sea superior a la de la otra, no tengo por qué preocuparme". No es tan peregrino como parece. Mientras la compañía fué una empresa controlada por una sola persona, ésta siempre podía mirar a su libreta y saber exactamente sus ingresos y sus gastos. Y mientras supiera que los gastos eran para la adquisición de materias primas que producirían mayores ventas al mes siguiente, podía tener un control efectivo de la empresa.

Ahora bien, cuando la empresa se amplió hasta comprender 800 trabajadores remunerados, cuando tuvo dos factorías situadas a 320 kilómetros una de otra, cuando el inventario llegó a comprender diez mil piezas diferentes -- piezas estampadas, forjadas, cortadas, matrices -- ya no pudo tener toda la información necesaria en su pequeña libreta.

Antes de entrar en esta empresa, insistimos en el problema de la contabilidad, hicimos las gestiones necesarias para que una firma de contadores públicos realizara una investigación de la compañía. Más importante aún, exigimos que la compañía llegara a un acuerdo con un asesor en contabilidad para establecer un sistema de controles contables más perfecto que la pequeña libreta del propietario. Esto supuso un sistema continuo de controles del inventario. Supuso también un sistema continuo de análisis de costos, porque la compañía estaba fabricando muchas piezas diferentes y necesitaba tener información acerca de las que resultaban productivas y de las que no lo eran.

Además, la compañía tenía un problema de programación de la producción. Por ejemplo, podía darse el caso de que recibiera información de un cliente fabricante de automóviles en el sentido de que en los meses de octubre, noviembre y diciembre, aquél proyectaba producir 2.000 automóviles al mes y necesitaría, por lo tanto, las piezas para un total de 6.000 vehículos. La compañía tenía que estar en condiciones de fabricar, antes de octubre, las bocinas eléctricas, los interruptores y las demás piezas que se necesitaban para los 6.000 automóviles. Esto exigía una programación muy complicada, debido a que cada uno de esos productos acabados podían comprender 10 o 50 pequeñas piezas de metal diferentes que había que cortar o estampar y ajustar. Era evidente que se necesitaba un sistema de contabilidad. Ese sistema se ha ido introduciendo poco a poco y comienza a demostrar su eficacia. Pero este es un ejemplo de un problema que se previó antes de que surgieran dificultades. Si no se hubieran tomado medidas administrativas mediante el establecimiento de un control contable adecuado podían haberse presentado -- y yo creo que se habrían presentado -- graves problemas.

Otro caso que he de mencionar es el de una compañía que fabrica un producto que vende otra compañía, propiedad de las mismas personas que controlan la primera. En este caso el problema es que la compañía vendedora obtiene más beneficios que la productora. También es un problema de gerencia en el sentido de que el inversionista de fuera, que es socio de la compañía productora no está seguro de que recibe una proporción equitativa de los beneficios de la empresa.

Un tercer ejemplo de un problema de gerencia inadecuada es el que se plantea por el hecho de no haberse efectuado los estudios pertinentes respecto a la situación local antes de efectuar la inversión en un negocio. Se trata en este caso de un proyecto para producir materiales de construcción a base de desperdicios. En esta elaboración, los desperdicios se mezclan con una masa ligera de cemento, dando un material de construcción parecido a los bloques de cemento o de concreto de cenizas.

El proyecto se inició en un país tropical por un hombre que conocía el éxito alcanzado en Europa con un material determinado de construcción. Creía que había hecho un estudio cuidadoso de las posibilidades de mercado, de los costos y del suministro de materias primas. Parecía que había suficientes materias primas disponibles. En consecuencia, decidió emprender el proyecto. Inmediatamente tropezó con dificultades.

La primera fué la desaparición del suministro de materias primas. Las materias primas eran materiales de desperdicio siempre que nadie quisiera comprarlos. En lugar de poder adquirirlas a un precio ínfimo, aparte de los costos de entrega y transporte, descubrió que se sabía que dicho material se necesitaba para su fábrica y en consecuencia, le cobraban precios elevados, lo que hacía que el costo de la producción fuese más alto que el de otros materiales de construcción, tales como los ladrillos.

El segundo problema consistió en que, en dicho país, el costo de la mano de obra para la construcción de edificios no era un factor muy importante. El país tiene un excedente de mano de obra, los jornales son bajos y, por tanto, resultaba más barato utilizar el doble de obreros colocando ladrillos que la mitad de obreros colocando bloques de cemento, ya que éstos cuestan más que los ladrillos.

El tercer factor fué el de que este bloque de cemento especial tenía propiedades de aislamiento que resultaban convenientes en Europa, pero no en un país tropical donde el clima es siempre caluroso.

La enseñanza que se deduce de este ejemplo es la de que el extraño que viene a hacer un estudio de la viabilidad de un proyecto, aún cuando conozca a fondo las características técnicas del mismo, debe tener cuidado de no subestimar ciertas circunstancias locales importantes que son esenciales para el éxito del proyecto. No se pueden resolver los problemas inherentes a la gerencia contratando un grupo de fuera para efectuar un estudio de la viabilidad de un proyecto. Este estudio ha de estar basado en un conocimiento profundo de las circunstancias y factores locales, y el hecho de no tomar en cuenta esas circunstancias y factores puede dar lugar a dificultades.

Un cuarto ejemplo que quiero mencionar se refiere al tamaño de un proyecto que se iba a emprender. El primer problema consistió en que la fábrica diseñada era demasiado pequeña. Evidentemente, era imprudente construir una planta para fabricar mayor cantidad de un producto determinado que la que podía consumirse en el país. Dada la situación general del mercado mundial respecto a dicho artículo, era dudoso que éste pudiera producirse a un costo que permitiera competir en el mercado mundial. Por consiguiente, era razonable limitar el tamaño de la fábrica a las posibilidades del mercado nacional. Pero ésto suponía que los gastos de producción serían muy elevados. Se proyectaba resolver este problema mediante un acuerdo con el Gobierno del país para establecer tarifas aduaneras que protegieran a dicha industria contra las importaciones de costo más bajo.

El segundo problema radicaba en que los costos de construcción de la fábrica ascendieron a un 25% más de los que en un principio se habían previsto. No sé cuál pudo ser la razón exacta de ese incremento en los costos de la construcción.

El tercer problema era de carácter técnico. En toda operación manufacturera, no se trata sencillamente de colocar el equipo, tirar de un interruptor eléctrico y dejar que las máquinas funcionen. En casi todas las plantas se tropieza con dificultades técnicas que no se pueden prever. En este caso, uno de los problemas técnicos era que el agua utilizada para el sistema de refrigeración tenía mayor contenido de mineral del que se suponía, y los depósitos de mineral obstruían los tubos de dicho sistema. Debido a esto, el equipo estaba trabajando a una temperatura más elevada que la prevista, dando lugar a una corrosión por el ácido sulfúrico utilizado en la fábrica. En consecuencia, se produjeron escapes y se averiaron las bombas. En realidad, este proyecto tuvo menos problemas de diseño que varias plantas similares que visité en otros países. Menciono estas dificultades técnicas y costos imprevistos únicamente porque ocurren con frecuencia en nuevas empresas.

Hubo otras dificultades debidas al hecho de que los ingenieros extranjeros empleados en el proyecto no podían entenderse bien con los obreros que estaban adiestrándose para trabajar en la fábrica. Algunas de las dificultades mecánicas se debieron simplemente al hecho de que cada hora no se hacía girar una válvula a fin de desviar la corriente de un tanque a otro. Los ingenieros decían que era culpa de los obreros que no hacían lo que se les indicaba. La administración local decía que la culpa era de los ingenieros extranjeros que debían haber ido cada hora a la factoría, para asegurarse de que se hacía girar la válvula.

Estos ejemplos son suficientes para exponer algunas de las muchas clases de problemas administrativos que pueden plantearse en las empresas industriales nuevas o en proceso de expansión en los países menos desarrollados. Antes de concluir mi exposición, quiero examinar otros dos problemas en la gerencia de empresas que, a mi juicio, son de importancia y carácter general.

El primero se refiere al hecho de que se establezca un nuevo proyecto industrial sin una estructura de capital que permita el funcionamiento satisfactorio de la empresa. En muchos casos, empresarios inexpertos han emprendido negocios con capital insuficiente o bien obtenido en condiciones muy onerosas o imposibles. Hemos visto, con demasiada frecuencia, empresas en las que el capital permanente necesario ha sido obtenido por medio de préstamos bancarios a corto plazo o por créditos concedidos por los abastecedores a un plazo de dos a cuatro años. Un empresario inexperto hace pronósticos financieros favorables para la nueva compañía y llega a la conclusión de que ésta será suficientemente productiva para poder reembolsar los créditos obtenidos a dos o tres años de plazo. La experiencia nos ha enseñado que desconfiemos de semejantes propuestas, porque es probable que los nuevos proyectos tengan dificultades imprevistas que exijan más capital o a más largo plazo que el previsto. La capacidad de prever esas dificultades y las consiguientes necesidades de capital es una de las cualidades de una buena gerencia.

El segundo punto de carácter general a que me quiero referir es el del mantenimiento de relaciones adecuadas entre las autoridades locales, la empresa local y la empresa extranjera con el fin de asegurar una gerencia competente. A este propósito, señalaré tres categorías de proyectos de acuerdo con su tamaño.

La primera categoría consiste de proyectos muy grandes y complejos, por ejemplo, minas de hierro, fábricas metalúrgicas, de productos químicos, etc. Cuando, como ocurre en la mayoría de los casos, no hay en el país personas con la capacidad técnica y la experiencia administrativa necesarias y con frecuencia falta también el capital indispensable, creo que no hay duda alguna de que la gerencia de la empresa debe estar a cargo de una firma extranjera experta. El costo de esos proyectos es muy elevado, los problemas técnicos son muy difíciles y las tareas administrativas y de dirección son muy complejas. No habrá muchos proyectos de esta clase, pero cuando existan, creo que la gerencia debe estar a cargo de extranjeros si se ha de conseguir la competencia necesaria.

En segundo lugar, hay proyectos que son muy pequeños, que emplean pocos trabajadores, tal vez hasta unos veinte y que en realidad sólo necesitan una persona como gerente. Es indudable que esos proyectos deben ser de carácter local. Lo que es importante en este caso es que se disponga de servicios complementarios gubernamentales que ayuden a la empresa local. Es de particular importancia que haya una corporación adecuada para financiar el desarrollo industrial. También es importante que exista un organismo público dedicado a las investigaciones científicas y técnicas, incluso investigaciones sobre el mercado, a fin de que facilite los datos que necesita un empresario local para decidir si es conveniente o no fabricar bicicletas o artículos textiles.

La categoría más difícil es la tercera, que abarca los proyectos de tamaño medio: por ejemplo, una fábrica de abonos, una factoría de cemento o un proyecto para la producción de medicamentos. En estos casos, los problemas administrativos pueden ser demasiado grandes y complejos para que puedan confiarse a personal del propio país, pero esto no quiere decir que el proyecto tenga que dejarse totalmente en manos de una gerencia extranjera. En este caso, creo que la solución es una empresa mixta con participación financiera local y extranjera y en que la composición de la gerencia más o menos guarde relación con las inversiones de los participantes locales y extranjeros en la empresa. La empresa mixta es, a mi juicio, la solución más eficaz a este nivel medio. Es preciso que los dos grupos sean seleccionados cuidadosamente. Los participantes extranjeros deben estar dispuestos a abordar el problema del adiestramiento no sólo de los trabajadores no especializados, sino también de los especializados, y especialmente del personal dirigente a nivel medio y superior. Los participantes locales pueden proporcionar los conocimientos indispensables acerca de las condiciones y limitaciones locales y, por lo general, pueden abordar mejor los problemas de las relaciones con las autoridades locales. De este modo, en esta amplia categoría media de industrias, cada participante aporta lo mejor que puede a la empresa colectiva.

Enero de 1963.

Lecture given by Martin M. Rosen
Executive Vice President of IFC
at the EDI on June 25, 1962.
(being pub'd in Oct 1962 issue of Development Research Review of National Planning Assn

SOME MANAGEMENT SHORTCOMINGS IN
UNDERDEVELOPED COUNTRIES AND THEIR REMEDIES

Martin M. Rosen

Among the principal causes of the lack of success of new industrial projects in underdeveloped countries is inadequate management. Specific examples of different kinds of management shortcomings, and of the remedies necessary for overcoming them are outlined in this abridgment -- beginning on the next page -- of a lecture recently given by Mr. Martin Rosen, Executive Vice President of the International Finance Corporation (IFC), at the Economic Development Institute of the World Bank.

The IFC is an autonomous international investment institution closely affiliated with the World Bank. Its operations are distinct, however, as it deals exclusively with private business. It invests in productive enterprises -- primarily industrial -- in member countries in underdeveloped areas to provide them with part of the capital needed to start or expand operations which will have a significant impact on economic growth.

In September 1961, its Charter was amended to permit it to make investments in capital stock. With the right to invest in equity as well as make loans, the IFC has increased flexibility of financing to meet the varying needs of private enterprise in the underdeveloped countries and to assist directly in the growth of capital markets in these countries by underwriting share issues pending their sale to the public. More recently, the IFC has established a Development Bank Services Department, which provides technical assistance in the promotion of new privately owned development banks, as well as advice and assistance to existing banks.

To date, the IFC has invested ~~close to~~ over $62 million in 20 countries and it has not only supplemented much larger amounts of private business capital, local and foreign, but it has also stimulated substantial additional private investment into participation. Essentially it has always been an investing rather than a lending institution, judging projects on their merits as investments for private capital.

"The problem I am going to talk about is that of management in private industry in developing countries. Some of what is said on the problem of management in private industry will be equally applicable to management in the public sector. In most approaches to the problem of industrial success, or industrial failure, it is assumed that management is the factor which makes the success or failure of the enterprise. By management is meant the combination of technical, administrative and business qualities, all of which combine together to determine whether a particular undertaking will be successful or not. Thus management means much more than the simple administrative organization of an enterprise. Defined in these broad terms -- as I believe it should be -- management certainly is the fundamental factor in determining the success or failure of industrial investment undertakings.

"There are many different elements which enter into making an industrial enterprise successful. One of them, of course, is the problem of obtaining sufficient capital for the investment on proper terms. Another is the problem of obtaining the proper number, quality and experience of the labor force. Another is the problem of making adequate studies of the project before the investment decisions have been undertaken. By adequate, I mean studies which would cover not only all the engineering aspects of the problem, but the marketing aspects as well. Finally, there is the problem of reaching proper agreements with the government to determine whether the project will receive governmental support or governmental opposition. It is in the effective study and consideration of these problems in advance, and then in the effective establishment and operation of the project taking account of these problems, that successful management is distinguished from unsuccessful management.

"Now I would like to talk a little about how we have considered successful management can effectively be obtained and how it can be fitted together. We in the International Finance Corporation have had the opportunity to review many different industrial projects in many different countries. We are familiar with the projects in which we have made our own investments, and we have examined perhaps a hundred or more other projects in which we have decided not to make investments. In reviewing these projects, we have consistently found that there are two key elements which determine their success. These two elements are accounting controls and management capability.

"The problem of inadequate accounting control has been present in each project which has caused us difficulty. In most cases, the problem of accounting has arisen because the company has started from a very small family-owned enterprise in which the leading member of the family in charge of the enterprise knew every fact about the business. It has then grown and developed until it was too big for one person, or for two of three brothers, or for a father and son, to know all the facts about the business.

"Let me tell the story of one of our projects, where we could see in advance that the accounting problem might become a very serious one. This is a company which manufactures electrical components for the automobile industry. The founder of the firm had a great deal of experience in this industry and he started manufacturing, almost by hand, small parts for motorcycles, for motorbicycles, and for automobiles -- generators, distributors, windscreen-wipers, etc. His son was trained as an engineer and entered the business.

"As the motor-car ~~industry~~ industry in the country in question grew, the problem of this enterprise was to grow as fast as the total automobile industry was growing. It had the exclusive license to provide electrical equipment for several types of motor-cars. If it were to maintain this exclusive license, it had to be able to produce as many parts as were needed or lose the franchise. Therefore, it had to expand. The expansion involved heavy financial cost for enlarging the existing plant and more important, the expense of building a new plant at some distance from the original one, where certain of the parts could be manufactured.

"The man who started the company is now about 60 years old. In his view, the problem of accounting was a very simple one as he explained it to me. He pulled a little book out of his pocket and he said, "On this page I write all the money I receive, and on that page I write all the money I pay, and as long as this page is more than that page, I have nothing to worry about." It is not as foolish as it sounds. While the company was a one-man controlled enterprise, he could always look in his pocket and see exactly what the intake of money was and what the outflow was. As long as he knew in his own mind that outflow of money was for raw materials which were going to result in bigger sales next month, he could keep effective control over the enterprise.

"However, when the enterprise expanded to include 800 paid workers, when he had two factories 200 miles apart, when the inventory of components became an inventory of ten thousand different pieces -- stampings, forgings, cuttings, forms -- it was no longer possible to keep all the information that was needed in his little notebook.

"We emphasized the accounting problem before we entered into this undertaking; we arranged to have a public accounting firm make an investigation of the company. More important, we required that the company enter into an arrangement with an accounting adviser to set up a system of accounting controls that went beyond the little notebook in the pocket. This meant a continuing system of inventory controls. It meant a continuing system of cost analysis, because the company was manufacturing many different parts and needed to have information as to which part was profitable and which part was not profitable.

"Also, it had a scheduling problem. For example, the company might receive information from a customer making motor cars that in the months of October-November-December the customer planned to produce 2,000 cars a month and would need, therefore, the components for a total of 6,000 cars. The company had to be in a position to manufacture before October the horns, the switches, and all of the other parts that had to go into the 6,000 cars. This required very complicated scheduling, because each of these finished products might require 10 or 50 different little pieces of metal to be cut out or to be stamped and fitted together. Clearly an accounting system was needed. Such a system has slowly been introduced, and is beginning to show its effectiveness. But, this is an example of a problem which was foreseen before the difficulty actually arose. A failure to take management action through approved accounting control might -- and I believe would -- have led to serious problems.

Another case that I will mention is that of a company which manufactures a product which is sold by another company which is owned by the same people who control the manufacturing company. Here the problem is that the profits accrue to the sales company to a greater extent than to the manufacturing company. This, too, is a problem of management in the sense that the outside investor, who is a partner in the manufacturing company, is not sure of being given a fair share of the profits of the enterprise.

A third example of a problem of inadequate management arises from a failure to make proper studies regarding the local situation prior to entering into the investment. This is a project which produces building materials out of a waste material. Under its process, the waste is put together with a very thin mixture of cement, yielding a building material something like cement block or cinder block.

The project was started in a tropical country by a man who was familiar with the success of the particular building material in Europe. He thought that he had made a careful study of the market possibilities, cost, and supply of raw materials. It appeared that there was sufficient raw material available. In consequence, he decided to start the project. At once, he ran into difficulties.

The first difficulty was that the raw material supply disappeared. The raw material was a waste material only as long as nobody wanted to buy it. Instead of being able to buy it at a price which was only a token above the costs of delivery and transportation, he found that it became known that this material was needed for his factory and accordingly, very high prices were charged for it -- prices which made the cost of production much higher than the cost of substitute building materials.

The second problem was that in this country the labor component of building construction costs was not very important. The country has surplus labor, wage rates were low, and therefore it was cheaper to use twice as many workers putting in bricks than half as many workers putting in cement blocks if they cost more than the bricks.

The third factor was that this special cement block had insulation qualities which were desirable in Europe but not in a tropical country where the weather is warm.

The lesson of this example is that the outsider coming in to make a study of the feasibility of a project, even if he is very familiar with the technical characteristics of the project, must guard against overlooking certain important local circumstances which are essential to the success of the project. You cannot meet your management decision problem by hiring an outside group to make a feasibility study. The feasibility study needs to be based on intimate knowledge of local circumstances and factors, and failure to take account of these local circumstances and factors will lead to difficulties.

A fourth example I want to mention is the problem of the size of the project being undertaken. The first problem was that the plant was designed too small. It was obviously unwise to build a plant to produce more of the particular product than could be consumed in the country. With the general world market situation what it is for the particular commodity, it was doubtful that the project could be produced at a cost which permitted it to compete in world markets. Hence, it was reasonable to limit its size to the domestic market. But, this meant that the plant would be a high-cost producer. It was intended that this problem would be solved by an agreement with the government of the country that there would be tariff protection against lower-cost imports.

The second problem was that the costs of building the plant were about 25% more than had originally been expected. I do not know how to pinpoint the exact reason for these increased costs.

The third problem was a technical one. In any manufacturing operation, it is not merely a matter of putting in equipment, pulling a switch, and letting it run. Almost every plant runs into technical problems which cannot be foreseen. In this case, one of the technical problems was that the water used for cooling had a greater mineral content than had been expected, and was clogging the cooling tubes. Because of this the equipment was working at a higher temperature than had been designed, resulting in corrosion by the sulphuric acid used in the plant. Consequently leaks developed and pumps broke down. Actually, this project had many fewer design problems than similar plants which I visited in other countries. I mention these unanticipated costs and technical difficulties only because they frequently occur in new enterpries.

There were other difficulties arising from the fact that the foreign engineers involved in the operation were not able to communicate effectively with the labor which was being trained to operate the plant. Certain of the mechanical difficulties developed simply because a valve was not turned every hour to divert the flow from one tank to another. The engineers said it was the fault of the workers who wouldn't do what they were told. The local management said it was the fault of the foreign engineers who should have gone to the factory each hour in order to make sure that the valve was turned.

These examples will suffice to illustrate some of the many different kinds of management problems that can arise in new or expanding industrial enterprises in less-developed countries. Before concluding my remarks, I would like to discuss two additional problems of management which I believe are of general applicability and importance.

kinds of management problems that can arise in new or expanding industrial enterprises in less developed countries. Before concluding my remarks, I would like to discuss two additional problems of management which I believe are of general applicability and importance.

"The first relates to the failure to establish a new industrial project with a capital structure which makes it possible for the enterprise to work successfully. In many cases, inexperienced managements have started enterprises with insufficient capital, or with capital which has been obtained on very onerous terms or with impossible conditions. All too frequently, we have seen enterprises in which the capital needed on a permanent basis has been borrowed on a short-term basis from banks or obtained on two-to-four-year credits from suppliers. An inexperienced management looks at optimistic financial forecasts for the new company and concludes that it will be profitable enough to repay credits obtained on a two or three-year basis. We have learned to be very suspicious of such proposals, because new projects are likely to have unanticipated difficulties which require more capital or longer-term capital than anticipated. The ability to forecast such difficulties and to anticipate the resulting capital requirements is one of the qualifications of good management.

"The second general point I wish to make concerns the appropriate relationships among the local government, local enterprise, and foreign enterprise from the point of view of ensuring adequate management competence. For this purpose, I would distinguish three categories of projects on the basis of size.

"The first category consists of very large and complex projects, for example, iron-ore mining, metal smelters, chemical plants, etc. Where, as in most cases, the country lacks people with the requisite technical skills and managerial experience, and often lacks the necessary capital as well, I think there can be no doubt that the management needs to be an experienced foreign concern. The cost of such projects is very large; the technical problems are very difficult; the administrative and managerial tasks are very complex. There will not be very many projects of this kind, but where they exist, I think the management will have to be foreign if the necessary competence is to be obtained.

"Second, there are the projects which are very small. These projects may involve a few workers maybe up to twenty -- and really require only one person as manager. Such projects should certainly be local. What is important here is that there be supporting governmental services which will help local enterprise. The proper kind of industrial development financing corporation is particularly important. It is also important that there be a public organization undertaking scientific and technical research, including market research, so as to provide the data needed by a local entrepreneur for deciding whether a bicycle or a textile plant makes sense or not.

"The more difficult category is the third, covering the middle range of projects -- for example, a fertilizer plant, a cement factory, a medical drug project. Here the management problem may be too large and complex for the experience available in the country, but the project may not be the kind that necessarily would have to be turned over completely to foreign management. In this case, I think the answer is a mixed enterprise with local and foreign financial participation, and in which the management relationship corresponds more or less to the ownership holdings of the local and foreign participants. The joint enterprise, the joint venture, is, I believe, the most effective solution at this middle level. The two groups need to pick each other carefully. The foreign participants have to be willing to tackle the problem of training, not only of unskilled workers, but also of skilled workers, and particularly of both middle-management and top-management people. The local participants must supply the indispensable knowledge of local conditions and limitations, and can usually best handle the problems of relationships with the local government. Thus, in this broad middle category of industrial enterprises, each participant contributes what he is best able to do to the joint venture."

Page 5 - FEMSA
Page 11 - Luven + Landrellos
Page ~~12~~ - Durisol
Page 16 - FerTisa

Remarks of Mr. Rosen
to the Economic Development Institute
on June 25, 1962

Let me start then by making the assumption that the industrial sector is an important sector if the developmental purpose is to be accomplished. The second assumption I would like to make is that in the development of the industrial sector the role of private industry is of great importance. Again I do not wish to get into dialectic, or as I sometimes call them, religious controversies as to whether industrial development should be accomplished privately or publicly. I happen to feel rather strongly myself that the industrial sector can in most cases be more effectively done privately than publicly, but nevertheless I think in any of the economies of any of the member countries there is the feeling that there is certainly a role for the private industrial sector.

The problem I am going to talk about is that of management in private industry. Some of what is to be said on the problem of management in private industry will be equally applicable for management in the public sector, and to this extent we can keep away from the need to consider this controversial question of how industrial development should take place.

The concept of management has become almost a mystique. It has become, when I use the word mystique, it has become this very significant factor, partially because of the way management is defined. In most approaches to the problem of industrial success, or industrial failure, it is assumed that management is that which makes the success or failure of the enterprise, By this is meant the combination of the technical, the administrative, the business qualities, all of which combine together to determine whether a particular undertaking will be successful or not.

Now naturally, when management is defined in these broad terms, management necessarily becomes a fundamental factor determining whether something will be successful. Yet however I think it is desirable that management should be defined in these broad terms. Management means much more than the simple administrative organization of an enterprise, and because it does mean so much more is the reason why management, in my opinion, is the fundamental factor in determining the success or failure of industrial investment undertakings.

There are many different elements which enter into making an industrial enterprise successful. One of them of course is the problem of obtaining sufficient capital for the investment on proper terms. One of them is the problem of obtaining the proper number, quality and experience of the labor force. Another one is the problem of making adequate studies of the project before the investment decisions have been undertaken, studies which would cover all the engineering aspects of the problem, studies which would cover the marketing aspects as well. Finally there is the problem of making proper understandings with the government, as to whether or not the project will be one which will receive governmental support or receive governmental opposition. This is on the assumption that it is a private project.

All of these elements must be put together in the preparatory stage of considering a project. All of these elements must then, after the project has been considered, be fitted together into the operation of the project. It is in the effective study and consideration of these problems in advance, and finally the effective consideration and operation of the project taking account of these problems, that successful management is distinguished from unsuccessful management.

Now I would like to talk a little a bit about how that kind, how what we have considered as successful management, can effectively be obtained and how it can be fitted together. We in the International Finance

Corporation have had the opportunity to review many different industrial projects in many different countries. We have seen the projects in which we have made our own investments, and we have seen perhaps a hundred or more other projects which we have studied and where we have decided not to make investments. In seeing these projects, we have consistently found that there are two key elements which determine their success. I am going speak frankly and off the record here, because I am going to talk about names, I am going to talk about countries, I am going to talk about names of companies.

We have recently established in the IFC a Committee of Advisers consisting of the leading of the leading bankers of the world. We have a Committee of five bankers, one French, one German, one British, and two Americans who are the outstanding industrial bankers of their countries. We have brought each of these people to Washington to meet with us and to review our portfolio of investments. We have in particular reviewed the investments which have been unsuccessful. And we have investments among ours which have been unsuccessful. The conclusion which has emerged from this review has been that there are two elements which stand out as being the key factors resulting in the lack of success of the ten projects or so which are causing us problems. These two elements are accounting controls and management capability.

The problem of accounting control has been present in each project which has caused us difficulty. In most cases the problem of accounting has arisen because the company has started from a very small family-owned enterprise in which the leading member of the family in charge of the enterprise knew every fact about the business. It has then grown and developed into a situation where it was too big for one person, or for two or three brothers, or for a father and son to know all the facts of what was going on in the business.

Let me tell the story of one of our projects where this, where we have not yet had trouble, but where we could see in advance that the accounting problem would be a very serious one. This is a company in Spain called FEMSA. It is a company which manufactures electrical components for the automobile industry. It was a company which was begun twenty-five or thirty years ago by an Italian engineer who moved to Spain. He had a great deal of experience in this industry and he started manufacturing, almost by hand, small parts for motorcycles, ~~motorbikes~~ for motorbicycles, and for automobiles--generators, distributors, windscreen-wipers, all of the electrical equipment that is used in magnetos, the electrical equipment used in the motor-car - motor-bicycle industry. He had a very successful enterprise.

His son was trained as an engineer and entered into the business. They had a successful plant in Madrid.

As the motor-car industry in Spain grew, the problem of this industry was that it had to grow as fast as the total automobile industry was growing. It had the exclusive license to provide electrical equipment for several types of motor-cars. If it were to maintain this exclusive license, it was essential that it should be able to produce as many parts as were needed or lose the franchise. Therefore it had to expand. The expansion involved heavy financial cost for enlarging the plant in Madrid, and more important in cost, the expense of building a new plant in a smaller town outside of Madrid where certain of the parts could be manufactured.

The man who started the plant is now a man of about 60 years old. He was about 30-35 years old when he came to Spain and when he began this enterprise. In his view, the problem of accounting is a very simple one and he explained it to me. He pulled a little book out of his pocket [redacted] and he said, "On this page I write all the money I receive and on this page I write all the money I pay, and as long as this page is more than this page, I have nothing to worry about." It is not as foolish as it sounds, because in fact while the enterprise was worked as a one-man controlled enterprise, as long as he [redacted] was in the position that he could always look in his pocket and see exactly what the intake of money has been and what the [redacted] outflow has been, as long as he knew in his own mind whether that outflow of money was for raw materials which were going to result in a bigger amount of sales the next month when he turned the page and started on another page, he could keep effective control over the enterprise.

However, when the enterprise expanded to a plant of 800 paid workers, when the enterprise expanded so that he had one factory in Madrid and another factory 200 miles away, when the enterprise expanded to a position where the inventory of components becomes an inventory of ten thousand different pieces, different types of stampings, of forgings, of cuttings, of forms, it is no longer possible in his little pocket to keep all the information that is needed.

We emphasized the accounting problem before we entered into this undertaking; we arranged to have a public accounting firm make an investigation of the company. And I might say parenthetically that it is a requirement of the IFC that [redacted] before it will make an investment in any company, that an audit to that company should be made by an outside accounting firm. This is a standard requirement which we have. We required this to be made, but more important we required that the company should enter into an arrangement with an accounting adviser to set up a system of accounting controls that went beyond the little red book in the pocket. This meant a continuing system of inventory controls, it meant a continuing system of cost analysis because the company was manufacturing many different parts and it needed to have information as to which part was profitable and which part was not profitable. It didn't have that kind of analysis.

More important, it had to enter into a scheduling problem. If they received information from the manufacturer of the Fiat motor-car that in the month of October-November-December Fiat planned to produce 2000 cars a month and would need therefor the components for 6000 cars, this company had to be in a position to manufacture before October the horns, the clacktons, the switches, all of the parts that had to go into the cars so there would be 6000 of each of these available by September. Doing this required very complicated scheduling because each of these finished products might require 50 or 250 different little pieces of metal to be cut out or to be stamped, and what was needed was an effective production scheduling program which would make sure that they produced exactly as many little pieces bent four times to go into the horn as would be needed.

Now some of these little pieces went not only into the magneto, but also into the distributor, so for these they would need not 6000, but 12,000. All of this would have to be worked out, and clearly an accounting system was needed to be able to do this. The system has slowly has been introduced, and I think at this point is beginning to show its effectiveness. But this is the example of the situtation in which one could see before the difficulty arose that the failure to take management action through approved accounting control would lead to serious problems.

One has the separate problem which arises also out of this case. That problem is the question of how profitable or how successful the enterprise will be. This problem arises from the fact that there is in Spain, as in other countries, the practice of keeping two or three of books. One set of accounting records is kept for the tax-collector and another set of accounting records is kept for the owner. This is not unusual. This happens in many different countries. We feel that action to correct this situation should be taken in two ways.

One way is to make the tax system a reasonable system and sometimes the cause for a double set of books is because taxation is an impossible system is an impossible system of taxation, and in fact the tax authorities openly accept the fact that the official records kept for tax purposes are not correct. The other direction [redacted] in which we try to press is to emphasize to the entrepreneurs with whom we are dealing that it is in their own interests to try to keep accurate sets of books in order to be able more effectively to do their management problems.

Finally we have a separate problem which occurs to us if we invest in a company of this sort, and that is that we want to be sure that the set of books which we see is the set which the management has and not the set which the tax-collector has. We want to be able to know what the real condition of the company is.

Now I have given this case of a company where one could see the management problem developing in advance of the difficulty and where we were able to take action which we think will solve the management problem. Let me give one or two other examples of where weaknesses of management have caused difficulty.

One case that I will give is the case of a company in Peru which manufactures bricks. In this case the company manufacturing the brick has relationships with companies which sell the bricks and companies which supply the raw materials. Here the problem is that the profits accrue to the sales company to a greater extent than they are accruing to the manufacturing company. Now this is a problem of management in the sense that the investor, the partner in the company, is not being given a fair share of the profits of the enterprise.

Lusen & Ladrillos

We have another project which is in difficulty where the managment problem is not like the first two I have talked about so far, but where the management problem is one of failure to make proper studies for the market for the product prior to entering into the project. This is a project which also produces building materials. It produces the building material out of a waste agricultural product. It intended to produce the material from using the straw which was waste after the rice was harvested. This is a process whereby the straw is put together with a very thin mixture of cement and makes a building material which is something like cement block or cinder block. Using a waste material it is, of course, a very cheap product. It is a product which is used rather extensively in Europe; it is used also in some other South American countries.

This particular product has two advantages. One of them is that it uses relatively little cement and a good deal of a waste material and therefore its raw material cost is low. The second advantage that it has is that it is easier to work and to use in building walls than bricks or cinder blocks or cement blocks. Therefore in countries where the labor cost of construction is an important part of the cost of construction, the saving in the labor cost is important. This particular project was started in the country, in the South American country in question, by a man who was familiar with its success in Europe. He made a careful study, he thought, of the market possibilities; he made a careful study of the cost; and he made a careful study of the supply of raw materials, and it appears that there was sufficient raw material available which was presently being wasted or burned. He started the plant and then he ran into difficulties.

The first difficulty was that the raw materials supply disappeared. The reason the raw materials supply disappeared was that the grass, the rice grass, was a waste material only as long as nobody wanted to buy it. As soon as somebody ~~wanted~~ was willing to pay something for it, it was no longer a waste material; and instead of his being able to buy the straw at prices which were only a token above the costs of delivery and transportation, he found that the farmers knew that this material was needed for his factory and tried to charge very high prices for it--prices which made the cost or production much higher than the cost of substitute building materials. The difficulty here was the amount of the supply of the raw material. In fact he needed to collect a considerable amount of the waste straw within the geographic area from which transportation was possible. If in fact, he had needed only 5% of the amount of waste material, this problem would not have developed.

But what he needed was something like 50% of the amount of the material in this area, and therefore it became quite easy for the farmers to raise the price. That was the first problem.

The second problem was that in the country in question, the cost, the labor costs of building construction is not very important. This country has surplus labor, wage rates are low, and therefore it is cheaper to use twice as many workers putting in bricks than it is to use half as many workers putting in blocks if ~~a~~ the blocks cost more than the bricks.

The third factor was that the bricks, as contrasted to this special building material, do not have an advantage that the special building material has. That special building material has insulation qualities, and in temperatures that get very cold, ~~in European~~ temperatures, of the European type, the insulation is valuable. But in this particular country there wasn't the weather problem and therefore this insulation problem did not ~~exist~~ occur.

Here then we have the fault of management--~~management~~ in the sense that it examined all three of these questions, but did not know enough about local circumstances to draw the proper conclusions. For these problems to have been avoided, it would have been necessary that management decisions were based on a very accurate knowledge of what the production of the rice straw was in the vicinity of the plant, of whether there was any alternative material that could be used (there is, and that material is bagasse, the sugar waste product). What should have been done should have been to have determined whether there was an alternative material, to have made provision to have used either one, so that if the price of one went up, the other would have been able to have been substituted. There should have been an investigation of what the advantages of these building blocks were as against bricks, taking account of these other factors. With all of this, I think the conclusion probably would have been not to go ahead with the plant.

Now here the lesson to be learned is that the outsider coming in to make a study of the feasibility of a project, even if he is very familiar with the technical characteristics of the project, is likely to fail to observe certain important local circumstances which are essential to the success of the project. The lesson I draw from this is to say that you cannot meet your management problems by going out and hiring an outside group to come in and make a technical study, a feasibility study; that the feasibility study needs to be based on intimate local knowledge of local circumstances and factors, and the failure to take account of these local circumstances and factors will lead to difficulties.

A third example I want to give is that of another project. This project was a project for the production of fertilizer. It was a project for the production of nitrogen in, also in this case, in Peru. As I say, I am speaking very frankly in this talk, I am mentioning countries, I am mentioning companies, I'd like this to be considered off the record. This project is a project which ultimately will be successful, but which has now run into difficulties. And the reason it has run into difficulties is also of a great deal of interest.

It is a project to take petroleum, manufacture ammonia from this, use the ammonia to manufacture ammonium nitrate - ammonium sulphate, the normal fertilizer operation that has possibly been considered in most of your countries at some time or other. The first problem that developed in this case is that the design of the ammonia plant was too small. This design, which was done in 1955, was based upon the demand for fertilizer in Peru, and this was the limiting factor. It was obviously unwise to build a plant to produce more fertilizer than could be consumed. [redacted] I think no further comment is needed on that. With the general world fertilizer situation what it is, there are very few countries that are going to be able to produce ammonium sulphate or ammonium nitrate economically to compete in world markets. The only possible opportunity is a domestic market where there is some willingness to pay a somewhat higher price, world market prices, in order to get the advantages for the agricultural sector.

The ammonia plant was designed too small. This meant that it was a high-cost producer. This problem was intended to be solved by an agreement with the Government that there would be protection, tariff protection, protection against dumping. The second problem that developed was that the costs of building the plant ended up being about 25% more than had originally been expected. I do not know how to pinpoint the exact reason for these increased costs. Sufficient be it to say again that our experience with many, many projects has been that it is only safe to go ahead in a project provided that project will be economical, even if the costs are much higher than originally estimated.

The third problem which developed was a technical problem. And here too there is a lesson to be learned which is, that in any manufacturing operation, it is not merely a question of putting in equipment, installing it according to the directions and pulling a switch and letting it run. Almost every plant runs into technical problems which were not to be foreseen. One of the problems in this case was that the water which was used for cooling water was harder water than had been expected, had a greater mineral content, and therefore there was a faster clogging of the cooling tubes; the deposit filled up in the cooling tubes faster than had been expected. Because of this the prop-head was working at a higher temperature than had been designed. This higher temperature meant that the sulphuric acid which is used in the plant was at this higher temperature, and the corrosive effect of sulphuric acid is dependent on its temperature. Consequently certain leaks developed, certain connections broke. The pumps which should have worked were corroded by the sulphuric acid. This is a very small problem, and yet this kind of design problem happens continually in any new project undertaken. This project had many fewer design problems than occur in other similar operations. I have visited similar fertilizer plants in Korea, Formosa (where the plant was ? not operating for 18 months after the design period because of the same kind of problem).

I have just mentioned the fact that there was an overrun of costs and that this normally happens. I have mentioned the fact that there were these difficulties in the technical operations and that these frequently happen. There were other difficulties arising from the fact that there was a group of foreign engineers involved in the operation who were not able to communicate effectively with the labor which was being trained to operate the plant. Certain of the mechanical difficulties developed simply because the valve was not turned every hour as it should have been to move from this tank to that tank. There were alternate tanks, each would work for an hour, it was necessary at the end of one hour to turn off this tank, to turn on this tank, and to refill this tank. And if the time period went on from an hour to an hour and fifteen minutes before the valve was turned off, the chemical which was entering the process from this tank didn't enter, and therefore there would be a breakdown. Whose fault was this? The engineers who were there said it was the fault of the laborers who wouldn't do what they were told. The local management, the local people involved, said it was the fault of the foreign engineers; they weren't frequently enough on the floor of the factory, they should have come out each hour in order to make sure that the valve was turned.

A related problem ~~which~~ that developed, which I think probably couldn't have been foreseen, or couldn't have been helped, was a serious union problem. This area is an area in which the Communist Party is quite active; ~~and the union operates~~ industry is unionized and the union operates as an instrument of political policy rather than only as an instrument of labor policy. The ~~company, the~~ workers would go out on strike in political opposition to certain actions taken by the Government. It would be a strike against the Government rather than a strike against the company. This I see no answer for. This is an inherent problem which again exists in many different countries. There is no simple solution to this problem. I don't think this is a management problem, but this needs to be understood and met when it arises.

We thought that the management situation in this company would be very well taken care of because management responsibility was given to Montecatini, which is one of the biggest chemical companies in the world and one of the most successful chemical companies in the world. Not only was management responsibility given to Montecatini, but Montecatini had a 25% investment in the company, so they had not only a problem of their reputation, but they had ~~[illegible]~~ the problem of the safety of their investments.

The problems that developed, however, were problems which can develop in any kind of a case. There was first of all the fact that ~~the company was too small,~~ the plant was too small. When world market prices dropped, farmers in the country pressured the Government to lower the price of fertilizer in accordance with the drop in world prices. This company, since it ~~[illegible]~~ had a plant that was below the optimum size, could not lower its costs in line with world market costs. A company producing 30,000 tons of fertilizer cannot compete with a company producing 300,000 tons of fertilizer.

Secondly, all of the financial charges increased because of this overrun. Thirdly, there developed rather strained relationships between the Montecatini personnel in the plant and the local personnel. These strained relationships were the result of misunderstandings in part, were the result of the fact that they were dealing with a company that was having difficulties rather than with a company that was having successes, they were the result of language difficulties which always arise, they were the result of the cultural differences in the backgrounds of people which also always arise, they were the result of these various labor factors that I have mentioned before. They were also partially a result of the fact that there was a desire to give all of the management responsibility but not all of the management authority to Montecatini, even though Montecatini held only a 25% interest in the company.

Now at this point, I think we have resolved these problems. We have arranged for an expansion of the plant to a size which makes it more economic in terms of its cost of production. We have worked out a new financial plan which reduces the burden of financial charges. We have arranged with the Government for a basis of tariff protection which does not impose a very large burden on the farmer, but provides some help to the company. We have worked out between Montecatini and the Peruvian personnel a new basis of relationship. And at this point I believe we have solved many of the difficulties.

But again I believe there is an important lesson to be drawn from this particular operation. That lesson is that the problems of management do not get solved by importing and imposing a foreign management group. Many times in discussions I've had in some of the 50 countries I've visited, I've heard the answer given that we recognize the management problem, but we can meet this by hiring management from outside. Let me say that I don't believe the management problem can be met that way. I think, if I may come back to one of the assumptions I made at the beginning, this is why I believe the private rather than the public industrial company is the more efficient. I don't think it is possible to set up a government steel mill or even a local private steel mill and hire outside people to come in and run it. All of the problems that developed in the Montecatini case in Peru are going to develop in this kind of case. Who has the final responsibility? Who has the responsibility for determining whether the plant can operate with 600 workers or with 400 workers?

(Indian)

But one of the problems in the Peruvian plant is that the construction of it was done before Montecatini came in, the building of it; it was done by the same company; these workers were hired by the company; and under

Peruvian law, once a worker is hired, you can't fire him except for cause, you can't fire him because he is not needed for the efficient operation of the plant, you can only fire him if he's dishonest or he does something wrong. So when they brought in 600 workers in order to lay the bricks and lay the foundations, they ended up with 600 workers who had to stay with the plant once it was producing fertilizer. And in bringing in a foreign management group you've got this basic problem of what will be local labor policies. ~~This is~~ Is it going to be determined by the foreign management group who's been hired? The answer to that is obviously no. You can't hire a management group and expect that they're going to take over that kind of responsibility.

Second problem is, How are you going to handle management relations with Government? Again the foreign group can't take that. If [redacted] this were [redacted] entirely a Montecatini operation, this couldn't be done. [redacted] In my opinion the only successful way to do this is to have management closely related to ownership, and to have that management to the maximum extent possible local management, or to have a partnership management relationship which leads to local management.

These are several case studies I've mentioned of the problems of management. I could give some others where the management's abilities have been successful in making operations profitable, economic, where one would have thought they would have ended up being uneconomic. But I think the points have been made as to what the role of management is, why that role is of fundamental importance especially in industrial undertakings, and why I believe it is important that the management responsibility be, to the extent possible, locally oriented with understanding of local conditions and that the management responsibility be closely related to the ownership of the enterprise.

At this point I would like to stop and answer any questions.

Q: Which is more important, technical competence, management or capital?

A: I think it's fair to say the factor of capital is fundamental to the success of an enterprise. Also, of course, one of the aspects of management is to understand properly the extent to which capital is required and to get a capital structure which makes it possible for the enterprise to work successfully. In many cases inexperienced management has started enterprises with insufficient capital or with capital which has been obtained on very onerous terms or with impossible conditions. Very frequently we have seen enterprises which have begun where the capital which has been needed for a permanent basis has been borrowed on a short-term basis from banks or has been borrowed on a two-to-three-year basis or four-year basis from suppliers credits. The inexperienced management will look at the financial forecasts for the company and will think that the company will be profitable enough so that he can finance [redacted] his enterprise on a two-year basis or on a three-year basis. Every week I have people coming into my office who explain that all they need is another $100,000 or another $250,000 and that they have a project which will make so much money that it can be paid off in a year or paid off in two years. I have learned to be very suspicious of these projects and I have learned to be very suspicious of the ability of the people who present these projects because in fact a new project is likely to have the unanticipated difficulties which require more capital or require capital on a longer-term basis. The ability to forecast these difficulties or at least to anticipate the possibility of these difficulties and to be prepared to meet them if they arise is one of the problems of management.

Now, which is more important, the management or the money? Which is more important, the technical ability or the money? I don't know. I think what is needed is the combination of proper technical competence, married together with satisfactory amount of financing, made available on a suitable basis to the project and for the unexpected and unfortunate developments that will arise. It is often said that you can go out and get the technical facilities and it is true you can hire engineers. You can't hire them very easily; you may not be able to hire engineers who are experienced in this particular operation; but frequently you can hire the purely technical ability. But getting the technical ability in by itself is not enough. In the Peruvian case that I mentioned, there were excellent fertilizer technical personnel. They said the problem was that the workers didn't turn a valve every hour. They said they should turn them; they issued an instruction that they should be turned; and the valves weren't turned every hour. They said, "All we can do is say 'Do it.'" Now what management has to do is to see that the technical advice is brought together with the carrying out of this, just as management has to see that the financial requirements are brought in in a way which could make it possible to meet all these needs.

Q: Are the same principles and problems of management applicable to agricultural projects as are applicable to industrial projects?

A: I think in general the answer is yes. Although there are certain differences. One of the differences is that agricultural policy of governments is I believe more formed by national considerations than is the case for industrial policy. Let me explain. In a country in which agriculture is the dominant productive sector, where 75% of the population are engaged in agriculture, where the bulk of the national income is generated by agriculture, there will be certain public policies concerned with agriculture which take into account political, social and national considerations over and above the economic considerations. On the other hand the policy in terms of a factory which produces shoes, or even a factory which produces fertilizer, will be or should be more concentrated on economic considerations than is the agricultural project. A second difference is that much of agriculture is done either at what might be called the peasant level or the individual farm level. And in these cases the problems are of course very, very different ~~than~~ ~~certainly~~ the problem of managing the holding of an individual landowner is complicated, but it's more like the problem of the small merchant managing his affairs than it is like the problem of an industrial enterprise [redacted] with 50 workers or 250 workers. When one gets into what is called plantation agriculture, which I think is of a great deal of interest to most of your countries, then the problem of management becomes of course much more similar to those of industrial enterprises. Here, however, there are again certain national interests which interpose. Whether your countries, for example, are going to develop the production of coffee, and the extent to which there should be plantation development of coffee or cocoa production depends on market considerations which the individual plantation owner is not in a position to make very meaningful decisions on. Whereas a project for the manufacture of small motors for motorbicycles is a project where the entrepreneur can decide what the market is likely to be. So these aspects of agricultural enterprise are different from industrial enterprise. But in plantation agriculture the problem of accounting, of cost control, of inventory control, of investment financing, of labor scheduling, of recruitment and training, all of these problems are the same.

Q: Would IFC finance a project that is soundly organized but lacks management? If so, how is sound management to be obtained?

A: If a project is presented to us for financing, or a project is presented to any financial institution for financing, one of the questions which must be answered "yes" is that there is satisfactory management or arrangements to obtain satisfactory management. [redacted] So that the answer to the question as you put it was, if we have a project properly studied, properly engineered, properly financed, properly surveyed, but without the people, the management personnel available, would we finance it? the answer is no, we would not. Nor I think would any financial institution. But the question, of course, is a broader question than this. The question is, in a country which does not have a large cadre of management personnel, how can a beginning be made at doing these projects? I believe this is the question you have in mind. I think to answer this question we need to look at three different types of projects. In a country, I don't know the Ivory Coast, but a country like Gabon for example, there may be projects that are very large. There is for example the Kabala project, the iron project in Gabon, which is a very big project. In this

I think there is no doubt that the management needs to be foreign. The cost of the project is a very large cost, the technical problems are very difficult, the administrative and managerial problems are difficult. And in this kind of very big project, management, I believe, needs to be foreign. There will not be many projects of this kind, but where they exist, I think you will have foreign management. The Volta smelter in Ghana is the same kind of project. Secondly, there are the projects which I would call the very small projects. Now these projects are projects which may involve a few workers, ten workers, five workers, may end up with twenty workers, but really involve one person as management. The way the Spanish example which I gave began thirty years ago. Now I believe that you do have in most of your countries personnel who can do this kind of operation; maybe not many but there are. I think what is important is that there be supporting services which will help them. In my opinion the existence of the proper kind of an industrial development financing corporation, something which inthe Spanish-speaking countries they call the Financiera, is very important. ~~I think it is also important that if the~~ And I think that can be quasi-public, quasi-private. I think it is also important that there be something which again in the Spanish-speaking countries they call a Fomento which is a public organization which is infact doing research, which is doing scientific and technical research, is doing some market research, is doing the preparation which makes it possible for the entrepreneur to decide whether a bicycle or a plant makes sense or not, It does the research which makes it possible to know what the costs are of putting in a small-scale textile operation, of putting in the finishing facilities for a gray-cloth plant. This will help in the very small operations. The more difficult field is the middle range. The industry which is important to the country, the fertilizer plant, the cement plant, perhaps a chemical plant, an industry which is important to the country but is not a huge monolithic enterprise like the Volta smelter, where the management problem is too large for the experience available in the country, but where the project is not the kind that it could possibly beturned over fully to foreign management. In this case I think the answer is a mixed enterprise in which there is local and foreign financial participation and in which there is management relationship worked out by the ~~firm~~ foreign and the local group corresponding more or less to their ownership holdings. My Peruvian fertilizer example had many difficulties, but nevertheless these problems are being solved, and Peru does have a fertilizer plant; it is now operating successfully and I think will be operating profitably. It has been able to be solved because there was a joint management responsibility, because there was a joint ownership responsibility. [redacted] The joint enterprise, the joint venture, is I think, the only solution to this middle level. The groups need to be picked carefully, they need to undertake the problem of training, not only training unskilled workers, training skilled workers, training what are called middle-management people, and training top-managers. But this happens. I spoke yesterday to a small [redacted] group of leading American businessmen, examining the same question of what the American business community can do in the development process. They [redacted] fully recognize the fact that any investment they make involves an important element of training management to take over.

Q: Could not internationally-established institutions often provide [redacted] more efficient management than locally available personnel?

A: What I was trying to say is that bringing in the foreign group, even with an international reputation, does not by itself solve all the problems. What is necessary is to bring in, for the preliminary studies, people who are experienced in the undertaking in question. But equally important is to make sure that that group is experienced in the local conditions, the local circumstances, and the local problems. It is very different to do the planning for a pulp and paper factory in France than to do the planning for a pulp and paper factory in Africa. We have seen exactly this kind of problem developing. The chemistry tends to be somewhat different. The problem of the laboratory controls tend to be different. The assumption that there will be available at short notice the materials necessary to rectify a problem if it develops, either that there will be the acids available or that there will be the chemicals available which may be needed to make the mixture the proper one. If one is dealing in Africa, or if one is dealing in Honduras, or if one is dealing in the Philippines, these materials may not be available overnight. Whereas if one is dealing in France, they can be provided out of Paris. So that the studies must be done not only by someone who has a world-wide experience in the industrial process, but by people who have familiarity with the particular problems of the locality. I don't want to imply that one shouldn't get a group which has world-wide experience. Far better to have that than not. All I am saying is that bringing in a company which does have this world-wide reputation does not solve the problem unless one also brings in knowledge of local circumstances.

#

From October 1962 issue of Development Research Digest,
published by National Planning Association, Washington, D.C.

Address June 25, 1962

SOME MANAGEMENT SHORTCOMINGS IN UNDERDEVELOPED COUNTRIES AND THEIR REMEDIES

Martin M. Rosen

[Among the principal causes of the lack of success of new industrial projects in less developed countries is inadequate management. Specific examples of different kinds of management shortcomings, and of the remedies necessary for overcoming them are outlined in this abridgment -- beginning on the next page -- of a lecture recently given by Mr. Martin M. Rosen, Executive Vice President of the International Finance Corporation (IFC), at the Economic Development Institute of the World Bank.

The IFC is an autonomous international investment institution closely affiliated with the World Bank. Its operations are distinct, however, as it deals exclusively with private business. It invests in productive enterprises -- primarily industrial -- in member countries in underdeveloped areas to provide them with part of the capital needed to start or expand operations which will have a significant impact on economic growth.

In September 1961, its Charter was amended to permit it to make investments in capital stock. With the right to invest in equity as well as make loans, the IFC has increased flexibility of financing to meet the varying needs of private enterprise in the less developed countries and to assist directly in the growth of

Martin M. Rosen is Executive Vice President
of the International Finance Corporation.

capital markets in these countries by underwriting share issues pending their sale to the public. More recently, the IFC has established a Development Bank Services Department, which provides technical assistance in the promotion of new, privately owned development banks, as well as advice and assistance to existing banks.

To date, the IFC has invested over $62 million in 20 countries and it has not only supplemented much larger amounts of private business capital, local and foreign, but it has also stimulated substantial additional private investment into participation. Essentially, it has always been an investing rather than a lending institution, judging projects on their merits as investments for private capital.]

[Following is an abridgment of Mr. Rosen's lecture:]

The problem I am going to talk about is that of management in private industry in developing countries. Some of what is said on the problem of management in private industry will be equally applicable to management in the public sector. In most approaches to the problem of industrial success, or industrial failure, it is assumed that management is the factor which makes the success or failure of the enterprise. By management is meant the combination of technical, administrative and business qualities, all of which combine together to determine whether a particular undertaking will be successful or not. Thus, management means much more than the simple administrative organization of an enterprise. Defined in these broad terms -- as I believe it should be -- management certainly is the fundamental factor in determining the success or failure of industrial investment undertakings.

There are many different elements which enter into making an industrial enterprise successful. One of them, of course, is the problem of obtaining sufficient capital for the investment on proper terms. Another is the problem of obtaining the proper number, quality and experience of the labor force. Another is the problem of making adequate studies of the project before the investment decisions have been undertaken. By adequate, I mean studies which would cover not only all the engineering aspects of the problem, but the marketing aspects as well. Finally, there is the problem of reaching proper agreements with the government to determine whether the project will receive governmental support or governmental opposition. It is in the effective study and consideration of these problems in advance, and then in the effective establishment and operation of the project taking account of these problems, that successful management is distinguished from unsuccessful management.

Now, I would like to talk a little about how we have considered successful management can effectively be obtained and how it can be fitted together. We in the International Finance Corporation have had the opportunity to review many different industrial projects in many different countries. We are familiar with the projects in which we have made our own investments, and we have examined perhaps a hundred or more other projects in which we have decided not to make investments. In reviewing these projects, we have consistently found that there are two key elements which determine their success. These two elements are accounting controls and management capability.

The problem of inadequate accounting control has been present in each project which has caused us difficulty. In most cases, the problem of accounting has arisen because the company has started from a very small family-owned enterprise in which the leading member of the family in charge of the enterprise knew every fact about the business. It has then grown and developed until it was too big for one person, or for two or three brothers, or for a father and son, to know all the facts about the business.

Let me tell the story of one of our projects, where we could see in advance that the accounting problem might become a very serious one. This is a company which manufactures electrical components for the automobile industry. The founder of the firm had a great deal of experience in this industry and he started manufacturing, almost by hand, small parts for motorcycles, for motorbicycles, and for automobiles -- generators, distributors, windscreen-wipers, etc. His son was trained as an engineer and entered the business.

As the motor-car industry in the country in question grew, the problem of this enterprise was to grow as fast as the total automobile industry was growing. It had the exclusive license to provide electrical equipment for several types of motor cars. If it were to maintain this exclusive license, it had to be able to produce as many parts as were needed or lose the franchise. Therefore, it had to expand. The expansion involved heavy financial cost for enlarging the existing plant and, more important, the expense of building a new plant at some distance from the original one, where certain of the parts could be manufactured.

The man who started the company is now about 60 years old. In his view, the problem of accounting was a very simple one, as he explained it to me. He pulled a little book out of his pocket and he said, "On this page I write all the money I receive, and on that page I write all the money I pay, and as long as this page is more than that page, I have nothing to worry about." It is not as inadequate as it sounds. While the company was a one-man controlled enterprise, he could always look in his pocket and see exactly what the intake of money was and what the outflow was. As long as he knew in his own mind that the outflow of money was for raw materials which were going to result in bigger sales next month, he could keep effective control over the enterprise.

However, when the enterprise expanded to include 800 paid workers, when he had two factories 200 miles apart, when the inventory of components became an inventory of ten thousand different pieces -- stampings, forgings, cuttings, forms -- it was no longer possible to keep all the information that was needed in his little notebook.

We emphasized the accounting problem before we entered into this undertaking; we arranged to have a public accounting firm make an investigation of the company. More important, we required that the company enter into an arrangement with an accounting adviser to set up a system of accounting controls that went beyond the little notebook in the pocket. This meant a continuing system of inventory controls. It meant a continuing system of cost analysis, because the company was manufacturing many different parts and needed to have information as to which parts were profitable and which parts were not profitable.

Also, it had a scheduling problem. For example, the company might receive information from a customer making motor cars that in the months of October-November-December the customer planned to produce 2,000 cars a month and would need, therefore, the components for a total of 6,000 cars. The company had to be in a position to manufacture before October the horns, the switches, and all of the other parts that had to go into the 6,000 cars. This required very complicated scheduling, because each of these finished products might require 10 or 50 different little pieces of metal to be cut out or to be stamped and fitted together. Clearly an accounting system was needed. Such a system has slowly been introduced, and is beginning to show its effectiveness. But, this is an example of a problem which was foreseen before any difficulty actually arose. A failure to take management action through approved accounting control might -- and I believe would -- have led to serious problems.

Another case that I will mention is that of a company manufacturing a product which is sold by another company owned by the same people who control the manufacturing company. Here the problem is that the profits accrue to the sales company to a greater extent than to the manufacturing company. This, too, is a problem of management in the sense that the outside investor, who is a partner in the manufacturing company, is not sure of being given a fair share of the profits of the enterprise.

A third example of a problem of inadequate management arises from a failure to make proper studies regarding the local situation prior to entering into the investment. This is a project which produces building materials out of a waste material. Under its process, the waste is put together with a very thin mixture of cement, yielding a building material something like cement block or cinder block.

The project was started in a tropical country by a man who was familiar with the success of the particular building material in Europe. He thought that he had made a careful study of the market possibilities, cost, and supply of the raw material. It appeared that there was sufficient raw material available. In consequence, he decided to start the project. At once, he ran into difficulties.

The first difficulty was that the raw material supply disappeared. The raw material was a waste material only as long as nobody wanted to buy it. Instead of being able to buy it at a price which was only a token above the costs of delivery and transportation, he found that it became known that this material was needed for his factory and accordingly, very high prices were charged for it -- prices which made the cost of production much higher than the cost of substitute building materials, such as bricks.

The second problem was that in this country the labor component of building construction costs was not very important. The country has surplus labor, wage rates were low, and therefore it was cheaper to use twice as many workers putting in bricks than half as many workers putting in cement blocks, since they cost more than the bricks.

The third factor was that this special cement block had insulation qualities which were desirable in Europe but not in a tropical country where the weather is always warm.

The lesson of this example is that the outsider coming in to make a study of the feasibility of a project, even if he is very familiar with the technical characteristics of the project, must guard against overlooking certain important local circumstances which are essential to the success of the project. You cannot meet your management decision problem by hiring an outside group to make a feasibility study. The feasibility study needs to be based on intimate knowledge of local circumstances and factors, and failure to take account of these local circumstances and factors will lead to difficulties.

A fourth example I want to mention relates to the size of the project being undertaken. The first problem was that the plant was designed too small. It was obviously unwise to build a plant to produce more of the particular product than could be consumed in the country. With the general world market situation what it is for the particular commodity, it was doubtful that the product could be produced at a cost which permitted it to compete in world markets. Hence, it was reasonable to limit its size to the domestic market. But, this meant that the plant would be a high-cost producer. It was intended that this problem would be solved by an agreement with the government of the country that there would be tariff protection against lower-cost imports.

The second problem was that the costs of building the plant were about 25% more than had originally been expected. I do not know how to pinpoint the exact reason for these increased construction costs.

The third problem was a technical one. In any manufacturing operation, it is not merely a matter of putting in equipment, pulling a switch, and letting it run. Almost every plant runs into technical problems which cannot be foreseen. In this case, one of the technical problems was that the water used for cooling had a greater mineral content than had been expected, and mineral deposits were clogging the cooling tubes. Because of this, the equipment was working at a higher temperature than had been designed, resulting in corrosion by the sulphuric acid used in the plant. Consequently, leaks developed and pumps broke down. Actually, this project had many fewer design problems than similar plants which I visited in other countries. I mention these unanticipated costs and technical difficulties only because they frequently occur in new enterprises.

There were other difficulties arising from the fact that the foreign engineers involved in the operation were not able to communicate effectively with the labor which was being trained to operate the plant. Certain of the mechanical difficulties developed simply because a valve was not turned every hour to divert the flow from one tank to another. The engineers said it was the fault of the workers who wouldn't do what they were told. The local management said it was the fault of the foreign engineers who should have gone to the factory each hour in order to make sure that the valve was turned.

These examples will suffice to illustrate some of the many different kinds of management problems that can arise in new or expanding industrial enterprises in less developed countries. Before concluding my remarks, I would like to discuss two additional problems of management which I believe are of general applicability and importance.

The first relates to the failure to establish a new industrial project with a capital structure which makes it possible for the enterprise to work successfully. In many cases, inexperienced managements have started enterprises with insufficient capital, or with capital which has been obtained on very onerous terms or with impossible conditions. All too frequently, we have seen enterprises in which the capital needed on a permanent basis has been borrowed on a short-term basis from banks or obtained on two- to four-year credits from suppliers. An inexperienced management looks at optimistic financial forecasts for the new company and concludes that it will be profitable enough to repay credits obtained on a two- or three-year basis. We have learned to be very suspicious of such proposals, because new projects are likely to have unanticipated difficulties which require more capital or longer-term capital than anticipated. The ability to forecast such difficulties and to anticipate the resulting capital requirements is one of the qualifications of good management.

The second general point I wish to make concerns the appropriate relationships among the local government, local enterprise, and foreign enterprise from the point of view of ensuring adequate management competence. For this purpose, I would distinguish three categories of projects on the basis of size.

The first category consists of very large and complex projects, for example, iron-ore mining, metal smelters, chemical plants, etc. Where, as in most cases, the country lacks people with the requisite technical skills and managerial experience, and often lacks the necessary capital as well, I think there can be no doubt that the management needs to be an experienced foreign concern. The cost of such projects is very large; the technical problems are very difficult; the administrative and managerial tasks are very complex. There will not be very many projects of this kind, but where they exist, I think the management will have to be foreign if the necessary competence is to be obtained.

Second, there are the projects which are very small. These projects may involve a few workers, maybe up to twenty -- and really require only one person as manager. Such projects should certainly be local. What is important here is that there be supporting governmental services which will help local enterprise. The proper kind of industrial development financing corporation is particularly important. It is also important that there be a public organization undertaking scientific and technical research, including market research, so as to provide the data needed by a local entrepreneur for deciding whether a bicycle or a textile plant makes sense or not.

The more difficult category is the third, covering the middle range of projects -- for example, a fertilizer plant, a cement factory, a medical drug project. Here the management problem may be too large and complex for the experience available in the country, but the project may not be the kind that necesarily would have to be turned over completely to foreign management. In this case, I think the answer is a mixed enterprise with local and foreign financial participation, and in which the management relationship corresponds more or less to the ownership holdings of the local and foreign participants. The joint enterprise, the joint venture, is, I believe, the most effective solution at this middle level. The two groups need to pick each other carefully. The foreign participants have to be willing to tackle the problem of training, not only of unskilled workers, but also of skilled workers, and particularly of both middle-management and top-management people. The local participants must supply the indispensable knowledge of local conditions and limitations, and can usually best handle the problems of relationships with the local government. Thus, in this broad middle category of industrial enterprises, each participant contributes what he is best able to do to the joint venture.

Text of Mr Rosen's speech
May ~~8~~ 9, 1962
to Business Advisory Committee of the Dept of Commerce

Mr. Secretary, Mr. Grace, Gentlemen:

The contribution which the International Finance Corporation -- or IFC -- brings to the Alliance for Progress is established by Article I of its charter, the opening words of which are: "The purpose of the Corporation is to further economic development by encouraging the growth of productive private enterprise...."

While you all understand IFC and its activity in general, it will do us no harm this morning, even though we are disciplined by time, to begin on this fundamental, if familiar, note. After stating first that IFC's mission is to assist economic development, the charter uses two words which govern whatever IFC does or will do in supporting the Alliance for Progress. The charter directs that IFC must assist "productive" enterprises. It is generally accepted that this means that IFC is to assist industrial development. Then it stipulates that IFC must make its contribution in the field of "private" enterprise. There can be little dispute about the meaning of that.

We are here, therefore, as a financial institution ready to do whatever we can to support private industrial development in Latin America. In fact, of the several public financial agencies in Washington, IFC is the only one which assists private enterprise exclusively. In expanding upon the contribution which IFC may make, let me review some of the purposes for which the Alliance was created and then see where IFC can do its part.

A clear public image has been formed of the Alliance as a means of assembling large sums to be passed along in the form of loans and grants to governments to be dispensed for various worthy purposes. A second, perhaps slightly blurred, image has been formed of the Alliance as an instrument that will effect various reforms including redivision of land, housing, illiteracy, and public health. My suspicion is that any image which the public may have of the Alliance as a vehicle that will encourage private initiative in the Latin countries -- or private industrial development on a meaningful scale -- is less clear.

A recent speech by Teodoro Moscoso, U.S. Coordinator of the Alliance for Progress, ~~was right to the mark when he said~~ included this statement: "If we cannot achieve an environment in which both local and foreign private enterprise can grow soundly we will in my judgment have failed to mobilize the most important resource available for the economic development of Latin America." This, it seems to us at IFC, ~~is~~ needed ~~well stated~~ to be said.

As IFC studies the problems to be solved in the unfoldment of Latin America in the next decade, it appears that the overriding need is for widespread employment achieved through creating productive jobs. Where are the jobs to be found? Largely they are to be found in industry. And how are these jobs to be created? Largely through the growth and expansion of industry.

An example of what can happen is before us in the extraordinary industrial surge which has come about in Western Europe and Japan in the last decade. These remarkable developments have their incentives in the well springs of private enterprise. We sincerely hope that Latin American countries will in time be able to do likewise.

IFC entered the area of Latin American industrial development in 1957. It made, in fact, its first loan to a company in Brazil. Since then there have been few business days that a member of IFC's staff could not be found somewhere south of the Rio Grande. IFC now has made loan commitments to 31 enterprises in nine Latin American countries. These loan commitments total over $42 million, a good deal of which is still being disbursed to many types of manufacturing and processing industries.

Let me include a reference to IFC's ground rules. As you know, in its investments or loans, IFC assumes normal business risks and operates generally like an investment bank, with two exceptions. First, its funds for investments or loans are institutional, subscribed by 62 countries which are members also of the International Bank for Reconstruction and Development (the World Bank) with which IFC is affiliated. Second, it invests only in enterprises which may be expected to contribute to a country's economic growth. IFC's charter prohibits any request for, or acceptance of, a government guarantee. And you will recall that at the annual meeting of IFC's Board of Governors last September in Vienna, changes were effected in its charter to enable IFC to invest in equity. Today it has the power to buy and sell stock or capital shares, to underwrite, and to make stand-by agreements.

IFC does not invest either very large sums or very small. The average size of our investments to date is $1.25 million. While we have no formal upper or lower limits, we must stay in a medium range. Our investment funds, however, do reach small industries through the instrument of the intermediary financing institution such as a financiera, a fomento, or a development bank.

These versatile institutions serve as local channels through which financial assistance can be made available to industries whose number and relatively small scale make direct World Bank or IFC financing administratively impracticable and uneconomic. So far IFC has made two investments in development Banks in Latin America, both in Colombia for $2 million each. Presently these institutions are providing financial support for a new electric power company, a gas pipe-line company, two cattle breeding and export companies, and a feasibility study for a phosphate plant. In all these enterprises there is some IFC investment, indirectly.

Most South American countries today are, from the economic aspect, at or near the threshold of investment growth. The larger countries have established basic industries, money markets, and the foundations for expansion. While the basis of investment operations is primarily economic, the matter of political stability is never far from the minds of investors, whether private or, like IFC, institutional. Political stability, sound investments, industrial growth, steady employment -- that is the formula.

As confidence in their future develops, the Latin countries will attract investors from Europe and the United States, leading to the capital infusions necessary to build. It is this prowess that IFC uniquely is designed to support through its investments in equity as well as its loans. I can report this morning, for example, that we hope that IFC's first large underwriting of a capital issue will be done in a Latin American country in association with several investing partners. We expect others.

IFC's contribution to the Alliance for Progress will be greater than the amount it invests from its own capital funds. In the projects in which it invests, IFC always has partners. For every $1 of IFC money in a project, we estimate there is an average of an additional $3 invested by others. This additional capital comes from within the country where the project is situated or from abroad, either of which usually is desirable. As the enterprises assisted by these funds grow and become profitable, other investors may be attracted. Then IFC may sell half or all of its investment in a project and, with its capital replenished, invest again in a new proposition. In this way IFC has helped to strengthen a local investment market, leading to growth of its capital resources. This process of investing and selling and helping a country to build its reservoir of capital is the vital ingredient, or the "raison d'etre" of IFC.

###

NOTED BY MR. DEMUTH

Statement by Mr Rosen at ECAFE

Mr ROSEN

11 March 1958

I gather Murphy edited this

P 5 and unusual

STATEMENT BY THE REPRESENTATIVE OF THE

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (IBRD)

Looking back over the period since your meeting last year in Bangkok, few would question that we have lived through a time of great accomplishments but also of great challenge. During the early part of the period the value of world trade continued to rise, accompanied by large international transfers of public funds and a record flow of private foreign investment. Consequently, substantial progress was made in carrying out government development plans and private investment projects. As several of the distinguished speakers have pointed out however, the later months were marked by weakening of the prices of many primary commodities on which the export earnings of the ECAFE area depended. The resulting balance of payments problems were also accentuated by a downturn in foreign investment.

These circumstances had given rise to urgent discussion of the problems of sustaining economic development during periods of fluctuation. They had also led to concern over the evident difficulty of building up reserves adequate to tide over such periods of reduction in the worldwide level of business, and they had drawn attention to the continued dependence of some countries on emergency forms of support.

The Bank has had the privilege of collaborating both in the financing and in the detailed planning of a variety of far-reaching investment projects in the ECAFE region. We have now lent $211 million for electric power projects which will add a total of more than one million kilowatts of capacity in the region. These projects include the Yanhee multipurpose investment in Thailand, on which contracts are now being awarded. This project, for which the Bank made a loan of $66 million, is the largest ever undertaken in Thailand and one

/of the most

of the most remarkable in Asia. It looks forward to the eventual installation of more than half a million kilowatts of generating capacity, an addition many times greater than the entire power supply presently available in Thailand. A 500-foot dam on the Ping River will help to prevent flooding and, through irrigation, will increase the value of agricultural production by the equivalent of about \$15-20 million annually.

In Ceylon a smaller but no less vital hydroelectric project is nearing completion in the mountains behind Colombo. Discussions are already under way with a view to providing Bank funds for a further phase of the project and Bank representatives are now in Ceylon in connection with this loan request.

Other recent Bank lending for power has been in the Philippines. Our first loan to that country of \$21 million lent in November will help to add 100,000 kilowatts of hydroelectric capacity in the Manila area. The new plant will help to supply the needs of industry in Manila, which have been mounting at the rate of 25 per cent a year, and to meet the many other requirements of this rapidly growing urban area. Several loans for electric power projects in Japan, Pakistan and India are under active study, and the Bank has undertaken, jointly with the Government of Italy, a study of the economics of electric power which should be of considerable value to the members of ECAFE who are considering the possibilities of installing nuclear reaction to produce electric power.

Improvements in transport also occupy a very important place in the Bank's lending in the ECAFE region. A total of \$258 million has been provided, mainly to provide new equipment for national railway networks, and to help them to keep pace with the very rapid growth of production over the last decade. In the last nine months alone we have lent \$121 million for the rail services of

/India and Pakistan.

India and Pakistan. A loan of $90 million to India is particularly interesting, not only because of the contribution made by it to assisting in the solution of the transportation problem of India probably the most important bottleneck, in the development programme, but also because it is an example of intra-regional corporation in economic development. $30 million of the equipment required is being produced in Japan and Japan has made available over $8\frac{1}{2}$ billion yen of its subscription to capital of the Bank to finance these purchases. A similar case is the release by Burma of part of its capital subscription to finance Pakistan imports for its railway programme. Earlier loans for a similar purpose went to Burma and Thailand. To allow for the further growth of export and import traffic we have financed improvements at the ports of Bangkok, Karachi and Rangoon, and we at present have negotiation in Washington working out plan for two further loans for ports in India.

Recent years have witnessed a very rapid increase in our loans made directly for industry in Asia. We have lent a total of $157 million for the expansion of the two largest steel mills in India -- those of the Tata Iron and Steel Company, and of the Indian Iron and Steel Company. These loans are helping to speed the industrialization of the Damodar Valley, where we have also lent $27 million for hydroelectric and thermal power, flood control and irrigation. In Japan we have lent $35 million for modernization and expansion of the Kawasaki Yawata and Nippon Kokan steel mills, and further sums for ship building, automotive and other industrial companies.

A way that the Bank has sometimes found particularly effective in stimulating the growth of private industry is through supporting the establishment or expansion of development banks. These institutions can play a valuable role in supporting private industrial ventures which would otherwise find it difficult to raise the capital they need. They can also offer new channels through which managerial and technical skills can flow into industry.

/Within the

Within the last few months we have advised on the establishment of a new development bank in Pakistan -- the Pakistan Industrial Credit and Investment Corporation, and we have also made a loan to this new institution. In addition to powerful backing by Pakistan investors, both Government and private, British, American and Japanese investors also demonstrated their belief in the opportunities open to this new institution by providing some of its initial capital. A similar institution established in India has now been in operation for three years and has built up a varied and useful portfolio of investments in Indian industry. In Ceylon the Development Finance Corporation was set up a year ago with our technical assistance and has already made a number of investments. In Thailand a similar institution, to be known as the Industrial Finance Corporation, is at present being established and we are assisting in recruiting staff for it.

Among the many types of technical assistance offered by the Bank in this region I might also mention the research institute set up in Ceylon. The Institute of Scientific and Industrial Research has now been operating for three years and is providing a wide range of services for Ceylonese industry and agriculture. It has helped to develop new manufacturing processes and to find uses for such previously waste products as coconut fibre and banana stalks. The interest aroused outside as well as inside Ceylon by the work of the Institute is indicated by the proposals to work up a similar undertaking here in Malaya. We have a survey mission presently resident in Thailand helping that country to draw up a long term development programme and make plans for the execution of the programme. We currently have an economic mission in Burma undertaking a similar review of the Burmese situation.

/The capabilities

The capabilities of the Bank are, of course, small in relation to the huge population, area, and natural resources of the ECAFE region. But the sums lent by the Bank, have in recent years, accounted for a substantial proportion of the capital invested in the region from abroad. Since making its first loan in the region $8\frac{1}{2}$ years ago, the Bank has lent here a total of $472 million. The ECAFE region contains the country - India - in which the largest amount of our funds has been lent -- and in which, incidentally, our own annual meeting will be held this year. It is also the part of the globe where Bank operations have recently been expanding most rapidly. Indeed, during the last eight months a total of $260 million, well over half of all Bank lending in the period, has been in this region.

In the years that lie ahead we are confident that we shall see continued additions to this total and to knit still closer ties with the countries represented here today.

Mr. Chairman

I wish to thank you for permitting the representative of the International Bank for Reconstruction and Development to participate in this stimulating and interesting discussion on the economic situation in Asia and to report on the Bank's work in the EDAFE area. I should like first, Mr. Chairman, to convey my sincere gratitude to the Federation of Malaya for the hospitable and the warm welcome which has been accorded to us here. For the Bank it is particularly appropriate to be meeting here for Malaya is just now, while the conference is being held completing the final step required to make it the 65th member of the World Bank. We have already begun our operational activities in Malaya and a member of the Bank's technical staff has been in the Federation for the past fortnight examining an electric power project which has been proposed for consideration for a Bank loan.

INTERNATIONAL FINANCE CORPORATION

Remarks by Martin M. Rosen, Executive Vice President, at a luncheon meeting of the Federal Bar Association and the Bureau of National Affairs, Washington, D.C., May 5, 1962

Development Banks

Mr. Rosen spoke substantially as follows:

My subject is development financing corporations or development banks as they are frequently called. A few of the institutions which have come to be known as development banks began to appear in less developed countries before World War II but it is since that war that they have grown rapidly in number and in importance as instruments of industrial financing.

Let me begin by telling the story of the World Bank's first experience in assisting the design and establishment of a development bank. In the late 1940's the World Bank was approached by the Turkish Government and by private business interests in Turkey for assistance in meeting that country's pressing economic problems. The Bank was approached in this period, in fact, by two Turkish administrations representing the major political parties of the Republic. The Bank felt, therefore that it had non-partisan support when it decided in 1949 to accept the invitation to send a mission to Turkey to analyze its economic problems and to suggest a program of industrial development based upon private capital investment.

You will recall that until well into the 20th century, Turkey had not emerged from the Ottoman Era. It was not until Ataturk became president that some of the reforms were achieved necessary, as a prelude, to creating a powerful state in the modern sense. He abolished church law and adopted civil, criminal and commercial codes based upon Western principles. He adjusted time reckoning to the international clock and the Gregorian calendar. He outlawed the fez and adopted western dress.

Ataturk had to make changes equally as profound in the country's economic structure and customs. At first he relied upon private enterprise in Turkey to promote its industrial development. But for many reasons private enterprise was unable to produce the wanted results. As a result, a system of state enterprise called "etatism" was begun in the 1920's. This was neither socialistic nor communistic, but nationalist. Its purpose was to promote industrialization as rapidly as possible.

This system also did not for many reasons produce desired results although under it Turkey made sufficient progress to carry through World War II. After the war Turkey found itself with a variety of problems: it was inhibited by the lack of long-term money at moderate rates of interest; by the lack of experience in mobilizing capital; by the lack of technical and managerial knowledge; and by the lack of foreign exchange. Considerable private capital existed in Turkey; but its owners preferred to invest in real estate, inventory, or gold, or to engage in short-term but highly lucrative commercial business rather than to invest in industry.

It came to be rather generally believed in Turkey that the World Bank might help as a catalyst for the combination of the local capital, foreign exchange, and experience required for the financing of many worthwhile industrial projects in particular and for the stimulation of private enterprise in general, which was considered essential to the development of the Turkish economy.

The Bank therefore sent a consultant to Turkey in the Fall of 1949 to discuss the issue with all interested groups. As a result of his visit, a plan was evolved for the establishment of an institution which would be privately owned; would be directed by competent management; and advised by a technical staff qualified to analyze investment applications and to assist the institution's clients in carrying out projects. It was also contemplated that such an institution would receive additional capital in the form of loans from the Central Bank of Turkey and the World Bank.

A second visit by World Bank representatives, early in 1950, resulted in the working out of details and was followed by the formal establishment of the Industrial Development Bank of Turkey. The new bank became a legal entity in June of that year. Its authorized capital of 12.5 million Turkish liras (about $4.5 million) was subscribed by a group of 18 private institutions including 13 Turkish and foreign banks, three associations of merchants and industrialists, and two textile firms.

The purposes for which the Turkish development bank was created were to assist in the establishment of new industries and in the modernization or expansion of existing industries; to encourage private capital investment, both foreign and domestic, in industry in the country; and to promote the development of a securities market in Turkey. To attain these ends, the development bank was empowered to grant medium and long-term loans at moderate rates of interest, to take equity participations and, in exceptional cases, to establish new enterprises of its own.

Another and equally important function -- which may prove to be lasting in its influence on the growth of the Turkish economy -- was to provide technical and managerial assistance to private enterprises in Turkey. The Bank's operational staff aided prospective clients to prepare their plans and screened their application. The staff became available also to enterprises financed by the Bank for services in such fields as engineering, management and accounting. Thus the Industrial Development Bank made an important contribution to Turkish enterprise. Its role in relation to clients has not been unlike that of the World Bank to its borrowers.

Since its enception the Turkish Development Bank has assisted foreign capital seeking to invest in Turkey, by placing at the disposal of potential foreign investors its information on local conditions and regulations and by suggesting local opportunities appropriate for foreign investment.

In the summer of 1950 the World Bank dispatched its mission to Turkey to assist the new development bank in undertaking its work. Its report was not completed until May, 1951. In the meantime the World Bank moved to support the new Turkish Bank by authorizing in October, 1950, a loan for $9 million. This loan, for 15 years, is guaranteed by the Republic of Turkey.

At the same time the Central Bank of Turkey agreed to lend the Development Bank an additional 12.5 Turkish liras to meet the local currency needs of the Bank. The loan from the World Bank, in an amount equal to the local currency resources available to the Turkish Bank, was intended to supply the foreign exchange requirements of the projects which the new Bank would finance in its initial stages. Thereafter, its foreign exchange resources were supplemented by the Government through a special arrangement.

In recent years, under the Menderes Government, the Turkish development bank has experienced difficulties along with most other institutions in Turkey.

However, the bank has been one of the very few institutions in Turkey to maintain its relative independence of government and its support of private enterprise during this difficult period has been commendable. The Turkish Bank is now in need of funds for further investment and we are holding talks with them to see what can be worked out at IFC and the World Bank.

Let me now turn to another case -- the establishment of an industrial development bank in India. One of the historical impediments to the growth of industry in India has been the lack of risk capital. From the time that the jute and cotton textile industries were established in the middle of the 19th century to the period after World War I, new industrial enterprises in India relied on capital raised abroad, chiefly in London. Such enterprises invariably were started by firms of managing agents who, experienced in Indian conditions and retaining control over their enterprises, were able to provide the assurance of sound management needed to attract investors.

It was largely as a result of these types of operations that stock markets were developed in India and that Indian capital began to flow toward industry. After World War I a large number of new industries producing both capital and consumer goods were started, financed substantially by capital raised in India. However, the supply of Indian capital never equalled the demand. During World War II and for a few years after Indian capital continued to provide new funds for industry. By 1948, however, the stimulus was largely spent and for several years thereafter it was difficult even for the largest and best established Indian concerns to raise new capital locally. The Government of India became disturbed by this situation and an inquiry committee was set up by the Indian Reserve Bank.

Towards the end of 1953 discussions were held in Washington between the World Bank, the U.S. Government, and the Government of India to consider the establishment in India of a privately-owned corporation to provide investment necessary to the growth of private industry. It was proposed that the equity capital be raised by an issue of shares in India and also that efforts should be made to obtain subscribers from abroad. It was further proposed that the Indian Government make an advance to the proposed corporation from U.S. counterpart funds and that the World Bank consider making a loan to the new institution.

As a result of these discussions, a mission was organized by the World Bank, the First Boston Corporation, and the American Securities Corporation. The misson's work in India led to the formation of a committee of five prominent Indian businessmen to prepare detailed proposals for the new development bank. The World Bank, meanwhile, explored with leading financial institutions in the United Kingdom and the United States the possibility of private British and American participation in the equity capital of the proposed bank.

Progress was made and in October 1954 all interested groups assembled in Washington where agreement was reached on major points and the drafts of essential documents were agreed upon. In December 1954 the Bank announced that it would make a loan of $10 million as soon as the new institution had come into being. It was established under Indian law on January 5, 1955, and was given authority to commence business on March 2 of that year. Thus came about "The Industrial Credit and Investment Corporation of India", known from that day to this as ICICI.

India's development bank was formed by private investors of India, the United Kingdom and the United States with initial share capital of 50 million rupees which is equivalent to $10.5 million. Indian investors took about two thirds of the shares and today hold 72%. Of the Indian subscription, more than half of about 20 million rupees was privately placed and the remainder sold through a public offering that was oversubscribed.

British investors -- some of the Eastern Exchange Banks, the Commonwealth Development Finance Company, Ltd., several insurance companies and industrial firms -- subscribed 10 million rupees ($2.1 million). American investors -- the Bank of America, the Rockefeller brothers, Olin Mathieson Chemical Corp., and Westinghouse Electric International Corporation -- subscribed 5 million rupees ($1,050,000). Subsequently private German investors participated. The Government of India made a long-term, interest-free advance of 75 million rupees ($15,750,000) to the Corporation.

In March 1955 the World Bank loan of $10 million to ICICI was completed. As in the case of the Turkish bank, it was for a term of 15 years to provide foreign exchange for the purchase of equipment, materials and services to be imported into India to carry out projects financed by the Corporation. The loan was guaranteed by the Indian Government.

The World Bank has since assisted ICICI to get on its feet in several ways. It found, after a considerable search, ICICI's first general manager; it sent one of its staff to New Delhi as a resident manager for more than a year. And it has made three additional loans to ICICI, its total loans today being $40 million.

In the past seven years ICICI has been a busy institution making long and medium-term loans to industrial enterprises; purchasing shares of industrial enterprises; underwriting new issues of securities; guaranteeing loans by other investors; and helping industry to obtain managerial, technical and administrative advice and assistance.

How well has ICICI succeeded in fulfilling the purposes for which it was created? Since 1955 it has done one fifth of all the underwriting in India. It has made investments in or loans to 133 companies, 70 of which were new undertakings. Its earnings per share for 1961 were $1.95 and its net income for 1961 was $980,000.

ICICI's portfolio of loans and investments is well diversified among industrial categories. The amount of ICICI assistance to a single company has ranged from about $3 million down to $60,000 with the average size of projects remaining constant at about $500,000. Probably no more than 25% of ICICI's projects yet are in commercial production. A few of these are proving troublesome, and a few others in the construction stages are incurring cost overruns and delays, but neither the number nor seriousness of the difficulties is greater than might be expected in a development finance operation of this size.

ICICI's management and staff have acquired a high degree of experience. The senior management works as an efficient team, the professional staff, numbering less than 100, displays competence. The management's relationships with the rest of the financial community appear to be solid and ICICI today is generally accepted as "setting the standard" for the appraisal and medium and long-term financing of industrial projects.

From these case histories of the Indian and Turkish development banks you can readily understand why these types of institutions are necessary to countries in the throes of economic development. While the Turkish bank was our first attempt, the World Bank has spent much time in the ensuing 12 years in helping groups in its member countries to organize similar banks, privately-owned and operated on business enterprise lines, with approval and support of their governments. The Bank has provided technical as well as financial assistance to these new institutions, sending resident advisers for substantial periods of service and training members of their staffs here in Washington.

While ICICI was the first development bank to have foreign shareholders, a number of banks which the IBRD subsequently helped to establish have followed its path of foreign and local ownership. PICIC (Pakistan) has German, Japanese, U.K. and U.S. shareholders and IMDBI (Iran) is owned by Belgian, Dutch, French, German, Italian, U.K. and U.S. investors.

Those of you who have had the first-hand, and sometimes frustrating, experience in the work of business development for your companies overseas know that a principal obstacle to getting projects started in most underdeveloped countries -- just as in Turkey and India -- is the drastic shortage of medium and long-term capital. You probably have seen for yourselves situations similar to what I have reported: that in many countries those who have savings are generally reluctant to withdraw them from the traditional investment fields of land and commerce; or that those who extend credit are unwilling to lend for more than short periods, except at a very high rate; or that lenders in most cases prefer investment opportunities which promise a quick and sure return to new industrial enterprises which offer a prospect of risk and gradual growth.

Some of you may have had an opportunity to observe the lack of adequate institutional machinery to mobilize, and then transfer, savings out of the agricultural or commercial sectors in which they were earned. And you may have discerned that the shortage of capital is often associated with other obstacles to industrialization, such as a disinclination on the part of the business community to seek out, or to enter, new fields of activity and a dearth of people trained adequately to plan, manage and operate a new enterprise. These are the difficulties which many countries are striving to overcome by creating development banks.

As those institutions which the World Bank helped to establish have grown over the years they not only have needed more loans, obtained from the World Bank or from other sources, but they have needed also more share capital to broaden their equity as a basis for these loans. There is a limit to the amount of loans which can properly be raised on a given share capital yet for development institutions it is not easy to raise share capital. This is due to the fact that development banks invest for the most part in new enterprises which will not show much of a return of the money invested for several years to come. It is this lack of share capital that IFC is equipped to help provide.

In the World Bank family -- there are now three institutions, the Bank itself, the IFC which was established six years ago, and IDA (the International Development Association) -- IFC now is assigned the primary responsibility for directing whatever assistance is to be provided from now on to development banks, both those which are established and expanding and others being created. This came about largely because of the change which was effected in IFC's charter last September enabling IFC, for the first time, to buy and sell capital shares. As the President of IFC, Eugene R. Black, remarked not long ago, IFC is itself carrying on an industrial development banking business on an international scale. IFC seemed, consequently, the logical institution in the World Bank family to take the lead in the consideration of all industrial development banking problems.

We at IFC believe this is going to have twofold benefits. As you now have seen, development banks are becoming important economic instruments for their countries which alone justifies their existence. But, with IFC acting in the same capacity on an international scale, the interests of development banks and of IFC can be joined together, supporting and strengthening their mutual purposes.

So far IFC itself has made loans to two development banks in Colombia. These were organized by a number of Colombian commercial banks and businessmen and insurance companies to provide capital chiefly for industrial development.

Presently they are providing financial support for a new electric power company, a gas pipeline company, two cattle breeding and export companies, and a feasibility study for a phosphate plant. IFC loaned $2 million to each of these two institutions in such a way as to give them long-term money without having to pay any fixed rate of interest; this insures that the Colombian banks can provide long-term capital for the industrial enterprises which they are financing. Since IFC made these loans it has converted part of each into shares of the corporations in the amounts of approximately $800,000 each.

In addition to the two Colombian investments, we are having serious discussions with about a dozen development banks concerning possible loans and/or IFC investments and reviewing problems of staffing and technical direction. Some of these discussions are with existing institutions to which the World Bank already has made loans. Others are with groups in countries such as Nigeria, the Philippines, and Venezuela. We will see in the relatively near future IFC equity investment, Bank loans and IDA credits in several new development institutions.

Of course, a development bank is only one of a number of instruments for economic development. The simple fact of one's establishment will not assure a faster growth of a country's economy in general, or even of the industrial sector in particular. A development bank's effectiveness depends upon coordinated action of related institutions and policies. Nevertheless, as we have seen today, the potential of a development bank, given the resources of local and foreign funds and personnel trained to its task, warrants describing this institution as versatile instrument of economic development, justifying support of international institutions.

THE FOLLOWING BACKGROUND MATERIAL WAS PREPARED FOR MR. ROSEN'S TALK BUT NOT USED BY HIM:

At the World Bank and the International Finance Corporation, or IFC, when the term "development bank" is used it invariably refers to an institution created and designed to stimulate private industrial enterprise. There are, also, development banks in the agricultural sector but these are outside the scope of Bank-IFC operations.

Some development banks are privately-owned and managed; some are government-owned and controlled. Whatever its ownership and control, a development bank must have support from its government which invariably means financial support. The interest at IFC and the World Bank is in favor of privately-owned and managed development banks. While it is recognized that most development banks will have government behind them, a minority interest on the part of government is encouraged. For experience teaches that if the management and control of banks designed to assist private industrial growth remain in private hands, then the banks will have the freedom of decision necessary to make sound investments.

For some 12 years the World Bank has spent much time in helping groups in its member countries to organize development banks which will be privately-owned and operated on business enterprise lines, with approval and support of their governments. The Bank has been providing technical as well as financial assistance to these institutions by sending out resident advisers for substantial periods of service and by training members of their staffs here in Washington.

Those who have had the first-hand, and sometime frustrating, experience in the work of business development know that a principal obstacle to getting projects started in most underdeveloped countries, is the drastic shortage of medium and long-term capital. In many countries those who have savings are generally reluctant to withdraw them from the traditional investment fields of land and commerce: those who extend credit are unwilling to lend for more than short periods, except at a very high rate; and lenders in most cases prefer investment opportunities which promise a quick and sure return to new industrial enterprises which offer a prospect of risk and gradual growth.

In the less developed countries there is a lack of adequate institutional machinery to mobilize, and then transfer, savings out of the agricultural or commercial sectors in which they were earned. The shortage of capital is often associated with other obstacles to industrialization, such as a disinclination on the part of the business community to seek out, or to enter, new fields of activity and a dearth of people trained adequately to plan, manage and operate a new enterprise. It is due to such circumstances that many countries have created, or are now planning, development banks with authority and resources necessary to provide these ingredients of economic development.

Before these or any development banks can meet demands for investment capital, they must have funds. Depending upon the circumstances of the country and in part upon the kind of role envisaged for a particular bank, a bank's equity may come in whole or in part from private sources or may be provided from public sources. In no country has it yet proved easy to raise private equity capital for a development bank. If private investors are not prepared to invest directly in industry, they are not likely to be eager to invest indirectly, by buying development bank shares. They have been influenced to do so by some form of inducement offered by the government: for example, a guaranteed dividend, preferential tax treatment for the bank's income or dividends paid or a loan to the bank on favorable terms.

Even so, initial subscribers have been Predominantly banks and insurance companies. But as development banks are successful in demonstrating the profitability of industrial investment, the situation may change.

Some of the private capital which flows into industry through the development bank may be foreign in origin. Foreign equity not only adds to a country's supply of foreign exchange and provides a point of contact with capital markets in the industrialized countries but, perhaps most important, brings with it or provides access to the managerial, professional and technical skills which a developing country so greatly needs. In addition to ICICI, other development banks which the IBRD has helped to establish have foreign as well as domestic shareholders. For example, PICIC (Pakistan) has German, Japanese, U.K. and U.S. shareholders and IMDBI (Iran) is owned by Belgian, Dutch, French, German, Italian, U.K. and U.S. investors.

A development bank supplies capital on terms which are not available elsewhere, to the extent consistent with its obligations to its shareholders and with an eye to making investments which may be marketed later. This means, for example, that it can lend for as long as 10 to 15 years with a substantial grace period to allow for construction and start-up. It means that in making investment decisions a development bank places more emphasis on an enterprise's earnings prospects and the quality of its management than upon current worth and conventional security. And it means that it is prepared to make equity investments. Often a development bank is one of the few sources of foreign exchange within a country for private industrial enterprise. PICIC in Pakistan is one example.

Development banks serve also as a channel through which financial assistance can be made available to new industries whose number and relatively small scale make direct World Bank or IFC financing administratively impracticable and uneconomic.

In its financial operations, a development bank plays a catalytic role. In part through the generally accepted policy of providing no more than 50% of the capital required for a project, a development bank helps to bring into being a volume of investment much larger than the amount of its own contribution. One development bank has estimated that the total investment in new projects of the companies it assisted in 1960 would be almost five times the amount of its assistance.

Of great importance to economic development is the building of capital markets. To this end development banks also provide a means. When a development bank makes an equity investment in a new enterprise, it does so not only with the prupose of starting a new industry -- which is the applicant's interest -- or for considerations related to its own earnings potential. But the bank also emphasizes equity because its holdings of capital shares contribute significantly to its ability to help to create and to maintain a market for private securities. One way for a bank to do this is to sell investments out of its portfolio. This increases the supply of marketable securities. And if the purchaser has never bought industrial securities before but might do so again if his confidence proves justified, the transaction broadens the base for future sales. Finally, portfolio sales serve to free the bank's funds for new investments.

A development bank may engage in underwriting. This too can be a service of special value to the new enterprise which, even in industrialized countries, does not find it easy to raise new capital by share issues or public borrowings. ICICI, for example, is now the single most important underwriting institution in India.

Participations are still another device, with the private investor invited to purchase a portion of a particular investment about to be made, relying on the bank's appraisal. The Government Development Bank of Puerto Rico and the Industrial Development Corporation of South Africa have employed this technique with success. Finally, the development bank may offer its own shares or debentures to the public. While this is essentially a means of adding to the bank's own resources, it has the consequence of increasing familiarity with investment techniques and contributing to changes in attitude towards direct investment in industrial securities. A number of banks have issued their own bonds: Nacional Financiera (Mexico), the Industrial Investment Institution of Israel and the Industrial Development Corporation of South Africa are among those which have done so successfully.

There are, also, other services by development banks of great value to their countries: promotional activities; research; surveys to uncover fields which offer export possibilities or would produce import substitutes. In the field of project analysis a bank can perform a most useful service in identifying and explaining the financial, engineering, managerial, production and marketing problems inherent in a proposal and advising how these may be anticipated or overcome. Many businessmen have told us voluntarily that they learn more about their project or business as a result of an appraisal by a development bank. Some report, for example, that they had never heard of the "break-even" point in determining their company's profitability.

Anyone who has been active in the work of economic development has soon discovered that complete and accurate record keeping, at least for public disclosure, is not customary in many countries. This is a serious problem in which we may expect help from development banks. They are in a position to bring about the acceptance of this practice, sometimes by conditioning financing on satisfactory performance in these respects. Notwithstanding the difficulties, often augmented by a lack of qualified public accountants, some banks -- notably the IDB of Turkey -- already have been responsible for a market change in the business mores and they count the reforms to which they have contributed as among the principal of their achievements. For the functioning of a capital market, it is essential that there be full, reliable and, above all, accessible information based on accurate accounts concerning enterprises whose shares are publicly offered.

DEVELOPMENT BANKS

At a luncheon meeting of the Federal Bar Association and the Bureau of National Affairs in the Shoreham Hotel, Washington, on 5 May 1962, Martin M. Rosen, Executive Vice President of the International Finance Corporation, spoke substantially as follows:

My subject is development financing corporations or development banks as they are frequently called. A few of the institutions which have come to be known as development banks began to appear in less developed countries before World War II but it is since that war that they have grown rapidly in number and in importance as instruments of industrial financing.

Let me begin by telling the story of the World Bank's first experience in assisting the design and establishment of a development bank. In the late 1940's the World Bank was approached by the Turkish Government and by private business interests in Turkey for assistance in meeting that country's pressing economic problems. The Bank was approached in this period, in fact, by two Turkish administrations representing the major political parties of the Republic. The Bank felt, therefore that it had non-partisan support when it decided in 1949 to accept the invitation to send a mission to Turkey to analyze its economic problems and to suggest a program of industrial development based upon private capital investment.

You will recall that until well into the 20th century, Turkey had not emerged from the Ottoman Era. It was not until Ataturk became president that some of the reforms were achieved necessary, as a prelude, to creating a powerful state in the modern sense. He abolished church law and adopted civil, criminal and commercial codes based upon Western principles. He adjusted time reckoning to the international clock and the Gregorian calendar. He outlawed the fez and adopted western dress.

Ataturk had to make changes equally as profound in the country's economic structure and customs. At first he relied upon private enterprise in Turkey to promote its industrial development. But for many reasons private enterprise was unable to produce the wanted results. As a result, a system of state enterprise called "etatism" was begun in the 1920's. This was neither socialistic nor communistic, but nationalist. Its purpose was to promote industrialization as rapidly as possible.

This system also did not for many reasons produce desired results although under it Turkey made sufficient progress to carry through World War II. After the war Turkey found itself with a variety of problems: it was inhibited by the lack of long-term money at moderate rates of interest; by the lack of experience in mobilizing capital; by the lack of technical and managerial knowledge; and by the lack of foreign exchange. Considerable private capital existed in Turkey; but its owners preferred to invest in real estate, inventory, or gold, or to engage in short-term but highly lucrative commercial business rather than to invest in industry.

It came to be rather generally believed in Turkey that the World Bank might help as a catalyst for the combination of the local capital, foreign exchange, and experience required for the financing of many worthwhile industrial projects in particular and for the stimulation of private enterprise in general, which was considered essential to the development of the Turkish economy.

The Bank therefore sent a consultant to Turkey in the Fall of 1949 to discuss the issue with all interested groups. As a result of his visit, a plan was evolved for the establishment of an institution which would be privately owned; would be directed by competent management; and advised by a technical staff qualified to analyze investment applications and to assist the institution's clients in carrying out projects. It was also contemplated that such an institution would receive additional capital in the form of loans from the Central Bank of Turkey and the World Bank.

A second visit by World Bank representatives, early in 1950, resulted in the working out of details and was followed by the formal establishment of the Industrial Development Bank of Turkey. The new bank became a legal entity in June of that year. Its authorized capital of 12.5 million Turkish liras (about $4.5 million) was subscribed by a group of 18 private institutions including 13 Turkish and foreign banks, three associations of merchants and industrialists, and two textile firms.

The purposes for which the Turkish development bank was created were to assist in the establishment of new industries and in the modernization or expansion of existing industries; to encourage private capital investment, both foreign and domestic, in industry in the country; and to promote the development of a securities market in Turkey. To attain these ends, the development bank was empowered to grant medium and long-term loans at moderate rates of interest, to take equity participations and, in exceptional cases, to establish new enterprises of its own.

Another and equally important function -- which may prove to be lasting in its influence on the growth of the Turkish economy -- was to provide technical and managerial assistance to private enterprises in Turkey. The Bank's operational staff aided prospective clients to prepare their plans and screened their application. The staff became available also to enterprises financed by the Bank for services in such fields as engineering, management and accounting. Thus the Industrial Development Bank made an important contribution to Turkish enterprise. Its role in relation to clients has not been unlike that of the World Bank to its borrowers.

Since its inception the Turkish Development Bank has assisted foreign capital seeking to invest in Turkey, by placing at the disposal of potential foreign investors its information on local conditions and regulations and by suggesting local opportunities appropriate for foreign investment.

In the summer of 1950 the World Bank dispatched its mission to Turkey to assist the new development bank in undertaking its work. Its report was not completed until May, 1951. In the meantime the World Bank moved to support the new Turkish Bank by authorizing in October, 1950, a loan for $9 million. This loan, for 15 years, is guaranteed by the Republic of Turkey.

At the same time the Central Bank of Turkey agreed to lend the Development Bank an additional 12.5 Turkish liras to meet the local currency needs of the Bank. The loan from the World Bank, in an amount equal to the local currency resources available to the Turkish Bank, was intended to supply the foreign exchange requirements of the projects which the new Bank would finance in its initial stages. Thereafter, its foreign exchange resources were supplemented by the Government through a special arrangement.

In recent years, under the Menderes Government, the Turkish development bank has experienced difficulties along with most other institutions in Turkey. However, the ~~Bank~~ bank has been one of the very few institutions in Turkey to maintain its relative independence of government and its support of private enterprise during this difficult period has been commendable. The Turkish Bank is now in need of funds for further investment and we are holding talks with them to see what can be worked out at IFC and the World Bank.

Let me now turn to another case -- the establishment of an industrial development bank in India. One of the historical impediments to the growth of industry in India has been the lack of risk capital. From the time that the jute and cotton textile industries were established in the middle of the 19th century to the period after World War I, new industrial enterprises in India relied on capital raised abroad, chiefly in London. Such enterprises invariably were started by firms of managing agents who, experienced in Indian conditions and retaining control over their enterprises, were able to provide the assurance of sound management needed to attract investors.

It was largely as a result of these types of operations that stock markets were developed in India and that Indian capital began to flow toward industry. After World War I a large number of new industries producing both capital and consumer goods were started, financed substantially by capital raised in India. However, the supply of Indian capital never equalled the demand. During World War II and for a few years after Indian capital continued to provide new funds for industry. By 1948, however, the stimulus was largely spent and for several years thereafter it was difficult even for the largest and best established Indian concerns to raise new capital locally. The Government of India became disturbed by this situation and an inquiry committee was set up by the Indian Reserve Bank.

Towards the end of 1953 discussions were held in Washington between the World Bank, the U.S. Government, and the Government of India to consider the establishment in India of a privately-owned corporation to provide investment necessary to the growth of private industry. It was proposed that the equity capital be raised by an issue of shares in India and also that efforts should be made to obtain subscribers from abroad. It was further proposed that the Indian Government make an advance to the proposed corporation from U.S. counterpart funds and that the World Bank consider making a loan to the new institution.

As a result of these discussions, a mission was organized by the World Bank, the First Boston Corporation, and the American Securities Corporation. The mission's work in India ~~lead~~ led to the formation of a committee of five prominent Indian businessmen to prepare detailed proposals for the new development bank. The World Bank, meanwhile, explored with leading financial institutions in the United Kingdom and the United States the possibility of private British and American participation in the equity capital of the proposed bank.

Progress was made and in October 1954 all interested groups assembled in Washington where agreement was reached on major points and the drafts of essential documents were agreed upon. In December 1954 the Bank announced that it would make a loan of $10 million as soon as the new institution had come into being. It was established under Indian law on January 5, 1955, and was given authority to commence business on March 2 of that year. Thus came about "The Industrial Credit and Investment Corporation of India", known from that day to this as ICICI.

India's development bank was formed by private investors of India, the United Kingdom and the United States with initial share capital of 50 million rupees which is equivalent to $10.5 million. Indian investors took about two thirds of the shares and today hold 72%. Of the Indian subscription, more than half or about 20 million rupees was privately placed and the remainder sold through a public offering that was over-subscribed.

British investors -- some of the Eastern Exchange Banks, the Commonwealth Development Finance Company, Ltd., several insurance companies and industrial firms -- subscribed 10 million rupees ($2.1 million). American investors -- the Bank of America, the Rockefeller brothers, Olin Mathieson Chemical Corp. and Westinghouse Electric International Corporation -- subscribed 5 million rupees ($1,050,000). Subsequently private German investors participated. The Government of India made a long-term, interest-free advance of 75 million rupees ($15,750,000) to the Corporation.

In March 1955 the World Bank loan of $10 million to ICICI was completed. As in the case of the Turkish bank, it was for a term of 15 years to provide foreign exchange for the purchase of equipment, materials and services to be imported into India to carry out projects financed by the Corporation. The loan was guaranteed by the Indian Government.

The World Bank has since assisted ICICI to get on its feet in several ways. It found, after a considerable search, ICICI's first general manager; it sent one of its staff to New Delhi as a resident manager for more than a year. And it has made three additional loans to ICICI, its total loans today being $40 million.

In the past seven years ICICI has been a busy institution making long and medium-term loans to industrial enterprises; purchasing shares of industrial enterprises; underwriting new issues of securities; guaranteeing loans by other investors; and helping industry to obtain managerial, technical and administrative advice and assistance.

How well has ICICI succeeded in fulfilling the purposes for which it was created? Since 1955 it has done one fifth of all the underwriting in India. It has made investments in or loans to 133 companies, 70 of which were new undertakings. Its earnings per share for 1961 were $1.95 and its net income for 1961 was $980,000.

ICICI's portfolio of loans and investments is well diversified among industrial categories. The amount of ICICI assistance to a single company has ranged from about $3 million down to $60,000 with the average size of projects remaining constant at about $500,000. Probably no more than 25%

of ICICI's projects yet are in commercial production. A few of these are proving troublesome, and a few others in the construction stages are incurring cost overruns and delays, but neither the number nor seriousness of the difficulties is greater than might be expected in a development finance operation of this size.

ICICI's management and staff have acquired a high degree of experience. The senior management works as an efficient team, the professional staff, numbering less than 100, displays competence. The management's relationships with the rest of the financial community appear to be solid and ICICI today is generally accepted as "setting the standard" for the appraisal and medium and long-term financing of industrial projects.

From these case histories of the Indian and Turkish development banks you can readily understand why these types of institutions are necessary to countries in the throes of economic development. While the Turkish bank was our first attempt, the World Bank has spent much time in the ensuing 12 years in helping groups in its member countries to organize similar banks, privately-owned and operated on business enterprise lines, with approval and support of their governments. The Bank has provided technical as well as financial assistance to these new institutions, sending resident advisers for substantial periods of service and training members of their staffs here in Washington.

While ICICI was the first development bank to have foreign shareholders, a number of banks which the IBRD subsequently helped to establish have followed its path of foreign and local ownership. PICIC (Pakistan) has German, Japanese, U.K. and U.S. shareholders and IMDBI

(Iran) is owned by Belgian, Dutch, French, German, Italian, U.K. and U.S. investors.

Those of you who have had the first-hand, and sometimes frustrating, experience in the work of business development for your companies overseas know that a principal obstacle to getting projects started in most underdeveloped countries -- just as in Turkey and India -- is the drastic shortage of medium and long-term capital. You probably have seen for yourselves situations similar to what I have reported: that in many countries those who have savings are generally reluctant to withdraw them from the traditional investment fields of land and commerce; or that those who extend credit are unwilling to lend for more than short periods, except at a very high rate; or that lenders in most cases prefer investment opportunities which promise a quick and sure return to new industrial enterprises which offer a prospect of risk and gradual growth.

Some of you may have had an opportunity to observe the lack of adequate institutional machinery to mobilize, and then transfer, savings out of the agricultural or commercial sectors in which they were earned. And you may have discerned that the shortage of capital is often associated with other obstacles to industrialization, such as a disinclination on the part of the business community to seek out, or to enter, new fields of activity and a dearth of people trained adequately to plan, manage and operate a new enterprise. These are the difficulties which many countries are striving to overcome by creating development banks.

As those institutions which the World Bank helped to establish have grown over the years they not only have needed more loans, obtained from the World Bank or from other sources, but they have needed also more share capital to broaden their equity as a basis for these loans. There is a limit to the amount of loans which can properly be raised on a given share capital yet for development institutions it is not easy to raise share capital. This is due to the fact that development banks invest for the most part in new enterprises which will not show much of a return on the money invested for several years to come. It is this lack of share capital that IFC is equipped to help provide.

In the World Bank family -- there are now three institutions, the Bank itself, the IFC which was established six years ago, and IDA (the International Development Association) -- IFC now is assigned the primary responsibility for directing whatever assistance is to be provided from now on to development banks, both those which are established and expanding and others being created. This came about largely because of the change which was effected in IFC's charter last September enabling IFC, for the first time, to buy and sell capital shares. As the President of IFC, Eugene R. Black, remarked not long ago, IFC is itself carrying on an industrial development banking business on an international scale. IFC seemed, consequently, the logical institution in the World Bank family to take the lead in the consideration of all industrial development banking problems.

We at IFC believe this is going to have twofold benefits. As you now have seen, development banks are becoming important economic instruments for their countries which alone justifies their existence. But, with IFC acting in the same capacity on an international scale, the interests of development banks and of IFC can be joined together, supporting and strengthening their mutual purposes.

So far IFC itself has made loans to two development banks in Colombia. These were organized by a number of Colombian commercial banks and businessmen and insurance companies to provide capital chiefly for industrial development. Presently they are providing financial support for a new electric power company, a gas pipeline company, two cattle breeding and export companies, and a feasibility study for a phosphate plant. IFC loaned $2 million to each of these two institutions in such a way as to give them long-term money without having to pay any fixed rate of interest; this insures that the Colombian banks can provide long-term capital for the industrial enterprises which they are financing. Since IFC made these loans it has converted part of each into shares of the corporations in the amounts of approximately $800,000 each.

In addition to the two Colombian investments, we are having serious discussions with about a dozen development banks concerning possible loans and/or IFC investments and reviewing problems of staffing and technical direction. Some of these discussions are with existing institutions to which the World Bank already has made loans. Others are with groups in countries such as Nigeria, the Philippines, and Venezuela. We will see in the relatively near future IFC equity investment, Bank loans and IDA credits in several new development institutions.

Of course, a development bank is only one of a number of instruments for economic development. The simple fact of one's establishment will not assure a faster growth of a country's economy in general, or even of the industrial sector in particular. A development bank's effectiveness depends upon coordinated action of related institutions and policies. Nevertheless, as we have seen today, the potential of a development bank, given the resources of local and foreign funds and personnel trained to its task, warrants describing this institution as versatile instrument of economic development, justifying support of international institutions.

* * * * * * * *

THE FOLLOWING BACKGROUND MATERIAL WAS PREPARED FOR
MR. ROSEN'S TALK BUT NOT USED BY HIM:

At the World Bank and the International Finance Corporation, or IFC, when the term "development bank" is used it invariably refers to an institution created and designed to stimulate private industrial enterprise. There are, also, development banks in the agricultural sector but these are outside the scope of Bank-IFC operations.

Some development banks are privately-owned and managed; some are government-owned and controlled. Whatever its ownership and control, a development bank must have support from its government which invariably means financial support. The interest at IFC and the World Bank is in favor of privately-owned and managed development banks. While it is recognized that most development banks will have government behind them, a minority interest on the part of government is encouraged. For experience teaches that if the management and control of banks designed to assist private industrial growth remain in private hands, then the banks will have the freedom of decision necessary to make sound investments.

For some 12 years the World Bank has spent much time in helping groups in its member countries to organize development banks which will be privately-owned and operated on business enterprise lines, with approval and support of their governments. The Bank has been providing technical as well as financial assistance to these institutions by sending out resident advisers for substantial periods of service and by training members of their staffs here in Washington.

Those who have had the first-hand, and sometimes frustrating, experience in the work of business development know that a principal obstacle to getting projects started in most underdeveloped countries, is the drastic shortage of medium and long-term capital. In many countries those who have savings are generally reluctant to withdraw them from the traditional investment fields of land and commerce: those who extend credit are unwilling to lend for more than short periods, except at a very high rate; and lenders in most cases prefer investment opportunities which promise a quick and sure return to new industrial enterprises which offer a prospect of risk and gradual growth.

In the less developed countries there is a lack of adequate institutional machinery to mobilize, and then transfer, savings out of the agricultural or commercial sectors in which they were earned. The shortage of capital is often associated with other obstacles to industrialization, such as a disinclination on the part of the business community to seek out, or to enter, new fields of activity and a dearth of people trained adequately to plan, manage and operate a new enterprise. It is due to such circumstances that many countries have created, or are now planning, development banks with authority and resources necessary to provide these ingredients of economic development.

Before these or any development banks can meet demands for investment capital, they must have funds. Depending upon the circumstances of the country and in part upon the kind of role envisaged for a particular bank, a bank's equity may come in whole or in part from private sources or may be provided from public sources. In no country has it yet proved easy to raise private equity capital for a development bank. If private investors are not prepared to invest directly in industry, they are not likely to be eager to invest indirectly, by buying development bank shares. They have been influenced to do so by some form of inducement offered by the government: for example, a guaranteed dividend, preferential tax treatment for the bank's income or dividends paid or a loan to the bank on favorable terms. Even so, initial subscribers have been predominantly banks and insurance companies. But as development banks are successful in demonstrating the profitability of industrial investment, the situation may change.

Some of the private capital which flows into industry through the development bank may be foreign in origin. Foreign equity not only adds to a country's supply of foreign exchange and provides a point of contact with capital markets in the industrialized countries but, perhaps most important, brings with it or provides access to the managerial, professional and technical skills which a developing country so greatly needs. In addition to ICICI, other development banks which the IBRD has helped to establish have foreign as well as domestic shareholders. For example, PICIC (Pakistan) has German, Japanese, U.K. and U.S. shareholders and IMDBI (Iran) is owned by Belgian, Dutch, French, German, Italian, U.K. and U.S. investors.

A development bank supplies capital on terms which are not available elsewhere, to the extent consistent with its obligations to its shareholders and with an eye to making investments which may be marketed later. This means, for example, that it can lend for as long as 10 to 15 years with a substantial grace period to allow for construction and start-up. It means that in making investment decisions a development bank places more emphasis on an enterprise's earnings prospects and the quality of its management than upon current worth and conventional security. And it means that it is prepared to make equity investments. Often a development bank is one of the few sources of foreign exchange within a country for private industrial enterprise. PICIC in Pakistan is one example.

Development banks serve also as a channel through which financial assistance can be made available to new industries whose number and relatively small scale make direct World Bank or IFC financing administratively impracticable and uneconomic.

In its financial operations, a development bank plays a catalytic role. In part through the generally accepted policy of providing no more than 50% of the capital required for a project, a development bank helps to bring into being a volume of investment much larger than the amount of its own contribution. One development bank has estimated that the total investment in new projects of the companies it assisted in 1960 would be almost five times the amount of its assistance.

Of great importance to economic development is the building of capital markets. To this end development banks also provide a means. When a development bank makes an equity investment in a new enterprise, it does so not only with the purpose of starting a new industry -- which is the applicant's interest -- or for considerations related to its own earnings potential. But the bank also emphasizes equity because its holdings of capital shares contribute significantly to its ability to help to create and to maintain a market for private securities. One way for a bank to do this is to sell investments out of its portfolio. This increases the supply of marketable securities. And if the purchaser has never bought industrial securities before but might do so again if his confidence proves justified, the transaction broadens the base for future sales. Finally, portfolio sales serve to free the bank's funds for new investments.

A development bank may engage in underwriting. This too can be a service of special value to the new enterprise which, even in industrialized countries, does not find it easy to raise new capital by share issues or public borrowings. ICICI, for example, is now the single most important underwriting institution in India.

Participations are still another device, with the private investor invited to purchase a portion of a particular investment about to be made, relying on the bank's appraisal. The Government Development Bank of Puerto Rico and the Industrial Development Corporation of South Africa have employed this technique with success. Finally, the development bank may offer its own shares or debentures to the public. While this is essentially a means of adding to the bank's own resources, it has the consequence of increasing familiarity with investment techniques and contributing to changes in attitude towards direct investment in industrial securities. A number of banks have issued their own bonds: Nacional Financiera (Mexico), the Industrial Investment Institution of Israel and the Industrial Development Corporation of South Africa are among those which have done so successfully.

There are, also, other services by development banks of great value to their countries: promotional activities; research; surveys to uncover fields which offer export possibilities or would produce import substitutes. In the field of project analysis a bank can perform a most useful service in identifying and explaining the financial, engineering, managerial, production and marketing problems inherent in a proposal and advising how these may be anticipated or overcome. Many businessmen have told us voluntarily that they learn more about their project or business as a result of an appraisal by a development bank. Some report, for example, that they had never heard of the "break-even" point in determining their company's profitability.

Anyone who has been active in the work of economic development has soon discovered that complete and accurate record keeping, at least for public disclosure, is not customary in many countries. This is a serious problem in which we may expect help from development banks. They are in a position to bring about the acceptance of this practice, sometimes by conditioning financing on satisfactory performance in these respects. Notwithstanding the difficulties, often augmented by a lack of qualified public accountants, some banks -- notably the IDB of Turkey -- already have been responsible for a market change in the business mores and they count the reforms to which they have contributed as among the principal of their achievements. For the functioning of a capital market, it is essential that there be full, reliable and, above all, accessible information based on accurate accounts concerning enterprises whose shares are publicly offered.

Declaration par M. Martin Rosen

Vice President Executif

Societe Financiere Internationale

Tunis
November 8
1962

Mr. Minister, please accept my profound thanks, which I express both for myself and my colleagues, for your very kind remarks here this morning. I think that you, sir, and we can all share a special feeling of accomplishment today, now that our careful and detailed work of many months has led to this successful conclusion.

For my part, permit me to underline briefly some of the important aspects of this unusual transaction in which we are engaged. In helping to provide capital for this new Tunisian company, the NPK Engrais, the Societe Financiere Internationale is making its first invesment not only in Tunisia but in all of North Africa. And while we have invested in Africa before, this is the first major industrial operation we have supported anywhere on the continent.

Secondly, let me say that the Societe Financiere Internationale takes greatK satisfaction from being associated with an enterpris that promises to be of importance to the Tunisian economy. The establishment of the NPK plant will add to industrial employment in Tunisia. Supplying the company with its chief raw material, that is to say r ock phosphate, will occasion more work in the mines and by the railroad which will bring the rock to the plant at Sfax. In sum, it can be said that this intensive employment of capital from outside Tunisia will give a Tunisian raw material a value which otherwise it would not have had. And since the product is to be exported, it will become an important source of foreign exchange earnings to Tunisia -- earnings on which further economic development in Tunisia can be based.

Thirdly, let me observe that the c ooperation of so many investors in this undertaking is in itself a striking demonstration of confidence in k the future of Tunisia. That confidence is being shown, of cours , by the S. F. I. itself, and by the two entrepreneurs, the Forenade company of Sweden and Freeport International of the United States. But this demonstration of faith extends e ven further, to four international financial ins titutions of private character which are taking up shares in the new enterprise or making loans to it -- namely, Laidlaw Securities of Canada, an affiliate of Hambros Bank in London, the Bank of America, the New World Development Corporation, an affiliate of Philadelphia National Bank of the United States, and Svenska Handelsbanken of Sweden.

To bring together so many diverse elements from such widely separated parts of the world would not have been possible without the full understanding and support of the Government of Tunisia. Over the course of time, I have had occasion to deal with many governments and many private parties, and this transaction is one of the most complex in which I have ever engaged. The attitude of the Government in welcoming private industrial partners to Tujisia was absolutely fundamental to the success of all our efforts, for the important effect of this attitude was to create an atmosphere of mutual confidence and respect without which it would not have been possible to carry out the time-consuming and very detailed negotiations which have led to the establishment of the NPK.

Fourth, let me point out one of the most interesting aspects of this very interesting operation. That is the desire of all the shareholders -- the Societe Financiere Internationale, the Forenade Company, Freeport International, Laidlaws and New World -- to bring private investors in Tunisia into the new company. Arrangements have been agreed to by all of us to reserve a portion of our shares for offering to Tunisian investors at par, and we have signed agreements to this effect here in Tunis this morning. This, I may say, is a most unusual undertaking. It is entered into because of the concern of the S. F. I., wherever it invests, to enlist the support of domestic capital, and I am very happy that our financial partners in Tunisia are also concerned with this objective. We are now in the process of working out the details of this offering to the Tunisian public. In the end, we expect to be able to announce a procedure whereby any prospective investor may go to any branch of the leading Tunisian banks and buy NPK shares as soon as they are issued.

Finally, let me say t hat tthroughout our long discussions, none of us has lost sight of the common objective of us all. That is to carry forward the economic development of Tunisia and to raise the living standard of its people. I have already mentioned how this objective will be served, through the new employment opportunities and added foreign exchange earnings to which the NPK will give rise. Beyond that, I think that NPK can show the way for additional ventures here in Tunisia -- demonstrating, as it does, how one can successfully bring together local resources, outside capital and domestic capital to the extent available, in an atmosphere provided by ~~xxx~~ stable administration and sound national financial policy.

Thank you.

Draft by J Croome

January 9, 1963

Rosen

Speech to the American Turkish Society

(For delivery January 10, 1963)

"Finance for Development: Attracting the Foreign Investor"

Your Excellency, Ladies and Gentlemen:

I am honored by your invitation to appear today as principal speaker at this Annual Luncheon of the American Turkish Society.

I do not seek to talk as an expert on Turkey; many of you here are closely involved with contemporary Turkish affairs, and are far more qualified as experts on Turkey's problems than I am. It is seven years since I was last in the country, and nine since I paid it an extended visit. Nevertheless, there is one subject of great concern to Turkey, and to you who are her friends, about which I would like to speak. This is the problem, confronting both Turkey and other countries in a similar economic situation, of encouraging foreign private investment.

Today, Turkey faces very serious economic difficulties. Agricultural output and exports, which at the time of my last extended visit were growing fast, have since increased much less rapidly, and have barely sufficed to offset the effects of a rapidly growing population. Exports of cotton and wheat, which alone earned $124 million in 1952, totaled only $50 million in 1961, and Turkey in fact had to import wheat. Imports now run far ahead of exports, so that for a long period of years there have been large balance of payments deficits. The loans and credits which financed those deficits have left Turkey with a fearsome burden of debt service.

In meeting these difficulties, Turkey can look for a great deal of help from other countries. The OECD is currently trying to arrange concerted assistance for Turkey from its members. But foreign aid will certainly not meet all of Turkey's needs; in any case, it cannot be expected to continue indefinitely. If the country is to achieve sustained economic growth, and a better standard of living for the Turkish people, it must do so largely by its own efforts. In my opinion, Turkey's economic future will depend heavily upon diversifying her economy and her exports. This means increased emphasis upon encouraging industrial growth. And one of the best ways to produce that growth is to attract foreign investment.

The audience does not, I am sure, need to be persuaded of the value which all concerned in such investment can derive from it. But foreign investment in the developing countries too often still has a bad name -- a bad name, I fear, on both sides. Investors have had some unhappy experiences; once bitten, they tend to be permanently shy. Moreover, it scarcely matters where the bite has occurred; the effects are felt everywhere. Expropriations by Mr. Castro in Cuba, to give one example, have damaged every country's chances of attracting support from the private investor for its development efforts. The developing countries themselves are suspicious of the motives and good faith of the foreign investor, and are often reluctant to allow profits derived -- as they see it -- from the wealth of their own countries to be siphoned away to other parts of the world. A few of these countries have actually resorted to nationalization and expropriation of foreign companies and investors. Many more, while professing to welcome the foreign investor, have in fact placed innumerable obstacles in his path.

Yet it is certain that private investment can offer a great deal that is desperately needed by the less developed countries. It can offer capital, of which they never have enough: modern industry characteristically absorbs immense amounts of money that cannot easily be found even by the most intensely nationalist government, which must meet other large commitments for roadbuilding, education and so forth. Direct private investment can also offer technical knowledge and managing ability -- both particularly scarce commodities in the developing countries. It can have a most valuable stimulating influence within a country, providing competition for existing domestic industries and training for local nationals. And finally, all private investment, when successful, has a unique characteristic unmatched by public investment from any source: it attracts further investment. The aid-giving countries do not usually rush in to make additional loans just because earlier loans have proved useful to the borrower. But successful and profitable private investments act as the most powerful inducement to further investment. Success breeds success.

It is obviously true, and often emphasized, that successful foreign investment requires that both the investor and the host country recognize certain oblications. I am not going to expound upon the duties of the foreign investor; they cover a whole range of requirements among which good faith, and public spirit, are perhaps to be ranked first. A company carrying out a large enterprise in a poor country is often in a position to exert considerable influence, and in the past this influence has not always been used wisely or well. But if the foreign investor has any sense, he will respect, and cultivate good relations with, his host country: ill conduct is likely in the end to earn its own nemesis.

No: unfair though it may seem, the primary responsibility for making foreign investment a success rests with the host country. For this, there is one very simple reason: investors have to be attracted to invest. Company directors owe a duty to their stockholders to make profits, not a moral duty to foreign countries to help fulfill national development plans. It is true that, once an investment has been made, the individual investor concerned is extremely vulnerable. His investment is more or less at the mercy of the host government. But if he is badly treated, the country is likely to lose much more than it gains, by discouraging potential investment by other foreign interests. There are a very large number of countries in the world today, and the great majority of them are competing to attract foreign investment. A country which makes itself unattractive will simply find that investors go elsewhere.

It is now six and a half years since the International Finance Corporation was set up, as the only international public organization exclusively concerned with promoting private investment in the underdeveloped countries. We have made over fifty investments in twenty-two countries. But I regret to say that we have made no investments in Turkey. Let us consider why, in spite of our desire to do so, we have so far not been able to make a Turkish investment.

Certain basic concerns are common to all foreign private investors. First, they are looking for a return on their investment — a profit, or a rate of interest, sufficiently high to justify the risks and effort involved in investing abroad. This means that developing countries must resist the temptation to tax away what may appear to them to be unnecessarily large profits: the prospect of such profits is the fundamental precondition of foreign investment. Second, and of almost equal importance, the foreign investor is looking for comparative security for his investment. He probably recognizes that in investing abroad he is running greater risks than he would face at home, and he tries to allow for this in asking a high return. But he still hopes to avoid serious shocks -- and particularly political shocks. He will of course be frightened by any threat of government interference in his investment. He will be equally frightened if the government of the country concerned is not reasonably stable: foreign investment is difficult enough without having to contend with radical and unpredictable changes in government policies and in the personnel responsible for applying them. A third basic preoccupation of the foreign investor concerns convertibility. He wants to be sure that he will be allowed to remit home his profits or interest and -- eventually, if he wishes -- his capital.

These are the basic conditions which the developing country must provide if it hopes to obtain private foreign support for its development efforts. But they are not, of course, enough in themselves. A good deal more than a reputation for probity is required to attract foreign investment.

It is difficult to generalize about the criteria which the investor adopts in judging whether to go ahead with a particular investment -- so much depends upon the circumstances of the individual investor. But it is important to recognize that there are two quite separate species of foreign investor, and that the same methods will not be appropriate for beguiling both into investing in a given country. These two species may be labeled the business investor and the financial investor.

The business investor is today much the more familiar figure. Typically, he might be represented by a large American manufacturer, perhaps of electric motors, who thinks that it might be a good idea to set up a subsidiary company in an Asian country to produce motors for sale in that country and in neighboring markets. An investor of this type is interested in such specific matters as the availability of markets and raw materials, the skills and wage levels of the local labor force, the competition his products will have to face, and the protection he will be given for his trademarks and designs. These are all matters which are, or should be, within the range of the investor's professional competence as a manager. The foreign business investor should find it reasonably easy to make by himself the decision whether or not to go ahead and invest. The developing country anxious to persuade him to do so can obviously provide powerful inducements, in the shape of tax holidays, tariff protection, export subsidies, and so on. Altogether, this side of foreign investment is fairly well understood today.

Sometimes, such business investment is the only kind possible for the foreigner. In the really primitive countries, a large or complex business enterprise can only be carried out if it is planned, financed and managed entirely by foreigners. There is no domestic capital market, and no business community. The monetary economy may scarcely exist. Often there is no market for the product, either: the foreign company ships the produce of its oil wells, mines or plantations entirely to overseas consumers.

But such countries are in the minority, and their number will certainly grow less. Most nations have some kind of entrepreneurial class, and at least a few light industries catering to the domestic market. As long as these industries remain at the level of employing ten or twenty men in a backyard workshop, there is not much that the foreign investor can do to lend a hand.

But as development proceeds, and industries become bigger, and more sophisticated, the scope for the foreigner also expands. Joint industrial ventures often become feasible, the domestic investor supplying knowledge of local conditions and markets, the foreigner contributing technical know-how and probably managerial experience as well.

Finally, the country reaches a stage at which a quite different variety of foreign investment becomes possible -- the purely financial investment, in which the investor provides capital in the expectation of earning a direct return, but does not look for other returns beyond his specified interest rate or his pre-arranged share of the profits of the enterprise.

The supply of capital for purely financial investment overseas is still rather limited . The World Bank, by the technique of offering participations in its loans, has tempted many private investors into taking portions, usually of comparatively short maturity, of obligations backed by the guarantee of a foreign government. It is more difficult to persuade investors to risk their capital abroad without either management control or the benefit of a government guarantee. Nevertheless, it can be done. It is not only the large industrial countries of Western Europe which have managed to attract the financial investor in recent years. The astonishingly rapid growth in portfolio investment in Japan and Italy has shown how much capital can become available to a developing country when it offers the investor the prospect of an expanding economy and a fair profit.

So far, the number of the developing countries which can provide satisfactory investment openings for financial capital is limited. Such capital is not likely to be attracted in significant quantities to countries which do not possess the basic substructure of a modern economy (roads, railroads, power supplies), as well as a developed entrepreneurial class, a fair variety of industry, and a domestic market of worthwhile size. Nevertheless, there is a sizeable list of countries which meet these conditions. Mexico is one. So is the Philippines. And Turkey can quite certainly become another. Each of these countries is capable, if it makes the right efforts, of attracting financial investment on a scale which could be very helpful both to the progress of individual companies and to the economic development of the whole country. But with rare exceptions, this investment is not being attracted today.

The financial investor is interested, like any other investor, in the return he gets on his money, in its safety, and in being able to repatriate it eventually. But in seeking safe and profitable investment, financial capital is not directly concerned with questions of markets, labor, spare parts, competition and the like. It does not look to receive any part of its return by such means -- important to the business investor -- as the granting of licenses, the receipt of royalties, or the protection of sales markets. It is not forced to restrict its attention to countries where one particular brand of technical and management know-how can be put to work. Against this, however, the financial investor recognizes that he cannot possibly become expert in the technology of all the wide range of industrial activities into which he might theoretically be willing to put his money. He is forced to rely heavily upon others -- and upon his own judgment of the management abilities of his investment partners, who will be directly responsible for running the business.

If financial capital is to be attracted into a developing country, it is necessary therefore to provide it with reliable and knowledgeable associates. We have found that a very large proportion of our work at the International Finance Corporation consists, essentially, of finding and matching up partners for investment projects.

In many cases, IFC itself has in effect been the partner for foreign capital. A primary objective of the Corporation, ever since it was founded, has been to build up a reputation for painstaking and thorough investigation of every project in which we invest, in order that financial investors in the United States and elsewhere may feel able to lean on our judgement. Naturally this does not (and cannot) mean that we claim to be infallible, but we hope it does mean that the interests who rely on us as partners are taking no more than the normal risks involved in industrial investment. Since 1956, we have undertaken to make investments totaling well over $70 million in the less-developed countries. Every dollar of IFC money has attracted about three dollars more of investment from private sources -- to a great extent, sources in the industrialized countries.

In some of these investments, the foreign participants were directly interested in management of the enterprise: here, in fact, you have "business" capital engaged in a joint venture with local interests. In others, IFC has been working only with local investors. But in many cases, the part played by the foreign investor has been almost entirely passive: he has had money to invest; we have found for him what appears in our judgment to be a profitable and useful investment. Let me tell you about one recent investment of this kind, since I think it shows clearly the considerations that have to be borne in mind in setting up a purely financial investment, as well as the advantages which such investment can bring to all concerned.

The largest textile company in Latin America is a firm called Compania Colombiana de Tejidos, S.A. -- better known as COLTEJER. COLTEJER was one of the first manufacturing enterprises to be established in Colombia. It was founded in 1907, and today has 30,000 shareholders. Its textile and other plants, all located in the Medellin area, employ over 8,000 persons. The company has net assets equivalent to about U.S. $43 million; supplies nearly half of all cotton goods consumed in Colombia; and has recently begun to export to other Latin American countries and to Africa.

COLTEJER is a pretty impressive enterprise. But it is not well known outside Latin America. And thus it was faced with a financial problem when, early last year, it found that the Colombian capital market could not supply some $2 million which it needed to complete a $13 million program of modernization and expansion upon which it had embarked in 1959. In January of 1962, the President of COLTEJER approached us, and proposed a medium-term investment of $2 million. After study, we concluded that an investment by IFC was amply justified by the importance of the project and by the prospect for its success. We believed that in a time of relative foreign-exchange stringency, an outside investment would be helpful to the finances of Colombia as a whole. Moreover, we felt that in view of the quality of COLTEJER, we could enlist the participation of other banks in an investment in COLTEJER, and that such participation would both help the company directly and also give a useful demonstration of the confidence of investors in Colombia and its future.

We persuaded six banks -- four affiliates of American banks, and two European banks -- to take up no less than $1,725,000 of the $2 million investment. The terms of the investment were carefully tailored to meet the needs of COLTEJER and the investors: half of it is represented by unsecured notes due for repayment between 1963 and 1966, the other half by notes maturing between 1966 and 1969. Both series of notes carry 7% interest, and the longer-dated series may, by agreement, be converted into capital shares of COLTEJER.

In the upshot, we think everyone has gained. Finance has been found for a project of importance to Colombia. Banking houses on two continents have been linked with one of Colombia's pioneer industrial companies. And in a wider context, both United States and European capital has been channeled into Latin American development at a time when broadened financial support is an objective of the Alliance for Progress.

This kind of direct relationship between foreign investor and local company is less practicable when the project or investment is comparatively small. Unless the local company is reasonably large, it cannot readily establish relations with investors abroad; intermediaries like IFC have not the time, staff or local knowledge to provide the necessary service. To fill this gap, however, the World Bank and the IFC, over a period of more than a dozen years, have been helping to establish and finance development banks in many countries. It so happens that the very first of all the development banks with which we were concerned was the Industrial Development Bank of Turkey, set up in 1950 with advice from the World Bank, and provided with its initial resources of foreign exchange by two loans from the World Bank totaling $18 million.

Earlier, I mentioned regretfully that the International Finance Corporation has made no investments in Turkey. I am happy to be able to say that we are now actively considering an equity investment in the Industrial Bank of Turkey. Already -- just six weeks ago -- another member of the World Bank family, the

International Development Association, agreed to provide the Industrial Development Bank with $5 million to meet its needs for foreign exchange over the next year or two. IFC is also looking at other possible investments in Turkish industrial enterprises. We are not alone in this interest; Turkey's prospects of stability and of economic development now appear sufficiently encouraging that the interest of foreign investors in Turkey is reviving. Whether this interest will broaden will depend upon the factors about which I have talked at such length. It would not need very much discouragement for it to vanish again altogether. But if real efforts are made to welcome both business and financial capital, and if -- above all -- the investor is provided with the prospect of political stability and a fair profit on his efforts, then Turkey can expect to receive very substantial help from foreign private investors in its efforts to forward its economic development and raise the standard of living of its peoples.

Given out in N.Y.C.

FOR IMMEDIATE RELEASE

INTERNATIONAL FINANCE CORPORATION
1818 H STREET, N.W., WASHINGTON 25, D. C. TELEPHONE: EXecutive 3-6360

FINANCE FOR DEVELOPMENT: ATTRACTING THE FOREIGN INVESTOR

Address by

Martin M. Rosen, Executive Vice President,
International Finance Corporation
Washington, D. C.

to the Annual Meeting of the American Turkish Society,
Plaza Hotel, New York, January 10, 1963

Your Excellency, Ladies and Gentlemen:

I am honored by your invitation to appear today as principal speaker at this Annual Luncheon of the American Turkish Society.

I do not seek to talk as an expert on Turkey; many of you here are closely involved with contemporary Turkish affairs, and are far more qualified as experts on Turkey's problems than I am. It is seven years since I was last in the country, and nine since I paid it an extended visit. Nevertheless, there is one subject of great concern to Turkey, and to you who are her friends, about which I would like to speak. This is the problem, confronting both Turkey and other countries in a similar economic situation, of encouraging foreign private investment.

Today, Turkey faces very serious economic difficulties. Agricultural output and exports, which at the time of my last extended visit were growing fast, have since increased much less rapidly, and have barely sufficed to offset the effects of a rapidly growing population. Exports of cotton and wheat, which alone earned \$124 million in 1952, totaled only \$50 million in 1961, and Turkey in fact had to import wheat. Imports now run far ahead of exports, so that for a long period of years there have been large balance of payments deficits. The loans and credits which financed those deficits have left Turkey with a fearsome burden of debt service.

In meeting these difficulties, Turkey can look for a great deal of help from other countries. The OECD is currently trying to arrange concerted assistance for Turkey from its members. But foreign aid will certainly not meet all of Turkey's needs; in any case, it cannot be expected to continue indefinitely. If the country is to achieve sustained economic growth, and a better standard of living for the Turkish people, it must do so largely by its own efforts. In my opinion, Turkey's economic future will depend heavily upon diversifying her economy and her exports. This means increased emphasis upon encouraging industrial growth. And one of the best ways to produce that growth is to attract foreign investment.

The audience does not, I am sure, need to be persuaded of the value which all concerned in such investment can derive from it. But foreign investment in the developing countries too often still has a bad name -- a bad name, I fear, on both sides. Investors have had some unhappy experiences; once bitten, they tend to be permanently shy. Moreover, it scarcely matters where the bite has occurred; the effects are felt everywhere. Expropriations by Mr. Castro in Cuba, to give one example, have damaged every country's chances of attracting support from the private investor for its development efforts. The developing countries themselves are suspicious of the motives and good faith of the foreign investor, and are often reluctant to allow profits derived -- as they see it -- from the wealth of their own countries to be siphoned away to other parts of the world. A few of these countries have actually resorted to nationalization and expropriation of foreign companies and investors. Many more, while professing to welcome the foreign investor, have in fact placed innumerable obstacles in his path.

Yet it is certain that private investment can offer a great deal that is desperately needed by the less developed countries. It can offer capital, of which they never have enough: modern industry characteristically absorbs immense amounts of money that cannot easily be found even by the most intensely nationalist government, which must meet other large commitments for roadbuilding, education and so forth. Direct private investment can also offer technical knowledge and managing ability -- both particularly scarce commodities in the developing countries. It can have a most valuable stimulating influence within a country, providing competition for existing domestic industries and training for local nationals. And finally, all private investment, when successful, has a unique characteristic unmatched by public investment from any source: it attracts further investment. The aid-giving countries do not usually rush in to make additional loans just because earlier loans have proved useful to the borrower. But successful and profitable private investments act as the most powerful inducement to further investment. Success breeds success.

It is obviously true, and often emphasized, that successful foreign investment requires that both the investor and the host country recognize certain obligations. I am not going to expound upon the duties of the foreign investor; they cover a whole range of requirements among which good faith, and public spirit, are perhaps to be ranked first. A company carrying out a large enterprise in a poor country is often in a position to exert considerable influence, and in the past this influence has not always been used wisely or well. But if the foreign investor has any sense, he will respect, and cultivate good relations with, his host country: ill conduct is likely in the end to earn its own nemesis.

No: unfair though it may seem, the primary responsibility for making foreign investment a success rests with the host country. For this, there is one very simple reason: investors have to be attracted to invest. Company directors owe a duty to their stockholders to make profits, not a moral duty to foreign countries to help fulfill national development plans. It is true that, once an investment has been made, the individual investor concerned is extremely vulnerable. His investment is more or less at the mercy of the host government. But if he is badly treated, the country is likely to lose much more than it gains, by discouraging potential investment by other foreign interests. There are a very large number of countries in the world today, and the great majority of them are competing to attract foreign investment. A country which makes itself unattractive will simply find that investors go elsewhere.

It is now six and a half years since the International Finance Corporation was set up, as the only international public organization exclusively concerned with promoting private investment in the underdeveloped countries. We have made over fifty investments in twenty-two countries. But I regret to say that we have made no investments in Turkey. Let us consider why, in spite of our desire to do so, we have so far not been able to make a Turkish investment.

Certain basic concerns are common to all foreign private investors. First, they are looking for a return on their investment -- a profit, or a rate of interest, sufficiently high to justify the risks and effort involved in investing abroad. This means that developing countries must resist the temptation to tax away what may appear to them to be unnecessarily large profits: the prospect of such profits is the fundamental precondition of foreign investment. Second, and of almost equal importance, the foreign investor is looking for comparative security for his investment. He probably recognizes that in investing abroad he is running greater risks than he would face at home, and he tries to allow for this in asking a high return. But he still hopes to avoid serious shocks -- and particularly political shocks. He will of course be frightened by any threat of government interference in his investment. He will be equally frightened if the government of the country concerned is not reasonably stable: foreign investment is difficult enough without having to contend with radical and unpredictable changes in government policies and in the personnel responsible for applying them. A third basic preoccupation of the foreign investor concerns convertibility. He wants to be sure that he will be allowed to remit home his profits or interest and -- eventually, if he wishes -- his capital.

These are the basic conditions which the developing country must provide if it hopes to obtain private foreign support for its development efforts. But they are not, of course, enough in themselves. A good deal more than a reputation for probity is required to attract foreign investment.

It is difficult to generalize about the criteria which the investor adopts in judging whether to go ahead with a particular investment -- so much depends upon the circumstances of the individual investor. But it is important to recognize that there are two quite separate species of foreign investor, and that the same methods will not be appropriate for beguiling both into investing in a given country. These two species may be labeled the business investor and the financial investor.

The business investor is today much the more familiar figure. Typically, he might be represented by a large American manufacturer, perhaps of electric motors, who thinks that it might be a good idea to set up a subsidiary company in an Asian country to produce motors for sale in that country and in neighboring markets. An investor of this type is interested in such specific matters as the availability of markets and raw materials, the skills and wage levels of the local labor force, the competition his products will have to face, and the protection he will be given for his trademarks and designs. These are all matters which are, or should be, within the range of the investor's professional competence as a manager. The foreign business investor should find it reasonably easy to make by himself the decision whether or not to go ahead and invest. The developing country anxious to persuade him to do so can obviously provide powerful inducements, in the shape of tax holidays, tariff protection, export subsidies, and so on. Altogether, this side of foreign investment is fairly well understood today.

Sometimes, such business investment is the only kind possible for the foreigner. In the really primitive countries, a large or complex business enterprise can only be carried out if it is planned, financed and managed entirely by foreigners. There is no domestic capital market, and no business community. The monetary economy may scarcely exist. Often there is no market for the product, either: the foreign company ships the produce of its oil wells, mines or plantations entirely to overseas consumers.

But such countries are in the minority, and their number will certainly grow less. Most nations have some kind of entrepreneurial class, and at least a few light industries catering to the domestic market. As long as these industries remain at the level of employing ten or twenty men in a backyard workshop, there is not much that the foreign investor can do to lend a hand. But as development proceeds, and industries become bigger, and more sophisticated, the scope for the foreigner also expands. Joint industrial ventures often become feasible, the domestic investor supplying knowledge of local conditions and markets, the foreigner contributing technical know-how and probably managerial experience as well.

Finally, the country reaches a stage at which a quite different variety of foreign investment becomes possible -- the purely financial investment, in which the investor provides capital in the expectation of earning a direct return, but does not look for other returns beyond his specified interest rate or his pre-arranged share of the profits of the enterprise.

The supply of capital for purely financial investment overseas is still rather limited. The World Bank, by the technique of offering participations in its loans, has tempted many private investors into taking portions, usually of comparatively short maturity, of obligations backed by the guarantee of a foreign government. It is more difficult to persuade investors to risk their capital abroad without either management control or the benefit of a government guarantee. Nevertheless, it can be done. It is not only the large industrial countries of Western Europe which have managed to attract the financial investor in recent years. The astonishingly rapid growth in portfolio investment in Japan and Italy has shown how much capital can become available to a developing country when it offers the investor the prospect of an expanding economy and a fair profit.

So far, the number of the developing countries which can provide satisfactory investment openings for financial capital is limited. Such capital is not likely to be attracted in significant quantities to countries which do not possess the basic substructure of a modern economy (roads, railroads, power supplies), as well as a developed entrepreneurial class, a fair variety of industry, and a domestic market of worthwhile size. Nevertheless, there is a sizeable list of countries which meet these conditions. Mexico is one. So is the Philippines. And Turkey can quite certainly become another. Each of these countries is capable, if it makes the right efforts, of attracting financial investment on a scale which could be very helpful both to the progress of individual companies and to the economic development of the whole country. But with rare exceptions, this investment is not being attracted today.

The financial investor is interested, like any other investor, in the return he gets on his money, in its safety, and in being able to repatriate it eventually. But in seeking safe and profitable investment, financial capital is not directly concerned with questions of markets, labor, spare parts, competition and the like. It does not look to receive any part of its return by such means -- important to the business investor -- as the granting of licenses, the receipt of royalties, or the protection of sales markets. It is not forced to restrict its attention to countries where one particular brand of technical and management know-how can be put to work. Against this, however, the financial investor recognizes that he cannot possibly become expert in the technology of all the wide range of industrial activities into which he might theoretically be willing to put his money. He is forced to rely heavily upon others -- and upon his own judgment of the management abilities of his investment partners, who will be directly responsible for running the business.

If financial capital is to be attracted into a developing country, it is necessary therefore to provide it with reliable and knowledgeable associates. We have found that a very large proportion of our work at the International Finance Corporation consists, essentially, of finding and matching up partners for investment projects.

In many cases, IFC itself has in effect been the partner for foreign capital. A primary objective of the Corporation, ever since it was founded, has been to build up a reputation for painstaking and thorough investigation of every project in which we invest, in order that financial investors in the United States and elsewhere may feel able to lean on our judgment. Naturally this does not (and cannot) mean that we claim to be infallible, but we hope it does mean that the interests who rely on us as partners are taking no more than the normal risks involved in industrial investment. Since 1956, we have undertaken to make investments totaling well over $70 million in the less-developed countries. Every dollar of IFC money has attracted about three dollars more of investment from private sources -- to a great extent, sources in the industrialized countries.

In some of these investments, the foreign participants were directly interested in management of the enterprise: here, in fact, you have "business" capital engaged in a joint venture with local interests. In others, IFC has been working only with local investors. But in many cases, the part played by the foreign investor has been almost entirely passive: he has had money to invest; we have found for him what appears in our judgment to be a profitable and useful investment. Let me tell you about one recent investment of this kind, since I think it shows clearly the considerations that have to be borne in mind in setting up a purely financial investment, as well as the advantages which such investment can bring to all concerned.

The largest textile company in Latin America is a firm called Compania Colombiana de Tejidos, S.A. -- better known as COLTEJER. COLTEJER was one of the first manufacturing enterprises to be established in Colombia. It was founded in 1907, and today has 30,000 shareholders. Its textile and other plants, all located in the Medellin area, employ over 8,000 persons. The company has net assets equivalent to about U.S. $43 million; supplies nearly half of all cotton goods consumed in Colombia; and has recently begun to export to other Latin American countries and to Africa.

COLTEJER is a pretty impressive enterprise. But it is not well known outside Latin America. And thus it was faced with a financial problem when, early last year, it found that the Colombian capital market could not supply some $2 million which it needed to complete a $13 million program of modernization and expansion upon which it had embarked in 1959. In January of 1962, the President of COLTEJER approached us, and proposed a medium-term investment of

$2 million. After study, we concluded that an investment by IFC was amply justified by the importance of the project and by the prospects for its success. We believed that in a time of relative foreign-exchange stringency, an outside investment would be helpful to the finances of Colombia as a whole. Moreover, we felt that in view of the quality of COLTEJER, we could enlist the participation of other banks in an investment in COLTEJER, and that such participation would both help the company directly and also give a useful demonstration of the confidence of investors in Colombia and its future.

We persuaded six banks -- four affiliates of American banks, and two European banks -- to take up no less than $1,725,000 of the $2 million investment. The terms of the investment were carefully tailored to meet the needs of COLTEJER and the investors: half of it is represented by unsecured notes due for repayment between 1963 and 1966, the other half by notes maturing between 1966 and 1969. Both series of notes carry 7% interest, and the longer-dated series may, by agreement, be converted into capital shares of COLTEJER.

In the upshot, we think everyone has gained. Finance has been found for a project of importance to Colombia. Banking houses on two continents have been linked with one of Colombia's pioneer industrial companies. And in a wider context, both United States and European capital has been channeled into Latin American development at a time when broadened financial support is an objective of the Alliance for Progress.

This kind of direct relationship between foreign investor and local company is less practicable when the project or investment is comparatively small. Unless the local company is reasonably large, it cannot readily establish relations with investors abroad; intermediaries like IFC have not the time, staff or local knowledge to provide the necessary service. To fill this gap, however, the World Bank and the IFC, over a period of more than a dozen years, have been helping to establish and finance development banks in many countries. It so happens that the very first of all the development banks with which we were concerned was the Industrial Development Bank of Turkey, set up in 1950 with advice from the World Bank, and provided with its initial resources of foreign exchange by two loans from the World Bank totaling $18 million.

Earlier, I mentioned regretfully that the International Finance Corporation has made no investments in Turkey. I am happy to be able to say that we are now actively considering an equity investment in the Industrial Bank of Turkey. Already -- just six weeks ago -- another member of the World Bank family, the International Development Association, agreed to provide the Industrial Development Bank with $5 million to meet its needs for foreign exchange over the next year or two. IFC is also looking at other possible investments in Turkish industrial enterprises. We are not alone in this interest; Turkey's prospects of stability and of economic development now appear sufficiently encouraging that the interest of foreign investors in Turkey is reviving. Whether this interest will broaden will depend upon the factors about which I have talked at such length. It would not need very much discouragement for it to vanish again altogether. But if real efforts are made to welcome both business and financial capital, and if -- above all -- the investor is provided with the prospect of political stability and a fair profit on his efforts, then Turkey can expect to receive very substantial help from foreign private investors in its efforts to forward its economic development and raise the standard of living of its peoples.

Insert

Once one has experienced the warmth of Turkish hospitality and friendship and has seen the enthusiasm of the ~~t~~ Turkish people for the future of their country, one continues to feel intimate links with the country. Consequently, although I am not coming here as an expert on Turkey, nevertheless, ...

FOR IMMEDIATE RELEASE

INTERNATIONAL FINANCE CORPORATION
1818 H STREET, N.W., WASHINGTON 25, D. C. TELEPHONE: EXecutive 3-6360

FINANCE FOR DEVELOPMENT: ATTRACTING THE FOREIGN INVESTOR

Address by

Martin M. Rosen, Executive Vice President,
International Finance Corporation
Washington, D. C.

to the Annual Meeting of the American Turkish Society,
Plaza Hotel, New York, January 10, 1963

Your Excellency, Ladies and Gentlemen:

I am honored by your invitation to appear today as principal speaker at this Annual Luncheon of the American Turkish Society.

I do not seek to talk as an expert on the current economic or political position of Turkey; many of you here are closely involved with contemporary Turkish affairs, and are far more qualified as experts on Turkey's problems than I am. It is seven years since I was last in the country, and nine since I paid it an extended visit. Insert ~~N~~evertheless, there is one subject of great concern to Turkey, and to you who are her friends, about which I would like to speak. This is the problem, confronting both Turkey and other countries in a similar economic situation, of encouraging foreign private investment.

Today, Turkey faces very serious economic difficulties. Agricultural output and exports, which at the time of my last extended visit were growing fast, have since increased much less rapidly, and have barely sufficed to offset the effects of a rapidly growing population. Exports of cotton and wheat, which alone earned $124 million in 1952, totaled only $50 million in 1961, and Turkey in fact had to import wheat. Imports now run far ahead of exports, so that for a long period of years there have been large balance of payments deficits. The loans and credits which financed those deficits have left Turkey with a fearsome burden of debt service.

In meeting these difficulties, Turkey can look for a great deal of help from other countries. The OECD is currently trying to arrange concerted assistance for Turkey from its members. But foreign aid will certainly not meet all of Turkey's needs; in any case, it cannot be expected to continue indefinitely. If the country is to achieve sustained economic growth, and a better standard of living for the Turkish people, it must do so largely by its own efforts. In my opinion, Turkey's economic future will depend heavily upon diversifying her economy and her exports. This means increased emphasis upon encouraging industrial growth. And one of the best ways to produce that growth is to attract foreign investment.

The audience does not, I am sure, need to be persuaded of the value which all concerned in such investment can derive from it. But foreign investment in the developing countries too often still has a bad name -- a bad name, I fear, on both sides. Investors have had some unhappy experiences; once bitten, they tend to be permanently shy. Moreover, it scarcely matters where the bite has occurred; the effects are felt everywhere. Expropriations by Mr. Castro in Cuba, to give one example, have damaged every country's chances of attracting support from the private investor for its development efforts. The developing countries themselves are suspicious of the motives and good faith of the foreign investor, and are often reluctant to allow profits derived -- as they see it -- from the wealth of their own countries to be siphoned away to other parts of the world. A few of these countries have actually resorted to nationalization and expropriation of foreign companies and investors. Many more, while professing to welcome the foreign investor, have in fact placed innumerable obstacles in his path.

Yet it is certain that private investment can offer a great deal that is desperately needed by the less developed countries. It can offer capital, of which they never have enough: modern industry characteristically absorbs immense amounts of money that cannot easily be found even by the most intensely nationalist government, which must meet other large commitments for roadbuilding, education and so forth. Direct private investment can also offer technical knowledge and managing ability -- both ~~particularly~~ scarce commodities anywhere and particularly scarce in the developing countries. It can have a most valuable stimulating influence within a country, providing competition for existing domestic industries and training for local nationals. And finally, <u>all</u> private investment, when successful, has a unique characteristic unmatched by public investment from any source: it attracts further investment. The aid-giving countries do not usually rush in to make additional loans just because earlier loans have proved useful to the borrower. But successful and profitable private investments act as the most powerful inducement to further investment. Success breeds success.

It is obviously true, and often emphasized, that successful foreign investment requires that both the investor and the host country recognize certain obligations. I am not going to expound upon the duties of the foreign investor; they cover a whole range of requirements among which good faith, and public spirit, are perhaps to be ranked first. A company carrying out a large enterprise in a poor country is often in a position to exert considerable influence, and in the past this influence has not always been used wisely or well. But if the foreign investor has any sense, he will respect, and cultivate good relations with, his host country: ill conduct is likely in the end to earn its own nemesis.

No: unfair though it may seem, the primary responsibility for making foreign investment a success rests with the host country. For this, there is one very simple reason: investors have to be attracted to invest. Company directors owe a duty to their stockholders to make profits, not a moral duty to foreign countries to help fulfill national development plans. It is true that, once an investment has been made, the individual investor concerned is extremely vulnerable. His investment is more or less at the mercy of the host government. But if he is badly treated, the country is likely to lose much more than it gains, by discouraging potential investment by other foreign interests. There are a very large number of countries in the world today, and the great majority of them are competing to attract foreign investment. A country which makes itself unattractive will simply find that investors go elsewhere.

It is now six and a half years since the International Finance Corporation was set up, as the only international public organization exclusively concerned with promoting private investment in the underdeveloped countries. We have made over fifty investments in twenty-two countries. But I regret to say that we have made no investments in Turkey. Let us consider why, in spite of our desire to do so, we have so far not been able to make a Turkish investment.

Certain basic concerns are common to all foreign private investors. First, they are looking for a return on their investment -- a profit, or a rate of interest, sufficiently high to justify the risks and effort involved in investing abroad. This means that developing countries must resist the temptation to tax away what may appear to them to be unnecessarily large profits: the prospect of such profits is the fundamental precondition of foreign investment. Second, and of almost equal importance, the foreign investor is looking for comparative security for his investment. He probably recognizes that in investing abroad he is running greater risks than he would face at home, and he tries to allow for this in asking a high return. But he still hopes to avoid serious shocks -- and particularly political shocks. He will of course be frightened by any threat of government interference in his investment. He will be equally frightened if the government of the country concerned is not reasonably stable: foreign investment is difficult enough without having to contend with radical and unpredictable changes in government policies and in the personnel responsible for applying them. A third basic preoccupation of the foreign investor concerns convertibility. He wants to be sure that he will be allowed to remit home his profits or interest and -- eventually, if he wishes -- his capital.

These are the basic conditions which the developing country must provide if it hopes to obtain private foreign support for its development efforts. But they are not, of course, enough in themselves. A good deal more than a reputation for probity is required to attract foreign investment.

It is difficult to generalize about the criteria which the investor adopts in judging whether to go ahead with a particular investment -- so much depends upon the circumstances of the individual investor. But it is important to recognize that there are two quite separate species of foreign investor, and that the same methods will not be appropriate for beguiling both into investing in a given country. These two species may be labeled the business investor and the financial investor.

The business investor is today much the more familiar figure. Typically, he might be represented by a large American manufacturer, perhaps of electric motors, who thinks that it might be a good idea to set up a subsidiary company in a foreign ~~an Asian~~ country to produce motors for sale in that country and in neighboring markets. An investor of this type is interested in such specific matters as the availability of markets and raw materials, the skills and wage levels of the local labor force, the competition his products will have to face, and the protection he will be given for his trademarks and designs. These are all matters which are, or should be, within the range of the investor's professional competence as a manager. The foreign business investor experienced in producing the particular products involved should find it reasonably easy to make by himself the decision ~~whether or not to go ahead and invest.~~ on the business prospects of the investment. The developing country anxious to persuade him to do so can obviously provide powerful inducements, in the shape of tax holidays, tariff protection, export subsidies, and so on, or can assure him that the negative factors -- excessive regulation, price control, competition by government-owned factories -- will not be present. Altogether, this side of foreign investment is fairly well understood today.

Sometimes, such business investment, wholly ~~[illegible]~~ foreign owned and managed, is the only kind possible. ~~for the foreigner.~~ In the really primitive countries, a large or complex business enterprise can only be carried out if it is planned, financed and managed entirely by foreigners. There is no domestic capital market, and no business community. The monetary economy may scarcely exist. Often there is no market for the product, either: the foreign company ships the produce of its oil wells, mines or plantations entirely to overseas consumers.

But such countries are in the minority, and their number will certainly grow less. Most nations have some kind of entrepreneurial class, and at least a few light industries catering to the domestic market. As long as these industries remain at the level of employing ten or twenty men in a backyard workshop, there is not much that the foreign investor can do to lend a hand. But as development proceeds, and industries become bigger, and more sophisticated, the scope for the foreigner also expands. Joint industrial ventures often become feasible, the domestic investor supplying knowledge of local conditions and markets, the foreigner contributing technical know-how and probably managerial experience as well.

Finally, the country reaches a stage at which a quite different variety of foreign investment becomes possible -- the purely financial investment, in which the investor provides capital in the expectation of earning a direct return, but does not look for other returns beyond his specified interest rate or his pre-arranged share of the profits of the enterprise.

The supply of capital for purely financial investment overseas is still rather limited. The World Bank, by the technique of offering participations in its loans, has tempted many private investors into taking portions, usually of comparatively short maturity, of obligations backed by the guarantee of a foreign government. It is more difficult to persuade investors to risk their capital abroad without either management control or the benefit of a government guarantee. Nevertheless, it can be done. It is not only the large industrial countries of Western Europe which have managed to attract the financial investor in recent years. The astonishingly rapid growth in portfolio investment in Japan and Italy, countries which a few years ago had what seemed to be insoluble balance of payments problems, has shown how much capital can become available to a developing country when it offers the investor the prospect of an expanding economy and a fair profit.

So far, the number of the developing countries which can provide satisfactory investment openings for financial capital is limited. Such capital is not likely to be attracted in significant quantities to countries which do not possess the basic substructure of a modern economy (roads, railroads, power supplies), as well as a developed entrepreneurial class, a fair variety of industry, and a domestic market of worthwhile size. Nevertheless, there is a sizeable list of countries which meet these conditions. Mexico ~~is one. So is~~ and the Philippines obviously come to mind. And Turkey can quite certainly become another. Each of these countries is capable, if it makes the right efforts, of attracting financial investment on a scale which could be very helpful both to the progress of individual companies and to the economic development of the whole country. But with rare exceptions, this investment is not being attracted today.

The financial investor is interested, like any other investor, in the return he gets on his money, in its safety, and in being able to repatriate it eventually. But in seeking safe and profitable investment, financial capital is not directly concerned with questions of markets, labor, spare parts, competition and the like. It does not look to receive any part of its return by such means -- important to the business investor -- as the granting of licenses, the receipt of royalties, or the protection of sales markets. It is not forced to restrict its attention to countries where one particular brand of technical and management know-how can be put to work. Against this, however, the financial investor recognizes that he cannot possibly become expert in the technology of all the wide range of industrial activities into which he might theoretically be willing to put his money. He is forced to rely heavily upon others -- and upon his own judgment of the management abilities of his investment partners, who will be directly responsible for running the business.

If financial capital is to be attracted into a developing country, it is necessary therefore to provide it with reliable and knowledgeable associates. We have found that a very large proportion of our work at the International Finance Corporation consists, essentially, of finding and matching up partners for investment projects.

In many cases, IFC itself has in effect been the partner for foreign capital. A primary objective of the Corporation, ever since it was founded, has been to build up a reputation for painstaking and thorough investigation of every project in which we invest, in order that financial investors in the United States and elsewhere may feel able to lean on our judgment. Naturally this does not (and cannot) mean that we claim to be infallible, but we hope it does mean that the interests who rely on us as partners are taking no more than the normal risks involved in industrial investment. Since 1956, we have undertaken to make investments totaling well over $70 million in the less-developed countries. Every dollar of IFC money has attracted about three dollars more of investment from private sources -- to a great extent, sources in the industrialized countries.

In some of these investments, the foreign participants were directly interested in management of the enterprise: here, in fact, you have "business" capital engaged in a joint venture with local interests. In others, IFC has been working only with local investors. But in many cases, the part played by the foreign investor has been almost entirely passive: he has had money to invest; we have found for him what appears in our judgment to be a profitable and useful investment. Let me tell you about one recent investment of this kind, since I think it shows clearly the considerations that have to be borne in mind in setting up a purely financial investment, as well as the advantages which such investment can bring to all concerned.

The largest textile company in Latin America is a firm called Compania Colombiana de Tejidos, S.A. -- better known as COLTEJER. COLTEJER was one of the first manufacturing enterprises to be established in Colombia. It was founded in 1907, and today has 30,000 shareholders. Its textile and other plants, all located in the Medellin area, employ over 8,000 persons. The company has net assets equivalent to about U.S. $43 million; supplies nearly half of all cotton goods consumed in Colombia; and has recently begun to export to other Latin American countries and to Africa.

COLTEJER is a pretty impressive enterprise. But it is not well known outside Latin America. And thus it was faced with a financial problem when, early last year, it found that the Colombian capital market could not supply some $2 million which it needed to complete a $13 million program of modernization and expansion upon which it had embarked in 1959. In January of 1962, the President of COLTEJER approached us, and proposed a medium-term investment of

$2 million. After study, we concluded that an investment by IFC was amply justified by the importance of the project and by the prospects for its success. We believed that in a time of relative foreign-exchange stringency, an outside investment would be helpful to the finances of Colombia as a whole. Moreover, we felt that in view of the quality of COLTEJER, we could enlist the participation of other banks in an investment in COLTEJER, and that such participation would both help the company directly and also give a useful demonstration of the confidence of investors in Colombia and its future.

We persuaded six banks -- four affiliates of American banks, and two European banks -- to take up no less than $1,725,000 of the $2 million investment. The terms of the investment were carefully tailored to meet the needs of COLTEJER and the investors: half of it is represented by unsecured notes due for repayment between 1963 and 1966, the other half by notes maturing between 1966 and 1969. Both series of notes carry 7% interest, and the longer-dated series may, by agreement, be converted into capital shares of COLTEJER.

In the upshot, we think everyone has gained. Finance has been found for a project of importance to Colombia. Banking houses on two continents have been linked with one of Colombia's pioneer industrial companies. And in a wider context, both United States and European capital has been channeled into Latin American development at a time when broadened financial support is an objective of the Alliance for Progress.

This kind of direct relationship between foreign investor and local company is less practicable when the project or investment is comparatively small. Unless the local company is reasonably large, it cannot readily establish relations with investors abroad; intermediaries like IFC have not the time, staff or local knowledge to provide the necessary service. To fill this gap, however, the World Bank and the IFC, over a period of more than a dozen years, have been helping to establish and finance development banks in many countries. It so happens that the very first of all the development banks with which we were concerned was the Industrial Development Bank of Turkey, set up in 1950 with advice from the World Bank, and provided with its initial resources of foreign exchange by two loans from the World Bank totaling $18 million.

Earlier, I mentioned regretfully that the International Finance Corporation has made no investments in Turkey. I am happy to be able to say that we are now actively considering an equity investment in the Industrial Bank of Turkey. Already -- just six weeks ago -- another member of the World Bank family, the International Development Association, agreed to provide the Industrial Development Bank with $5 million to meet its needs for foreign exchange over the next year or two. IFC is also looking at other possible investments in Turkish industrial enterprises. We are not alone in this interest; Turkey's prospects of stability and of economic development now appear sufficiently encouraging that the interest of foreign investors in Turkey is reviving. Whether this interest will broaden will depend upon the factors about which I have talked at such length. It would not need very much discouragement for it to vanish again altogether. But if real efforts are made to welcome both business and financial capital, and if -- above all -- the investor is provided with the prospect of political stability and a fair profit on his efforts, then Turkey can expect to receive very substantial help from foreign private investors in its efforts to forward its economic development and raise the standard of living of its peoples.

Outline of speech in Morocco — Probably Jan 16, 1963

PROJET D'ALLOCUTION POUR M. ROSEN

I - Permettez-moi de commencer cet exposé en attirant votre attention sur la nature de la Société Financière Internationale. Il s'agit essentiellement d'un organisme international, qui est une filiale de la Banque mondiale et comprend aujourd'hui 72 pays membres. Le Maroc est l'un des plus récents et, à ce titre, il est associé à la direction de la S. F. I. Il est représenté par un administrateur qui est, en même temps, le porte parole de 5 pays d'Afrique et d'Asie.

II - La S. F. I. a un capital de 100 Millions de dollars sur lesquels 98 millions ont été versés, ce qui représente environ 500 millions de dirhams. C'est en saisissant une part de ce capital qu'un pays peut devenir membre de la S. F. I. Ses revenus se sont élevés, depuis le commencement de ses activités, à 14 millions de dollars.

III - La Société Financière Internationale est un organisme de financement destiné à faciliter, par des investissements effectués dans des entreprises privées, le développement des pays membres dont l'économie est moins avancée. Les opérations financières de la S. F. I. peuvent prendre des formes variées: souscription d'actions, prêts de type classique, prêts assortis de participation au capital, ou combinaison de ces divers modes de financement.

IV - Je n'ai pas besoin de souligner que le capital de la S. F. I. étant plutôt limité, compte tenu des objectifs qu'elle poursuit, il est indispensable d'utiliser celui-ci de la manière la plus efficace. Pour que la S. F. I. s'intéresse à un projet, il convient d'indiquer que trois conditions sont, en règle générale, requises.

./.

D'abord ce projet doit contribuer utilement au développement du secteur privé de l'économie et revêtir un aspect prioritaire. Ensuite, il doit s'agir d'un projet rentable, dont la mise au point technique, la direction et le financement sont assurés sur des bases saines.

Enfin l'intervention de la S. F. I. doit apparaître nécessaire, soit parce que un financement privé suffisant n'a pu être obtenu, soit parce que une telle intervention rend plus aisé l'apport de capitaux privés. Un investissement de la S. F. I. ne peut d'ailleurs avoir lieu qu'en association avec des investissements privés et, obligatoirement, dans un pays membre. Une fois que ces conditions sont réunies, la S. F. I. peut faire preuve d'une grande souplesse dans le choix des projets qu'elle accepte de financer.

V - Aujourd'hui, les engagements réels de la S. F. I. atteignent un montant de 78 millions de dollars et correspondent à un ensemble d'opérations effectuées principalement dans les domaines suivants : industrie (construction électrique, engrais chimiques, textiles, construction mécanique, véhicules automobiles, industrie du caoutchouc, sidérurgie, matériaux de construction, pièces détachées pour automobiles, industrie du papier, ciment, industrie pétrochimique, industrie sucrière, etc..) Mines (transports et Services, institutions financières.)

Enfin, je dois dire que ces opérations ont intéressé les cinq continents.

VI - Laissez-moi maintenant illustrer par quelques exemples concrets les principes généraux dont j'ai parlé précédemment.

1) - Coltejer (Colombie)

Dans ce cas, la S. F. I. a pu obtenir le concours d'un certain nombre de grandes institutions financières d'Allemagne, des Etats-Unis et de Suisse en faveur de la plus grande entreprise textile d'Amérique du Sud.

./.

2) - N. P. K. Engrais - SFAX (Tunisie)

La S. F. I. a pu prendre part à une opération internationale de financement à la place des capitaux privés tunisiens qui n'avaient pu être trouvés sur place et avec l'intention de revendre plus tard à des intérêts privés tunisiens, une part des actions souscrites (10 %) . Cette opération ressemble par cet aspect à l'accord que nous venons de conclure avec la B. N. D. E. au Maroc......

3) - En Juin 1962, la SFI a procédé au Mexique à sa première opération de garantie d'émission. Elle a constitué un syndicat avec une société mexicaine d'investissement........

4) - TAMSA

La S. F. I. a accepté d'acheter une part des actions de la Compagnie mexicaine et d'offrir une assistance stand-by pour un montant complémentaire. Cette intervention a eu pour objectif d'encourager d'autres investissements privés.......

VII - Enfin, une forme d'action toute récente et très importante pour nous est la prise de participation, par la S. F. I., dans le capital des Banques de développement.

Dans certains cas, les entreprises privées qui ont besoin de notre aide sont trop petites et trop nombreuses pour pouvoir traiter directement avec la Société Financière Internationale. Les Banques de développement peuvent servir alors d'organismes -relais. Nous venons, ainsi, de souscrire une partie du capital de la B. N. D. E. au Maroc............ (see press-release).

SUBJECT: Financing Industrial
Development Abroad

Mr. Rosen in New York * NAM
February 20, 1963 (off the cuff) (copy sent to Paris 3/6/63)

I. Mr. Chairman, I'm very grateful to you for the opportunity to meet with this group representing American industry. The International Finance Corporation already has had a good deal of experience in helping to finance the establishment or expansion of American industries overseas, and it would like to be helping still more. For that reason, I will be very glad to tell you quite informally in the next few minutes something about our activities and about the specific situations in which we have been able to provide or find capital needed by American entrepreneurs.

IFC, to begin with, is unique. So far as I know, it is the only official organization in Washington which operates for the sole purpose of assisting the international spread of private enterprise. The IFC also is unusual, I think, in the geographic range of its interests and activities. We are an international organization, affiliated with the World Bank and drawing our membership and support from the member countries of the Bank. We have 72 member countries; they are located on every continent but they do not include, of course, any of the countries of the Eastern bloc.

Although IFC is affiliated with the World Bank, it is distinct from it in important ways. We have our own capital -- paid in by all our members but consisting entirely of United States dollars. Unlike the Bank we neither seek nor accept governmental guarantees of the investments we make in private industry. And unlike the Bank -- or for that matter, any other official institution of which I am aware -- the Corporation can and does provide equity capital to the companies in which it invests.

II. The basic facts about our investments are these:

a. 56 commitments: $74 million of investments (net of cancellations); $8 million of underwritings

b. only in less developed areas (but including Greece and New Zealand)

c. only in association with private business
   i. about a quarter of IFC investments in association with American industrial companies, especially in Latin America
   ii. but in great majority of cases, domestic interests also present: from standpoint of IFC's objective of promoting private industrial growth, this is essential.

III. The standards that a proposal must meet to qualify for IFC support are quite simple to state:

a. suggested project must make a useful contribution to the economy of the host country
   i. we have chosen to concentrate on industry, and especially on manufacturing, as the field in which our participation can be most helpful.
      Types of industry, including mining
      Processing.

b. secondly, the proposed project must be soundly engineered, managed and financed. One of our important functions is to help bring in appropriate management and financing if these are missing.

c. thirdly, there must be some special reason why IFC financing is needed. Sometimes this will be because sufficient financing is not available from other investors on reasonable terms, and IFC investment will make up the gap. Sometimes it will be because IFC's participation will, of itself, engage the interest and confidence of private investors and thereby increase the availability of capital from other sources.

IV. The actual form of IFC's investment depends on the nature of the case and the kind of financing that best meets the need. We can make straight loans, or we can invest in equity or we can make an investment which is a mixture of the two....

a. IFC's interest in equity and equity features; we are interested in selling off as a means of broadening the capital market.

V. Now let me illustrate how these principles have worked out in a few specific cases:

a. A big deal needing a last infusion to make it go: Petroquimica

b. A local enterprise unable to find local capital, therefor needing to turn overseas: COLTEJER

c. An international deal unable to find local partners: NPK.

VI. I have reserved for the last a type of IFC activity which in the end may prove to be the most useful of all. This is the interest we take in helping to establish and to finance privately owned development banks in the underdeveloped countries. Thanks both to the IFC and the World Bank, there are a growing number of these institutions around the world. Many of them are very flexible instruments, able to provide industries with loan capital, equity and, if need be, managerial and technical assistance. Since the problem of obtaining suitable financing in local currencies is one of chronic difficulty for American firms operating abroad, development banks are of particular interest to them. For interest, one of the oldest of these institutions, the Industrial Development Bank of Turkey, has been of notable assistance to Turkish companies in which Americans share ownership.

a. Private Development Corporation of the Philippines.

The International Affairs Committee
National Association of Manufacturers

Address By

Martin M. Rosen
Executive Vice-President
International Finance Corporation

February 20, 1963, New York City

I am pleased at the opportunity to speak to this group whose interests so closely parallel those of the IFC. Your committee represents private American business interested in international investments. The International Finance Corporation, on the other hand, has had a good deal of experience in financing privately owned industrial projects abroad. In our work we have had the opportunity of cooperating with a number of American companies whose officials are members of this Committee.

Some of these companies are Continental Oil, Olin Mathieson, Kaiser Industries, Champion Paper, W.R. Grace & Company, Universal American, Norma Hoffman and Freeport Sulphur.

In view of the similarity of our interests I shall spend a few minutes telling you about the IFC and what it does, and I shall be glad to answer any questions you may have concerning it.

IFC is unique. It is the only international organization in Washington, or so far as I know anywhere else, which operates for the sole purpose of assisting the international spread of private enterprise. We are an affiliate of the World Bank, and to be a member of IFC it is necessary that a country also be a member of the Bank. We have 73 member countries located on six continents, but they do not include, of course, any countries of the Communist bloc.

We have our own capital - about $100 million - paid in by all our member countries and consisting entirely of United States dollars. George Woods, and before him Gene Black, is President of IFC as well as of the World Bank, but we do have a separate operating staff. Unlike the World Bank - or for that matter any other U.S. based official institution of which I am aware - the Corporation can and does provide equity capital to the companies in which it invests.

We have so far made 58 commitments in 24 of our member countries. They include $74 million of investments, and more than $8 million of underwriting and standby agreements covering the sale and distribution of corporate shares or obligations. All of our investments are in the underdeveloped countries; we would not, for example, invest in Germany, France or Japan. All of our investments are made in association with private business and they extend only to the point necessary to insure that financing of investment requirements is successfully completed. About a quarter of IFC's investments have been made in association with American industrial companies, especially in Latin America where we have invested in projects with Willys Motors, Olin Mathieson, Champion Paper and other American concerns.

In doing our work abroad we are trying to perform three main functions or purposes that have been assigned to us. First, we finance private industrial projects in underdeveloped countries that are members of IFC. Second, we attempt to spur development of local capital markets in those countries; and here I shall digress a moment to underline for you the importance I attach to this second function.

Local capital markets are essential to the underdeveloped world because the development and maintenance of the private enterprise system is dependent on spreading local corporate ownership through the creation of a stockholding middle class. Our third purpose is to stimulate the international flow of private capital.

Let me, at this point, give several examples that demonstrate in practice how we achieve our three principal objectives. My first example covers the financing of a privately owned industrial project in an underdeveloped country - in this case India.

The Corporation has made a commitment to invest in a concern called "Precision Bearings India, Ltd.", which is building a plant at Baroda to manufacture various types and sizes of roller and ball bearings that in quality will meet U.S. standards. In this investment we are associated with able Indian sponsors and an experienced bearing manufacturing company in the United States.

The private sector in India has made great progress since the war but, in recent years, has been having difficulty in obtaining foreign exchange necessary to carry out many projects; and Precision Bearing is not exempt from this difficulty. In this instance, however, IFC through making an investment, part in loan and part in equity, is supplying the foreign exchange that is lacking and is urgently needed to make the whole deal move forward. By this investment we are not only helping Precision Bearing and its sponsors; we are also helping to forward a project that is of high priority to the Indian economy and to the progress of the country's Five-Year Development Plan.

As my example of how IFC is achieving its second purpose - the development of local capital markets - I shall touch on our activities in connection with the financing of FUNDIDORA, Mexico's largest privately owned steel company. FUNDIDORA is carrying out an expansion program to raise production from 200,000 to 500,000 ingot tons a year and to diversify its product lines. Last summer, it needed more than $5 million in equity financing to complete the financing of the program. In connection with a rights offering to the company's stockholders, we agreed to form a syndicate with a Mexican investment house, Credito Bursatil, in what turned out to be probably the largest underwriting of an industrial share issue ever undertaken in Mexico.

We ourselves, undertook to underwrite the issue to the extent of nearly $3 million, and we also bought outright shares valued at over $1.1 million, as an investment. IFC also obtained the support of three private banks, two American and one Swiss, who took over one-third of our underwriting commitment. A large part of the shares not subscribed for at the time by existing shareholders of FUNDIDORA have since gradually been sold off to investors in Mexico and elsewhere, and we have also found buyers for the greater part of the FUNDIDORA shares we had bought for ourselves.

The results have been to allow FUNDIDORA to raise capital by means of a far larger issue than would have been possible without our intervention; to bring three major foreign investment banking houses to take a direct interest in the company's needs; and to encourage and widen the Mexican capital market.

To illustrate how IFC works toward the fulfillment of its third goal - stimulation of the international flow of private capital - I have chosen the financing of COLTEJER in Colombia. This company is the largest manufacturer of cotton textiles in Latin America and supplies some 45% of all cotton goods consumed in Colombia. Behind it, COLTEJER has a long record of good management and profitable operations. Its shares are actively traded and widely held in Colombia and its shareholders are estimated to number nearly 30,000.

In 1959, the Company embarked on a $13 million modernization and expansion program with a view to strengthening its competitive position and to taking advantage of expanding market possibilities. In financing the program the Company decided to raise the bulk of the funds required through the sale of additional stock, retained earnings, suppliers' credits and sale of a $2 million medium-term bond issue in the Colombian market. In the first three instances financial targets were met, but conditions in the Colombian market prevented sale of the medium-term bond issue. The management of COLTEJER, in January 1962, approached IFC and asked us to help finance the gap in the financial program.

After examining the situation, IFC agreed to help in finding the missing $2 million. But, in view of the high quality of COLTEJER, we made our assistance conditional on our finding partners internationally to participate in the investment with us. In the search for partners we approached commercial banks abroad that had business relationships with COLTEJER. One of them, Chemical Bank New York Trust Company, through its affiliate Chemical Overseas Finance Corporation, agreed to take a major position in the transaction; and we worked together in arriving at terms for the deal. We ended up by designing a medium-term financing instrument that was sufficiently attractive to induce six private institutions in the U.S. and Europe, including Chemical, to take about 90% of the $2 million COLTEJER issue. The final result was successful completion of its financial program by COLTEJER and the establishment of the Company's obligations internationally.

Another transaction demonstrating how IFC works toward its objectives involved Freeport Sulphur Company and a leading Swedish concern who through a new affiliate - NPK Engrais - were sponsoring establishment of a triple superphosphate fertilizer plant in Tunisia. Successful establishment of this enterprise was and is of high economic importance to a country as poor and underdeveloped as is Tunisia. The new plant, located at the Port of Sfax, will use local deposits of phosphate rock for raw materials and thereby stimulate development of a major Tunisian resource. Its production of fertilizer - up to 150,000 tons a year - will all be exported from Tunisia and should materially increase the country's earnings of foreign exchange.

The financing of NPK's plant called for investments totaling a little over $14 million, including $6 million in equity. The two sponsors committed themselves for a total of $7¾ million in loan and equity investments and some $3.3 million would be obtained through suppliers' credits and other loan sources. A gap of $3.5 million in equity and loan capital remained to be financed and the sponsors hoped to raise at least part of this sum in Tunisia. They were not successful, however, and turned to IFC for help. We agreed to close the financial gap by investing in $1 million of NPK shares and by lending it $2.5 million.

Again we were able to obtain international participation in IFC's part of the financing. Two U.S. banks, a Canadian affiliate of Hambros Bank in London and a Swedish bank betseen them took nearly $1 million - part loan and part equity - of our investment in NPK.

In the case of NPK we achieved our first objective of financing privately owned industrial enterprise in an underdeveloped country. We also met our third objective by obtaining international participation in our part of the deal. But, we did not achieve our second objective of spurring local capital market development. As I pointed out previously, Tunisia is a poor country. Venture capital is in short supply and there is little tradition of share investment. It is our hope, and the hope of the sponsors, that as NPK's plant nears completion in 1965, private Tunisian interest in the company's shares will materialize. To insure the availability of shares for future local participation in the ownership of NPK, we and the sponsors have set aside 10% of our equity investment for sale to Tunisian investors.

Like all financial institutions we apply investment standards that must be met before IFC will support a project. We have three criteria for investment. The first requires that the project must be of high economic priority to the development efforts of the host country. This is essential. Our resources are quite limited and so too are private capital resources in the underdeveloped countries. For this reason, we have concentrated on helping industry, especially manufacturing industry, which is generally of small or medium size in the less developed countries, and thus enables us to employ our funds over a wide range of projects.

Nearly half of our investments have been made in manufacturing enterprises, including concerns making electrical equipment, motor vehicles, textiles, steel, household appliances, bearings and many other projects. Another third of our investments are in processing industries, including lumber and mill products, pulp and paper, cement, refractories, food products, flour milling and petrochemicals. We also have one substantial investment in copper mining and smelting, and a small one in a company servicing aircraft engines.

Our second investment standard is what we call "the investment bankers criterion". It requires that the project should be profitable, it should be properly prepared technically and financially, and it should be able to satisfy all the tests any sound investment banker would apply to any project in which he might invest.

The third criterion requires that adequate financing be not available on reasonable terms from private sources; and I shall discuss briefly some of our experiences in regard to this third test. In meeting this criterion we sometimes find that IFC is providing "the last key element" needed to make a financial deal go. Sometimes this key element is quite small in relation to the overall financing of which it is a part.

To illustrate this point I shall mention the case of Petroquimica Argentina which, in 1961, sought to raise $72 million in long-term and working capital. This company, whose sponsors include several leading U.S. firms, will become the largest petrochemical complex in Latin America when its plant is completed next year. It is expected to make a very important contribution to Latin America's economy.

Most of the funds needed for PASA were found without difficulty and private Argentine, Belgian, British and American sources agreed to put up a total of about $69 million. But $3 million of long-term funds were not readily available. The investment bankers involved turned to us and we agreed to supply the missing financing by investing in $3 million of PASA's subordinated debentures.

I cannot say that the deal would not have gone through without our help. But IFC's help did speed up the financing by many months; and it was fortunately timed in that it completed the financial package before the major political troubles that occurred in Argentina shortly afterward.

Under different circumstances we are currently involved in another deal where our intervention is helping to raise the last key financial element. In this case, we have entered into a standby agreement to a New York banking house, which is arranging placement of convertible debentures of an important Mexican industrial enterprise. Under the standby we are backing roughly 20% of the debentures to be sold. We have been assured that out entry into this deal, will better enable the New York bankers to find buyers for the issue. We expext, in the end, to have to take up only a small part of the debentures covered by our standby.

Before ending my talk I shall mention a relatively new activity, on our part, that is of great importance to both the future of IFC and to private enterprise. This is the assistance we are giving to the creation and financing of development institutions, such as privately owned industrial development banks. In this field we act both on our own and the World Bank's behalf.

By means of World Bank loans, vetted by IFC, and by direct IFC support and investment in these development institutions, we have found a means to provide financing to privately owned medium sized industrial enterprises that are not large enough to attract foreign investment in their own names. The development banks, in addition to serving as vehicles for World Bank and IFC funds to industry, also serve as sources of local capital to private industry, offer technical and managerial assistance to industry, and act as a link between domestic and foreign investors. Time does not permit an exhaustive discussion of our activities in this field, so I shall limited myself to one example: The support given by us and the World Bank to the establishment and financing of the new Private Development Corporation of the Philippines.

IFC and the World Bank have been able to help PDCP at three stages. First, we sent exploratory missions to the Philippines, which aroused local interest in the idea of such an institution. Second, IFC helped a committee of leading Philippine businessmen to establish the Corporation's legal and organizational framework. And third, both IFC and the Bank are participating in its financing.

The World Bank has already lent $15 million that will provide foreign exchange for PDCP's lending operations. IFC is deeply involved in the forthcoming sale and distribution of the Corporation's shares; it has committed itself to a standby covering shares equivalent to nearly $4.4 million, out of a total of roughly $6.4 million which is to be sold and distributed, and it will also purchase shares for its own account. We have succeeded in attracting broad international participation in the offering; a number of outstanding banking houses in Europe and America are purchasing shares in the new Corporation.

I trust these illustrations have given you some idea of the way IFC works, and the results it is able to achieve. IFC is not a large organization, and in money terms its contribution cannot be very great, even when account is taken of the investments of its partners, who usually provide several dollars for every one that we ourselves invest. But we hope and believe that our operations, beyond their own importance, are helping to lay the groundwork and create the conditions in which private industry can spread and flourish in the underdeveloped countries.

CORPORACION FINANCIERA INTERNACIONAL

1818 H STREET, N.W., WASHINGTON 25, D. C. TELÉFONO: EXECUTIVE 3-6360

INTERNATIONAL FINANCE CORPORATION

Redone — several changes

Discurso del señor Martin M. Rosen,
Vice Presidente Ejecutivo de la
Corporación Financiera Internacional
ante la
Reunión Internacional de Institutos Financieros de Fomento
Caracas, Febrero de 1964

Me complace mucho haber tenido esta oportunidad de venir a Venezuela para hablar ante ustedes. La Corporación Financiera Internacional ha mantenido beneficiosas y amistosas relaciones con la organización invitante, la Corporación Venezolana de Fomento. Hace muy poco nos hemos unido a la Corporación y a una gran cantidad de destacados inversionistas privados, venezolanos e internacionales, para suscribir capital accionario de una nueva sociedad de desarrollo, la Compañía Anónima Venezolana de Desarrollo. Nos satisface colaborar con la Corporación en esta empresa para ayudar al crecimiento de la industria; y abrigamos la esperanza de encontrar, por medio de nuestra cada vez más estrecha asociación con la Corporación, otras oportunidades para cooperar en el desarrollo económico de Venezuela.

Mi tarea esta tarde es sugerir respuestas a algunas interrogaciones: ¿Cuál es el papel que corresponde a una institución de financiamiento del desarrollo para promover el desarrollo industrial? ¿Hasta qué punto puede una institución de desarrollo tomar la iniciativa para originar o perfeccionar proposiciones para proyectos industriales? Estas son preguntas pertinentes, pues creo que todos sabemos que ninguna institución de desarrollo puede limitarse a un papel pasivo frente al proceso de desarrollo. No podemos limitarnos a esperar que lleguen a nuestras manos proposiciones bien concebidas para evaluarlas y luego decir sí o nó al financiamiento.

Pero no puede negarse que la función de la promoción tiene importancia, y que en las regiones menos desarrolladas hay demasiado pocos empresarios para cumplirla adecuadamente. En muchos países se han concluído acuerdos institucionales de diversa naturaleza para compensar, en este estado de cosas, la debilidad del impulso empresario; y en algunas naciones se han establecido instituciones especiales con el fin específico de cumplir la función promocional.

Luego de decir que la actividad promocional tiene importancia, debo agregar inmediatamente que, en mi opinión, una institución de desarrollo cuyo objetivo primordial es el financiamiento, sólo puede desempeñar un papel restringido en aquella función. Por una parte es probable que la promoción sea costosa y que no produzca resultados inmediatos; una institución de financiamiento puede acometer esta empresa sólo en escala modesta, pues debe estar atenta a las cifras de su balance.

Por otra parte, la promoción entraña responsabilidades que las sociedades de financiamiento no están necesariamente capacitadas para cumplir. En la promoción de un proyecto propio, la institución de desarrollo debe estar aún más segura de las posibilidades de éxito de lo que necesita estarlo cuando se trata de apoyar un proyecto ajeno, y ésto implica tiempo y estudio adicionales para lo cual esa institución de desarrollo quizás no esté preparada. Existe también un grado más de responsabilidad, que muy bien puede extenderse hasta el período de iniciación de una nueva empresa. Una compañía industrial por acciones, capaz de suministrar dirección administrativa, puede cumplir con esa responsabilidad; pero para que una institución de financiamiento pueda hacerlo, se requeriría un esfuerzo extraordinario.

Estos factores sirven también para explicar por qué en una sociedad de financiamiento del desarrollo la función de promoción debe estar bajo el estrecho control de la dirección. De otra manera podría llevar muy fácilmente a una relación errada con las otras actividades de la institución. Por ejemplo, sería evidentemente erróneo que una sociedad de desarrollo comprometiera demasiado de sus recursos financieros y técnicos en sus propias promociones a expensas de sus más amplias actividades generales. Se necesita una cuidadosa selección e insistencia en un juicio esmerado y objetivo para escoger la promoción.

Una institución de financiamiento no puede ser totalmente pasiva ni excesivamente promocional; debe fijar sus objetivos en un término medio. Como guía para la selección podría ser útil distinguir entre tres tipos diferentes de promoción en los cuales puede interesarse una sociedad de financiamiento del desarrollo. Uno de esos tipos deriva directamente de la naturaleza de la evaluación de proyectos que toda institución de desarrollo debería hacer. Consiste en el examen de una proposición y su modificación de manera que tome la forma más económica y más provechosa comercialmente. En este caso la institución de desarrollo hace la evaluación y toma la iniciativa para modificar el proyecto de la manera deseada. El segundo tipo de promoción es mucho más general; consiste en el estudio de una zona geográfica, o de un sector económico, para determinar qué clase de oportunidades existen para el desarrollo industrial, que puedan interesar a empresarios e inversionistas. Y el tercer tipo es, como el primero, muy específico: consiste en promover el establecimiento de una industria que llene un vacío importante y bien definido en la estructura económica del país.

Cada uno de estos tres tipos de promoción tiene aspectos y problemas peculiares que quisiera ilustrar más ampliamente con casos reales. Empezando con el primero, creo que en la evaluación y modificación de las proposiciones de un proyecto reside el punto en el que las sociedades de financiamiento industrial pueden, por lo general, contribuir de la manera más efectiva a la promoción de un proyecto.

La evaluación de proyectos comprende principalmente la investigación de cuatro aspectos importantes: el económico, el técnico, el administrativo y el financiero; y la investigación de cada uno de ellos puede resultar en modificaciones sustanciales de las proposiciones para un proyecto. La experiencia nos ha enseñado en la CFI que la debilidad de la administración es la causa más frecuente del fracaso tanto de las empresas nuevas como de las ya existentes. Y un aspecto de la administración al cual damos gran importancia es contar, en los proyectos nuevos, con el asociado técnico conveniente, particularmente en las industrias que utilizan procesos tecnológicos avanzados. El sector de producción de una industria moderna es de importancia primordial y no puede subordinarse a otros intereses. Las consideraciones técnicas dan forma a la organización de las empresas industriales y pueden tener una influencia decisiva en sus normas.

Por esta razón estimamos que una empresa industrial compleja requiere un asociado técnico, del extranjero si es preciso, que participe en capital de riesgo de la compañía y que se identifique con la suerte del proyecto. En los casos necesarios, una sociedad de financiamiento industrial, con sus amplias vinculaciones extranjeras y nacionales, debe estar en situación de ayudar a encontrar ese asociado.

De manera similar, la evaluación técnica de los proyectos resulta a menudo en revisiones de fondo de las proposiciones originales. Estas revisiones pueden originarse, por ejemplo, en las decisiones sobre la escala adecuada de operaciones del proyecto; o en las medidas necesarias para dar al proyecto el equilibrio técnico y la eficiencia de operaciones requeridos; o en las mejoras a los procesos técnicos propuestos para el proyecto. Tales modificaciones deben reflejarse de la manera apropiada en las estimaciones de los costos de capital del proyecto y de la estructura financiera de la empresa. Invariablemente requieren más dinero y, en ocasiones, encontrar un asociado técnico adicional. Al ayudar en esta labor, la institución de financiamiento está participando en un aspecto práctico e importante de la promoción industrial.

A guisa de ejemplo de este tipo de operación puedo citar una inversión que la CFI hizo en Túnez en 1962. Túnez no es un país rico; no tiene grandes industrias, cuenta con pocos empresarios industriales, escasa mano de obra especializada y una cantidad relativamente pequeña de capital privado. Sin embargo, comparte con otros países norafricanos una franja de ricos yacimientos de fosforita que ha sido mirada con creciente interés por la industria foránea de fertilizantes.

En 1959 una compañía sueca, Forenade -- la más grande fabricante de ácidos sulfúrico y fosfórico de Escandinavia -- empezó a investigar la posibilidad de establecer una subsidiaria tunecina para fabricar superfosfato triple utilizando fosforita de Túnez y azufre importado.

La compañía concluyó con éxito las negociaciones preliminares con el gobierno tunecino, que acordó otorgar beneficios tributarios a la nueva sociedad, garantizar las remesas de divisas, dar seguridades contra la expropiación o la nacionalización, y hacer arreglos para el suministro de fosforita por parte de las minas controladas por el gobierno mediante un contrato de 25 años de duración.

Sin embargo, Forenade no disponía de todos los recursos necesarios para realizar en su totalidad el proyecto. La empresa sueca acudió a la CFI en demanda de ayuda.

La evaluación del proyecto por parte de la CFI resultó en tres modificaciones importantes de las proposiciones: refuerzo de los arreglos de comercialización; adición de una fábrica de ácido sulfúrico para afianzar la base económica del proyecto; e inclusión de un asociado técnico adicional, así como de varios participantes financieros.

La fábrica, diseñada para producir unas 150.000 toneladas de superfosfato triple anualmente, estaba destinada a abastecer mercados de ultramar. El estudio del proyecto por parte de la CFI indicó que aún cuando la producción estuviera en posición de competir con la de otros productores, las perspectivas del mercado serían inseguras. Nos ayudó en nuestra evaluación un estudio del mercado internacional de superfosfatos triples hecho por el Banco Mundial, en el que se indicaba que si bien existía una gran demanda de fertilizantes fosfáticos en los países de alta renta y un gran mercado potencial en los países de baja renta de Africa, Asia y Sudamérica, era difícil predecir el crecimiento de estos últimos.

A fin de dar mayor fuerza a los arreglos de comercialización, y con ello reducir los riesgos comerciales contenidos en el proyecto, Forenade aceptó suscribir un contrato a largo plazo para la compra y distribución en Escandinavia de una parte importante del superfosfato que produciría la nueva fábrica. Forenade aceptó también garantizar, por un período inicial de las operaciones, un nivel mínimo de utilidades de la sociedad tunecina.

En el aspecto técnico la contribución de la CFI fue su insistencia para que se incluyera en el proyecto una fábrica de ácido sulfúrico. Nuestros estudios demostraron que en lugar de atenerse al ácido sulfúrico importado sería más barato producir el ácido necesario en el sitio del proyecto, utilizando azufre importado.

Se trataba, claramente, de una decisión técnica de alguna importancia que elevaba sustancialmente el costo de capital del proyecto. Más aún, introducía un proceso tecnológico separado en el proyecto que, en nuestra opinión, requería un asociado técnico más. Para satisfacer esta condición la CFI encontró un asociado norteamericano -- uno de los más grandes productores de azufre del mundo -- para que participase en el proyecto, suministrando a la sociedad tunecina una importante porción adicional de fondos en forma de préstamo y capital accionario y comprometiéndose a entregar el 75% de las necesidades de azufre del proyecto.

Así, como resultado de la investigación y evaluación de la CFI, los riesgos de la comercialización se redujeron, el proyecto se hizo más viable desde un punto de vista técnico y económico, y la dirección técnica se vió reforzada.

Cuando ayuda a modificar proyectos, una sociedad de financiamiento industrial estudia proposiciones que, en el fondo, ya han sido consideradas detenidamente, y entra en tratos con patrocinantes que ya están comprometidos en cierto grado, ya sea psicológica o financieramente, a participar en el proyecto. Estas circunstancias contrastan con lo que he definido como el segundo tipo de actividad promocional -- la de tratar de identificar las zonas generales de necesidad dentro de la economía. En teoría ésto es algo útil, pues la preparación de estudios preliminares de viabilidad y de identificación de posibles áreas para el desarrollo parecerían ser la esencia de la promoción industrial.

No obstante, creo que los resultados prácticos de tales estudios no son muy alentadores, y nuestra experiencia en este aspecto no ha sido mejor que la de otros. En 1961 la Organización del Plan del Irán y el Banco de Desarrollo Minero Industrial del Irán, nos pidieron que sugiriéramos consultores para realizar un estudio de la industria química irania. Nos ofrecimos para organizar el estudio nosostros mismos, en la creencia de que sería una valiosa experiencia en este campo. Tuvimos presente, además, que quizás nuestros estudios podrían resultar más útiles que otros, ya que si surgían oportunidades de inversiones como consecuencia del estudio, estaríamos preparados para apoyarlas y para alentar a inversionistas extranjeros a unirse a intereses locales para realizar proyectos seguros.

En verdad, nuestro estudio indicó que había varias industrias que parecían promisorias. Sobre la base de estos indicios preliminares realizamos esfuerzos especialmente serios para atraer a intereses europeos y norteamericanos para establecer una fábrica mezcladora de fertilizantes. Sin embargo, como a menudo ha ocurrido con este tipo de estudios, nuestros esfuerzos no tuvieron éxito alguno y, por lo que sabemos, el resultado directo del estudio ha sido nulo.

Es difícil explicar de manera precisa por qué tales estudios generales no logran despertar interés entre los inversionistas. A menudo son demasiado generales en su enfoque, perdiendo su utilidad específica; y pese a la tendencia a insistir más en las realidades potenciales que en las visibles los investigadores más sobrios y prudentes se ven obligados a limitar sus conclusiones mediante las más frías advertencias. Fundamentalmente, es difícil redactar estudios de viabilidad en términos que convenzan a empresarios extraños.

El hecho es que las instituciones de inversiones y las empresas industriales están constantemente tan preocupadas de las oportunidades de inversión que surgen dentro de sus propias organizaciones que un informe ajeno tiene que ser de verdad muy atractivo para merecer atención seria. Otro hecho es que la realización de estudios generales de viabilidad ofrece un grave problema a las sociedades de financiamiento del desarrollo que resuelvan efectuarlos. Ya hemos señalado que la promoción puede ser costosa en muchos casos. Los estudios generales de viabilidad pueden constituir un problema presupuestario más agudo que los corrientes. No solamente representan exigencias para los recursos de personal y financieros, sino que tiene repercusiones a largo plazo, ya que los primeros estudios pueden llevar posteriormente a estudios adicionales y más detallados. Es poco probable que duren mucho tiempo, pero es difícil recuperar los gastos que demanda su realización, ya que usualmente no es posible asignar su costo a una inversión determinada que pueda resultar.

Los estudios de viabilidad no son difíciles, pero existen verdaderas dudas acerca de su utilidad. Como ya he dicho, nuestra propia experiencia, y la de otros, no ha sido particularmente alentadora, y en el caso de la Corporación Financiera Internacional hemos resuelto que, en términos generales, ésta es una actividad que sólo podemos emprender después del más detenido estudio.

El tercer tipo de actividad promocional que he mencionado se relaciona igualmente con el desarrollo de un proyecto casi desde sus comienzos, pero tiene una ventaja importante sobre el enfoque del estudio general por cuanto se relaciona con un proyecto destinado a llenar un vacío bien definido en la estructura industrial, para satisfacer una demanda precisa. Un ejemplo feliz de este tipo de operación fue la instalación de una fábrica de cemento en Pakistán, en 1961. Es un caso que pertenece realmente a la Pakistan Industrial Credit and Investment Corporation -- PICIC -- más bien que a nosotros, pero es un buen ejemplo de una feliz cooperación entre dos instituciones de financiamiento del desarrollo. Es la historia de cómo PICIC logró cumplir una empresa para llenar un gran vacío, creado por sucesos políticos y de otra naturaleza, en la industria del cemento de Pakistán.

Después de la partición de India y Pakistán, quedaron solamente cuatro fábricas de cemento en Pakistán Occidental. Eran de propiedad de ciudadanos indios, y debido a las restricciones cambiarias vigentes entre los dos países, sus dueños no se sentían estimulados a ampliar su capacidad. Para satisfacer la creciente demanda de cemento de Pakistán Occidental, la Pakistan Industrial Development Company (PIDC), de propiedad del gobierno, construyó dos nuevas fábricas a mediados de la década de 1950. Al finalizar la década, sin embargo, se vió que sería necesario aumentar la capacidad para satisfacer la creciente demanda.

A fines de 1960 se presentó un nuevo e inusitado elemento en la situación con el arreglo formal de la disputa entre la India y Pakistán sobre la división de las aguas del sistema del río Indo. La ejecución de este acuerdo requería un vasto programa de obras públicas, incluso la construcción de una gigantesca presa y embalse y la construcción o rehabilitación de una amplia red de canales de regadío. El programa era el mayor de su naturaleza que se hubiera emprendido fuera del Hemisferio Occidental.

En estas circunstancias excepcionales la demanda de cemento era clara y urgente. El gobierno pakistano pidió un estudio general de la industria y PICIC se ofreció para asumir la responsabilidad de su ejecución. Posteriormente, PICIC escogió a una firma norteamericana de consultores para que realizara el estudio.

En un informe presentado en 1960 los consultores estimaron la demanda anual de cemento en 2.000.000 de toneladas en 1959 y predijeron que esa cifra se elevaría a 3.000.000 hacia 1962. Para satisfacer esta esperada demanda, recomendaban la expansión de dos de las fábricas existentes y la construcción de tres nuevas fábricas. La responsabilidad de promover el establecimiento de dos de estas nuevas fábricas recayó en PICIC que emprendió la tarea y pronto encontró a dos destacados industriales textiles dispuestos a patrocinar e invertir en las compañías de cemento. Más adelante PICIC negoció ayuda financiera para una empresa con la Commonwealth Development Finance Corporation de Londres, y para la otra recibió ayuda de la CFI.

El proyecto que la CFI ayudó a realizar iba a estar ubicado cerca del río Jhelum, en Gharibwal, y su principal mercado a corto plazo iba a ser la Presa de Mangla. Sin embargo, es muy difícil calcular la escasez de productos, y sospechamos que el estudio del mercado había sido demasiado optimista. Por esta razón comisionamos a otra firma de consultores para que hiciera un nuevo estudio, particularmente de una zona separada de mercadeo en la parte septentrional de Pakistán Occidental, donde iba a estar ubicado el proyecto. Este segundo estudio confirmó nuestras sospechas y, basándonos en sus conclusiones, pudimos persuadir al gobierno pakistano que redujese el programa de expansión autorizado, evitando de esa forma la instalación de capacidad superflua en la industria pakistana del cemento.

La CFI contrató a ingenieros consultores independientes para que asesorasen en la preparación, estudio y selección de las propuestas internacionales para el suministro de equipo, y el valor de la introducción de estos expertos en la compañía en un momento crítico de la formación del proyecto fue reconocida más adelante por la empresa, al contratarlos como consultores para los períodos de construcción y comienzo de operaciones.

Esta es una historia feliz y que en propiedad debería ser relatada con todos sus detalles por PICIC. Las estimaciones iniciales de costos, de algo más de US$12 millones, han demostrado ser razonablemente acertadas y las perspectivas de éxito de la empresa, que ahora está a punto de iniciar sus operaciones, son totalmente favorables.

La promoción de un proyecto destinado a llenar un vacío evidente en la economía ofrece ciertos problemas especiales. Si el proyecto es de clara necesidad para la economía, probablemente será grande -- requiriendo inversiones nó de dos o tres millones de dólares sino, digamos, más bien de 15 y aún de 50. Si el proyecto es de gran tamaño, es posible que toda la gama de los otros problemas se haga presente. Por ejemplo, es probable que, en estas circunstancias, una gran empresa tenga tanto capital como administración extranjeros, y uno u otro de éstos puede no ser bien recibido. Además, un proyecto grande puede requerir bastantes servicios de energía eléctrica y de transportes, y éstos pueden ser inadecuados. O el proyecto puede afectar un recurso natural importante cuyos títulos de propiedad posea el gobierno. En todo caso, el proyecto puede ser de tal tamaño que afecte claramente el interés público, surgiendo entonces la interrogante de la participación que debería tener el gobierno en él. A menudo ocurre que el gobierno desea una posición fuerte, pero en la realidad puede no tener el capital ni estar en situación de ofrecer la asistencia técnica que le dé derecho a esa posición.

En la actualidad estudiamos dos proyectos en diferentes partes del mundo, que ilustran de manera acertada las dificultades que ofrecen los grandes proyectos, particularmente aquéllos que envuelven intereses económicos del gobierno.

En una de las repúblicas americanas el proyecto para explotar un gran bosque, que proporcionaría una base atractiva para una importante industria de pulpa y papel, depende en alto grado de la negociación de condiciones satisfactorias con el gobierno local. El proyecto fue destacado inicialmente por una misión de la FAO, hace diez años; desde entonces el gobierno ha entrado en negociaciones, sin éxito, con firmas extranjeras interesadas en realizar el proyecto. Ahora ha pedido a la CFI que prepare proposiciones que den al gobierno un rendimiento equitativo y que, al mismo tiempo, sean aceptables para intereses locales y extranjeros.

Se estima el costo del proyecto en unos US$80 millones, de los cuales alrededor de US$12 millones serían para carreteras, puertos, viviendas y servicios comunales. Tales recursos están muy por encima de los que se dispone en el país y, por tanto, la empresa depende de asistencia externa. Sin embargo, la tierra es de propiedad del gobierno y el recurso forestal es una importante posesión del país. Por esa causa el gobierno considera que debe negociar condiciones que no solamente satisfagan las exigencias financieras sino que además sean aceptables desde el punto de vista de la política interna.

En otra parte del mundo estamos en negociaciones con el gobierno local respecto de las condiciones para establecer un importante complejo de fertilizantes, que se construiría a un costo estimado en unos US$40 millones. Aquí también el gobierno tiene posesión de los recursos naturales y desea, a cambio de su uso, contar con lo que considera una participación adecuada en la propiedad de la empresa propuesta. La realización de este proyecto se ha complicado debido a la decisión del gobierno, basada en razones sociales, de emplear un método de relativamente alto costo para producir azufre mediante la utilización de recursos locales de pirrotina. Parece probable que el proyecto se realice sólo con ayuda externa, y únicamente con un asociado industrial experimentado. Pero los acuerdos de esta naturaleza, que tratan de satisfacer los intereses nacionales y extranjeros y preservar los principios de viabilidad económica y comercial, son evidentemente muy difíciles de negociar.

Estos son algunos casos específicos en los cuales la CFI ha cooperado con otros para tratar de promover proyectos industriales. Indican los campos en los que hemos tenido alguna experiencia y sugieren los tipos de actividades promocionales que me parecen los más apropiados que una sociedad de financiamiento industrial puede emprender.

He subrayado deliberadamente las dificultades, pero no es mi propósito restar importancia a las actividades de la promoción. La falta de financiamiento es solamente una, y tal vez no la más importante, de las barreras que limitan la industrialización de los países en desarrollo. Hay otros obstáculos que pueden ser de igual importancia. Entre ellos se cuentan el vacío tecnológico que existe entre esos países y las economías industriales avanzadas, la carencia de familiaridad y la inexperiencia de los empresarios locales frente a los métodos modernos de administración, y la vacilación que a menudo muestran los inversionistas locales para aprovechar las nuevas oportunidades de inversión que se les presentan.

Con una actividad promocional adecuada, una sociedad de financiamiento puede ayudar a salvar estos obstáculos al progreso industrial. Sus recursos financieros, su personal técnico y sus contactos nacionales e internacionales pueden dar a la institución algunos de los medios para lograrlos. Su capacidad para promover nuevas empresas, para ayudar a preparar proyectos y para asumir la iniciativa en la modificación de las proposiciones que se le presenten, son elementos vitales de sus operaciones normales. He sostenido que la función de promoción debe estar encaminada a fines prácticos y mantenerse bajo cuidadoso control. Sostendría, además, que la promoción tiene su papel propio y que, en ocasiones, puede ser un papel de enorme importancia para la estrategia del desarrollo industrial.

I

REUNION INTERNACIONAL DE INSTITUTOS FINANCIEROS DE FOMENTO

INTERNATIONAL MEETING OF FINANCIAL INSTITUTIONS FOR DEVELOPMENT

CARACAS - FEBRERO 17 - 22 1964

ADDRESS BY MR. MARTIN M. ROSEN,

EXECUTIVE VICE PRESIDENT OF THE

INTERNATIONAL FINANCING CORPORATION

AT THE

I INTERNATIONAL MEETING OF FINANCIAL INSTITUTIONS FOR DEVELOPMENT

Mr. Chairman, Gentlemen:

I appreciate very much having been given this opportunity to come to Venezuela and to participate in the meeting of development financing institutions. The International Finance Corporation and the World Bank of which we are an affiliate has long had a close relationship with most if not all of the institutions represented at this meeting. That relationship has been particularly close with our host organization, the Corporación Venezolana de Fomento and I would here like to pay tribute to my good friend Luis Vallenilla and to his staff for the wonderful job they have done in organizing this meeting.

We have worked closely with the CVF. A few months ago, under their leadership, and together with a large number of private investors both Venezuelan and foreign, we joined in organizing and subscribing the share capital of a new development financing company, Compañia Venezolana de Desarrollo. This company, of which our distinguished chairman, Sr. Mendoza, is President, is predominantly privately owned. This is a good example of how a governmental financial institution can use its resources in support of the private sector, not only by direct loans to private industrial companies but by helping create and support privately-owned financieras. This pattern has been followed elsewhere in the world - the Philippines for example, where the privately owned PDCP was assisted by the government-owned Development Bank of the Philippines. There are other examples and I believe this is a useful pattern which we stand ready to support elsewhere.

I have been asked to concentrate my comments today on the general subject of industrial promotion. I would like to try to suggest answers to several questions.

What is the proper role of a development financing institution in promoting industrial development? How far should such an institution go in taking the iniciative for originating or perfecting proposals for industrial projects? The inquiry is a pertinent one, for it is clear to all of us, I think, that no development financing institution can play a merely passive role with respect to development. The projects which

simply walk in the front door and present themselves across the counter are usually rather shopworn and not particularly attractive. We cannot simply wait for well conceived proposals to come to us, then check them out and say yes or no to the financing.

It cannot be denied, either, that the promotional function is an important one, and that in the underdeveloped areas, there are too few private entrepreneurs to discharge it adequately. Many countries have made institutional arrangements of one kind or another to compensate for the weakness, in the present state of things, of the entrepreneurial impulse; and some countries have established special institutions for the particular purpose of carrying on promotional activity.

Having said that promotional activity is important, I must immediately add that in my opinion, a development institution whose primary purpose is financing can play only a limited role in promotion. For one thing, promotion is likely to be expensive and unlikely to produce an immediate return; it can be undertaken only on a modest scale by any financing institution which must be attentive to its own balance sheet.

For another thing, promotion entails responsibilities which finance companies are not necessarily well equipped to discharge. To promote a proposal of its own and to induce others to join in it, a development institution must be even more sure of the prospects of success than it needs to be when it is financing someone else's project. This implies a degree of investigative, analytical and organizational work for which a development finance company is not necessarily well prepared. There is also an extra degree of continuing responsibility, very likely extending well into the start-up period of a new enterprise. When projects run into difficulties, the promoting group may have to become intimately involved in the management. An industrial holding company, able to provide managerial direction, can discharge such a responsibility; a financing institution to do so would require extraordinary effort.

These factors also serve to explain why within a development financing institution, the promotion function must be under the close control of top management. This is necessary to make sure that those involved in promotion do no become overly enthusiastic. It obviously would be wrong, for instance, for a development company to commit too much of its financial and technical resources to its own promotions, at the expense of being able to handle its financing functions in an effective and expeditious manner. What is needed is careful selectivity, and an insistence on a careful and objective judgment of what is selected for promotion.

A financing institution cannot be entirely passive, nor can it be predominantly promotional; it must set its sights somewhere in between. As a guide to selectivity, it may be useful to distinguish between three different kinds of promotion with which a development finance corporation may be concerned. One kind arises directly from the kind of project analysis that any development institution ought to do. It consists of examining a proposal and modifying it so that it takes the most economic and most commercially profitable form. In this case, the development institution does the analysis, and takes the lead in re-shaping the project in the desired direction. A second kind of promotion is much more general; it consists of surveying a geographic region which may be economically backward or an economic sector, to see what kind of opportunities exist for industrial development that may be of interest to entrepreneurs and investors. And a third, like the first, is quite specific; it consists of promoting the establishment of a particular industry to fill an important and well-defined and well known gap in a country's economic structure.

Each of these three types of promotion has features and problems particular to itself, which I would like to illustrate more fully by actual cases. To begin with the first type, it is in assessing and modifying project proposals, that industrial financing institutions can in my opinion usually make their most effective contribution to project promotion.

The appraisal of projects consists principally in investigating four main aspects -- economic, technical, managerial and financial -- and the investigation in each of these fields can lead to substantial modifications in project proposals. Experience has taught us in IFC that weakness of management is the most common cause of failure in both new and existing companies. And one aspect of management to which we attach great importance is that of having an experienced technical partner in new projects, particularly in those industries using advanced technological processes.

We believe, therefore, that a complex industrial undertaking requires a technical partner, from abroad if necessary, and that the partner must participate in providing part of the share capital of the company, thus identifying itself with the fortunes of the project. It is not enough to have technical assistance arrangements or simply a profit sharing basis. The partner should be in a position where it loses money if the venture fails and not merely profits if it succeeds. Where necessary, an industrial financing company, with its wide foreign and domestic connections, should be prepared to give assistance in finding such a partner.

Similarly, the technical evaluation of projects often lead to substantial revisions of original proposals. These revisions may arise, for example, from decisions on the appropiate scale of operations of the proposed project, or from measures necessary to give the project proper technical balance and operating efficiency, or from improvements in the proposed technical processes to be employed in the project. Such modifications must be properly reflected in the estimated capital costs of the project and the financial structure of the company. Invariably they require extra money and sometimes the finding of an additional technical partner. In assisting in this work, the financing institution is engaging in a practical, and important, field of industrial promotion.

An example of this type of operation is illustrated by an investment that IFC made in Tunisia in 1962. Tunisia is not a rich country; it has no major industries, few industrial entrepreneurs, little skilled labor and a relatively small amount of private capital. One of its few natural resources is a rich deposit of phosphate rock.

In 1959, a Swedish company Forenade -- one of the largest fertilizer companies in Scandinavia -- began to explore the possibility of establishing a Tunisian subsidiary to manufacture triple superphosphate from Tunisian rock phosphate.

The company successfully concluded preliminary negotiations with the Tunisian Government, which agreed to grant tax benefits for the new Tunisian company, to guarantee remittances in foreign exchange, to give assurances against expropriation or nationalization, and to arrange for supplies of rock phosphate ~~supplies~~ to be obtained from government-controlled mines under a 25-year contract.

Forenade alone, however, did not have available all the financial resources required to carry out the entire project. The Swedish company turned to IFC for assistance.

IFC's evaluation of the project led to three important modifications in the existing proposals: a strengthening of the marketing arrangements, the addition of a sulphuric acid plant to increase the profitability of the project; and the bringing in of an additional technical partner.

The plant, designed to produce about 150,000 tons of triple superphosphate annually, was to supply overseas markets. IFC's survey of the project indicated that while production would be competitive with that from other producers, the market prospects were good but uncertain. Our survey of the international market for phosphatic fertilizer indicated that there existed a large demand in high income countries and a great potential market in low income countries of Africa, Asia and South America. The rate of growth of these latter markets was difficult to predict and we knew there were other proposals for substantial increase of production.

In order to strengthen the marketing arrangements, and thereby reduce the commercial risks involved in the project, Forenade itself agreed to enter into a long-term contract for the purchase and distribution in Scandinavia of a sizeable portion of the superphosphate to be produced by the new plant. Forenade also agreed to guarantee, for an initial period of the plant's operations, a minimum level of profits for the Tunisian company.

On the technical side, IFC's contribution was to urge the inclusion of a sulphuric acid plant in the project. Our studies showed that instead of relying on imported sulphuric acid it would be cheaper to produce the acid required on the site of the project, using imported sulphur.

This clearly was a technical decision of some importance, and substantially raised the capital cost of the project. Moreover, it introduced a separate technological process into the project and one, which in our view, required an additional technical partner. To meet this requirement, we found a U.S. partner -- one of the world's largest producers of sulphur -- to participate in the project, providing the Tunisian company with substantial additional loan and share capital, in exchange for the opportunity to sell sulphur to the new company.

Thus, as a result of IFC's investigation and evaluation, the marketing risks had been reduced, the project had been made more viable from a technical and economic point of view, and the technical management had been strengthened.

In assisting to modify projects, an industrial financing institution is considering proposals which, in essence, have already been thought through, and it is dealing with sponsors who already have some commitment, psychologically or financially, in the project. These circumstances are in contrast to what I have defined as the second kind of promotional activity -- that of endeavoring to identify general areas of need in the economy. In theory, these are useful exercises, for the preparation of preliminary feasibility studies and the identification of possible areas for development would seem to lie at the heart of industrial promotion.

Yet the practical results of such studies are not, I think, very encouraging, and our experience in this field has been no better than that of others. In 1961 we were approached by the Plan Organization of Iran and the Industrial Mining Development Bank of Iran to arrange a survey of the Iranian chemical industry. We volunteered to organize the survey ourselves, in the belief that it would be valuable experience for us in this field. We hoped it would lead to practical results, since if investment opportunities came to light through the survey, we would be ready to join in financing them.

In fact, our survey did point to several industries which appeared to show promise for their development. On the strength of these preliminary indications, we made particularly serious attempts to interest European and American interests in the establishment of a fertilizer mixing and bagging plant. However, as has often been true of this sort of survey, our efforts were entirely unsuccessful and, insofar as we are aware, the direct yield of the survey has been nil.

It is difficult to explain precisely why such general surveys fail to arouse interest among investors. Often they are too general in their approach to be of particular usefulness, and despite their tendency to dwell more on the potential than on stern realities, any objective investigator must qualify his findings with the necessary reservations. Fundamentally, it is difficult to draw up feasibility studies in terms that make them convincing to outside entrepreneurs.

The fact is that industrial organizations are constantly so preoccupied with investment opportunities originating within their own organizations that an outside report has to be very compelling indeed before it can attract their serious attention. The further fact is that making general feasibility studies offers a serious problem to development financing institutions that may choose to undertake them. We have already remarked that promotion in general may be expensive. General feasibility studies may present a more than ordinarily acute budget question. They not only call on both staff and financial resources, but they have long-term implications, since the first studies may possibly lead to additional and more detailed studies. They are not only likely to stretch over a long period of time, but it is difficult to recover the expense of making them, since it usually will not be possible to allocate their cost to any particular investment that may result.

Our experience in the Iranian case and in one or two other cases has not been especially encouraging, and we have decided that in the future this is a kind of activity we will undertake seldom if at all and only after the most careful consideration.

The third kind of promotional activity that I have identified is also concerned with developing a project almost from its foundations, but it has one important advantage over the general survey approach, inasmuch as this kind of promotion concerns a project designed to fill a well-defined gap in the industrial structure to meet a clear-cut market demand. A successful example of this type of operation was the installation of a cement factory in Pakistan in 1961. It is really a story that belongs to the Pakistan Industrial Credit and Investment Corporation -- PICIC -- rather than to us, but it is also a good example of a successful cooperation between two development financing institutions. It is the story of how PICIC successfully carried out an undertaking to fill a major gap opened up in Pakistan's cement industry by political and other developments.

After the Partition of India and Pakistan, there were only four cement plants located in West Pakistan. These were Indian-owned, and because of the exchange restrictions in force between the two countries, their owners had no incentive to expand their capacity.

A dramatic new factor in the situation was the formal settlement, late in 1960, of the dispute between India and Pakistan over the division of the waters of the Indus River system. The execution of the settlement involved a huge public works program, including the construction of a giant dam and storage reservoir and the building or rehabilitation of a wide-flung web of irrigation canals. The program was the largest of its kind ever to be undertaken anywhere in the world.

In these exceptional circumstances, the demand for cement was a clear and urgent one. The Pakistan Government called for a general review of the industry and PICIC volunteered to be responsible for the study. PICIC subsequently chose an American firm of consultants to undertake the survey.

In a report presented in 1960, the consultants estimated the annual demand for cement at 2 million tons in 1959 and forecast that this figure would rise to 3 million tons by 1962. To meet this projected demand, it recommended the expansion of two of the existing plants and the construction of three new plants. Responsibility for promoting the establishment of two of the new plants fell to PICIC, which set about and soon found two prominent industrialists willing to sponsor and invest in the cement companies. For one company, PICIC subsequently negotiated for financial assistance from the Commonwealth Development Finance Corporation in London, and for the other it received assistance from IFC.

The project which IFC helped to establish was to be near the Jhelum river, at Gharibwal, and in the short-term its main market was to be the Mangla Dam. However, shortages of products are notoriously difficult to estimate, and we suspected that the market survey had been over-optimistic. We therefore commissioned another firm of market consultants to make a fresh survey, particularly for the separate marketing area in the northern part of West Pakistan where the project was to be located. This second survey confirmed our suspicions, and on the basis of its findings we were able to persuade the Pakistan Government to scale down its licensed expansion program, and thus avoid the installation of wasteful surplus capacity in the Pakistan cement industry.

IFC also hired independent consulting engineers to advise on the preparation, processing and selection of international bids for the supply of the equipment, and the value of introducing these experts to the company at a critical moment in the formation of the project was later recognized by the company when they contracted them on a consultative basis for the constructional and start-up period.

This is a success story, and is one that should be rightfully told in detail by PICIC itself. The original cost estimates, of rather more than $12 million have proved to be reasonably accurate and the prospects for the success of the company, which is now about to begin operations, are entirely favorable. Shares offered at 50 rupees are now selling at 70 rupees.

The promotion of a project to fill an obvious gap in the economy offers certain special problems of its own. If the project is obviously needed in the economy, it is likely to be a big one -- requiring the investment not of two or three million dollars, say, but more likely of 15 or even 50. If the project is a big one, then a whole range of other problems is likely to exist. For example, a big undertaking in these circumstances is probably going to have to have both foreign capital and foreign management, and one or the other of these may not be welcome. A big project may also require a good deal in the way of power and transportation facilities, and these may be inadequate. Or the project may involve a major natural resource, title to which is vestedin the government. In any case, the project may be of such size as clearly to involve the public interest, and thereby to raise the question of what interest the government ought to take in it. If often happens that the government wants a strong role, but in fact may not have the capital or the technical assistance to offer which would entitle it to that role.

We are at present considering two projects, in different areas of the world, which well illustrate the difficulties of developing large projects, particularly those in which government economic interests are involved.

In one of the American republics, the exploitation of a large forest, which would provide an attractive basis for a major pulp and paper industry, is largely dependent on the negotiation of satisfactory terms with the local government. The project was first given prominence by an FAO mission ten years ago; since then, the government has negotiated unsuccessfully with foreign firms interested in developing the project. It has now asked IFC to draw up proposals which would give the government a fair return and yet be acceptable to local and foreign interests.

The project is estimated to cost about $80 million, of which about $12 million would be for highways, ports, housing and community facilities. Such resources are far beyond those available in the country, and the venture is therefore dependent on outside assistance. However, the title of the land is vested in the government and the forest resource is an important economic asset for the country. The government therefore feels that it must negotiate terms that will not only meet financial requirements but also be acceptable from the standpoint of internal politics.

In another part of the world, we are negotiating with the local government on the terms for the establishment of a major fertilizer complex, to be constructed at an estimated cost of about $40 million. Again the government holds title to the natural resources, and in return for their use, wishes to have what it deems to be an appropriate share in the ownership of the proposed company. The development of this project has been further complicated by the government's decision, for social reasons, to employ a relatively high-cost method of producing sulphur through the utilization of local resources of pyrrhotine. It seems likely that the project will be developed only with external assistance, and then only with an experienced industrial partner. But agreements of this nature, which try to satisfy national and foreign interests and preserve the principles of economic and commercial viability, are plainly difficult to negotiate.

These, then, are a number of specific cases in which IFC has cooperated with others in trying to promote industrial projects. They indicate the areas in which we have had some experience, and they suggest the types of promotional activities which to me seem the most appropriate for an industrial financing institution to undertake.

I have here deliberately emphasized the difficulties,but it is not my intention to minimize the importance of promotional activities. Lack of finance is only one, and perhaps not the most important, of the barriers holding back industrialization in the developing countries. There are other handicaps which can be of equal importance. They include the technological gap existing between these countries and the advanced industrial economies, the unfamiliarity and inexperience of local entrepreneurs with modern managerial methods, and the hesitation often shown by local investors in grasping the new investment opportunities opening up to them.

By proper promotional activity, an individual financing institution can help to break down obstacles in the path of industrial progress. The institution's financial resources, its technical staff and its contacts with both domestic and international investors may give it some of the means of doing so. Its ability to originate ventures, to help prepare projects and to take the lead in modifying proposals submitted to it, are vital elements in its normal operations. I have argued that promotional activities should be directed to practical ends and kept under careful control. I would argue, too, that promotion has its proper role, and that on occasion, it can be a role of great importance in the strategy of industrial development.

INDUSTRIAL PROMOTION

Address by
MARTIN M. ROSEN,
Executive Vice President,
International Finance Corporation
at the
First International Meeting of
Financial Institutions for Development

Caracas, Venezuela
February 18, 1964

I appreciate very much having been given this opportunity to come to Venezuela and to participate in the meeting of development financing institutions. The International Finance Corporation and the World Bank, of which we are an affiliate, have long had a close relationship with most if not all of the institutions represented at this meeting. That relationship has been particularly close with our host organization, the Corporacion Venezolana de Fomento, and I would here like to pay tribute to my good friend Luis Vallenilla and to his staff for the wonderful job they have done in organizing this meeting.

We have worked closely with the CVF. A few months ago, under their leadership, and together with a large number of private investors, both Venezuelan and foreign, we joined in organizing and subscribing the share capital of a new development financing company, Compania Venezolana de Desarrollo. This company, of which our distinguished chairman, Sr. Mendoza, is President, is predominantly privately owned. This is a good example of how a governmental financial institution can use its resources in support of the private sector, not only by direct loans to private industrial companies but by helping create and support privately owned financieras. This pattern has been followed elsewhere in the world—the Philippines for example, where the Private Development Corporation of the Philippines was assisted by the government-owned Development Bank of the Philippines. There are other examples and I believe this is a useful pattern which we stand ready to support elsewhere.

I have been asked to concentrate my comments today on the general subject of industrial promotion. I would like to try to suggest answers to several questions.

What is the proper role of a development financing institution in promoting industrial development? How far should such an institution go in taking the initiative for originating or perfecting proposals for industrial projects? The inquiry is a pertinent one, for it is clear to all of us, I think, that no development financing institution can play a merely passive role with respect to development. The projects which simply walk in the front door and present themselves across the counter are usually rather shopworn and not particularly attractive. We cannot simply wait for well conceived proposals to come to us, then check them out and say yes or no to the financing.

It cannot be denied, either, that the promotional function is an important one, and that in the underdeveloped areas, there are too few private entrepreneurs to discharge it adequately. Many countries have made institutional arrangements of one kind or another to compensate for the weakness, in the present state of things, of the entrepreneurial impulse; and some countries have established special institutions for the particular purpose of carrying on promotional activity.

Having said that promotional activity is important, I must immediately add that in my opinion, a development institution whose primary purpose is financing can play only a limited role in promotion. For one thing, promotion is likely to be expensive and unlikely to produce an immediate return; it can be undertaken only on a modest scale by any financing institution which must be attentive to its own balance sheet.

For another thing, promotion entails responsibilities which finance companies are not necessarily well equipped to discharge. To promote a proposal of its own and to induce others to join in it, a development institution must be even more sure of the prospects of success than it needs to be when it is financing someone else's project. This implies a degree of investigative, analytical and organizational work for which a development finance company is not necessarily well prepared. There is also an extra degree of continuing responsibility, very likely extending well into the start-up period of a new enterprise. When projects run into difficulties, the promoting group may have to become intimately involved in the management. An industrial holding company, able to provide managerial direction, can discharge such a responsibility; a financing institution to do so would require extraordinary effort.

These factors also serve to explain why, within a development financing institution, the promotion function must be under the close control of top management. This is necessary to make sure that those involved in promotion do not become overly enthusiastic. It obviously would be wrong, for instance, for a development company to commit too much of its financial and technical resources to its own promotions, at the expense of being able to handle its financing functions in an effective and expeditious manner. What is needed is careful selectivity, and an insistence on a careful and objective judgment of what is selected for promotion.

A financing institution cannot be entirely passive, nor can it be predominantly promotional; it must set its sights somewhere in between. As a guide to selectivity, it may be useful to distinguish between three different kinds of promotion with which a development finance corporation may be concerned. One kind arises directly from the kind of project analysis that any development institution ought to do. It consists of examining a proposal and modifying it so that it takes the most economic and most commercially profitable form. In this case, the development institution does the analysis, and takes the lead in reshaping the project in the desired direction. A second kind of promotion is much more general; it consists of surveying a geographic region which may be economically backward or an economic sector, to see what kind of opportunities exist for industrial development that may be of interest to entrepreneurs and investors. And a third, like the first, is quite specific; it consists of promoting the establishment of a particular industry to fill an important and well defined and well known gap in a country's economic structure.

Each of these three types of promotion has features and problems particular to itself, which I would like to illustrate more fully by actual cases. To begin with the first type, it is in assessing and modifying project proposals, that industrial financing institutions can in my opinion usually make their most effective contribution to project promotion.

The appraisal of projects consists principally in investigating four main aspects—economic, technical, managerial and financial—and the investigation in each of these fields can lead to substantial modifications in project proposals. Experience has taught us in IFC that weakness of management is the most common cause of failure in both new and existing companies. And one aspect of management to which we attach great importance is that of having an experienced technical partner in new projects, particularly in those

industries using advanced technological processes.

We believe, therefore, that a complex industrial undertaking requires a technical partner, from abroad if necessary, and that the partner must participate in providing part of the share capital of the company, thus identifying itself with the fortunes of the project. It is not enough to have technical assistance arrangements or simply a profit-sharing basis. The partner should be in a position where it loses money if the venture fails and not merely profits if it succeeds. Where necessary, an industrial financing company, with its wide foreign and domestic connections, should be prepared to give assistance in finding such a partner.

Similarly, the technical evaluation of projects often leads to substantial revisions of original proposals. These revisions may arise, for example, from decisions on the appropriate scale of operations of the proposed project, or from measures necessary to give the project proper technical balance and operating efficiency, or from improvements in the proposed technical processes to be employed in the project. Such modifications must be properly reflected in the estimated capital costs of the project and the financial structure of the company. Invariably they require extra money and sometimes the finding of an additional technical partner. In assisting in this work, the financing institution is engaging in a practical, and important, field of industrial promotion.

An example of this type of operation is illustrated by an investment that IFC made in Tunisia in 1962. Tunisia is not a rich country; it has no major industries, few industrial entrepreneurs, little skilled labor and a relatively small amount of private capital. One of its few natural resources is a rich deposit of phosphate rock.

In 1959, a Swedish company, Forenade—one of the largest fertilizer companies in Scandinavia—began to explore the possibility of establishing a Tunisian subsidiary to manufacture triple superphosphate from Tunisian rock phosphate.

The company successfully concluded preliminary negotiations with the Tunisian Government, which agreed to grant tax benefits for the new Tunisian company, to guarantee remittances in foreign exchange, to give assurances against expropriation or nationalization, and to arrange for supplies of rock phosphate to be obtained from government-controlled mines under a 25-year contract.

Forenade alone, however, did not have available all the financial resources required to carry out the entire project. The Swedish company turned to IFC for assistance.

IFC's evaluation of the project led to three important modifications in the existing proposals: a strengthening of the marketing arrangements, the addition of a sulphuric acid plant to increase the profitability of the project, and the bringing in of an additional technical partner.

The plant, designed to produce about 150,000 tons of triple superphosphate annually, was to supply overseas markets. IFC's survey of the project indicated that while production would be competitive with that from other producers, the market prospects were good but uncertain. Our survey of the international market for phosphatic fertilizer indicated that there existed a large demand in high income countries and a great potential market in low income countries of Africa, Asia and South America. The rate of growth of these latter markets was difficult to predict and we knew there were proposals for substantial increases of output by other producers.

In order to strengthen the marketing arrangements, and thereby reduce the commercial risks involved in the project, Forenade itself agreed to enter into a long-term contract for the purchase and distribution in Scandinavia of a sizable portion of the superphosphate to be produced by the new plant. Forenade also agreed to guarantee, for an initial period of operations, a minimum level of profits for the Tunisian company.

On the technical side, IFC's contribution was to urge the inclusion of a sulphuric acid plant in the project. Our studies showed that instead of relying on imported sulphuric acid it would be cheaper to produce the acid required on the site of the project, using imported sulphur.

This clearly was a technical decision of some importance, and substantially raised the capital cost of the project. Moreover, it introduced a separate technological process into the project and one which, in our view, required an additional technical partner. To meet this requirement, we found a U.S. partner—one of the world's largest producers of sulphur—to participate in the project, providing the Tunisian company with substantial additional loan and share capital, in exchange for the opportunity to sell sulphur to the new company.

Thus, as a result of IFC's investigation and evaluation, the marketing risks had been reduced, the project had been made more viable from a technical and economic point of view, and the technical management had been strengthened.

In assisting to modify projects, an industrial financing institution is considering proposals which, in essence, have already been thought through, and it is dealing with sponsors who already have some commitment, psychologically or financially, in the project. These circumstances are in contrast to what I have defined as the second kind of promotional activity—that of endeavoring to identify general areas of need in the economy. In theory, these are useful exercises, for the preparation of preliminary feasibility studies and the identification of possible areas for development would seem to lie at the heart of industrial promotion.

Yet the practical results of such studies are not, I think, very encouraging, and our experience in this field has been no better than that of others. In 1961 we were approached by the Plan Organization of Iran and the Industrial Mining Development Bank of Iran to arrange a survey of the Iranian chemical industry. We volunteered to organize the survey ourselves, in the belief that it would be valuable experience for us in the field. We hoped it would lead to practical results, since if investment opportunities came to light through the survey, we would be ready to join in financing them.

In fact, our survey did point to several industries which appeared to show promise for their development. On the strength of these

preliminary indications, we made particularly serious attempts to interest European and American interests in the establishment of a fertilizer mixing and bagging plant. However, as has often been true of this sort of survey, our efforts were entirely unsuccessful and, insofar as we are aware, the direct yield of the survey has been nil.

It is difficult to explain precisely why such general surveys fail to arouse interest among investors. Often they are too general in their approach to be of particular usefulness, and despite their tendency to dwell more on the potential than on stern realities, any objective investigator must qualify his findings with the necessary reservations. Fundamentally, it is difficult to draw up feasibility studies in terms that make them convincing to outside entrepreneurs.

The fact is that industrial organizations are constantly so preoccupied with investment opportunities originating within their own organizations that an outside report has to be very compelling indeed before it can attract their serious attention. The further fact is that making general feasibility studies offers a serious problem to development financing institutions that may choose to undertake them. We have already remarked that promotion in general may be expensive. General feasibility studies may present a more than ordinarily acute budget question. They not only call on both staff and financial resources, but they have long-term implications, since the first studies may possibly lead to additional and more detailed studies. They are not only likely to stretch over a long period of time, but it is difficult to recover the expense of making them, since it usually will not be possible to allocate their cost to any particular investment that may result.

Our experience in the Iranian case and in one or two other cases has not been especially encouraging, and we have decided that in the future this is a kind of activity we will undertake seldom if at all and only after the most careful consideration.

The third kind of promotional activity that I have identified is also concerned with developing a project almost from its foundations, but it has one important advantage over the general survey approach, inasmuch as this kind of promotion concerns a project designed to fill a well defined gap in the industrial structure to meet a clear-cut market demand. A successful example of this type of operation was the installation of a cement factory in Pakistan in 1961. It is really a story that belongs to the Pakistan Industrial Credit and Investment Corporation — PICIC — rather than to us, but it is also a good example of a successful cooperation between two development financing institutions. It is the story of how PICIC successfully carried out an undertaking to fill a major gap opened up in Pakistan's cement industry by political and other developments.

After the Partition of India and Pakistan, there were only four cement plants located in West Pakistan. These were Indian owned, and because of the exchange restrictions in force between the two countries, their owners had no incentive to expand their capacity.

A dramatic new factor in the situation was the formal settlement, late in 1960, of the dispute between India and Pakistan over the division of the waters of the Indus River system. The execution of the settlement involved a huge public works program, including the construction of a giant dam and storage reservoir and the building or rehabilitation of a wide-flung web of irrigation canals. The program was the largest of its kind ever to be undertaken anywhere in the world.

In these exceptional circumstances, the demand for cement was a clear and urgent one. The Pakistan Government called for a general review of the industry and PICIC volunteered to be responsible for the study. PICIC subsequently chose an American firm of consultants to undertake the survey.

In a report presented in 1960, the consultants estimated the annual demand for cement at 2 million tons in 1959 and forecast that this figure would rise to 3 million tons by 1962. To meet this projected demand, it recommended the expansion of two of the existing plants and the construction of three new plants. Responsibility for promoting the establishment of two of the new plants fell to PICIC, which set about and soon found two prominent industrialists willing to sponsor and invest in the cement companies. For one company, PICIC subsequently negotiated for financial assistance from Germany and for the other it received assistance from IFC.

The project which IFC helped to establish was to be near the Jhelum River, at Gharibwal, and in the short term its main market was to be the Mangla Dam. However, shortages of products are notoriously difficult to estimate, and we suspected that the market survey had been over-optimistic. We therefore commissioned another firm of market consultants to make a fresh survey, particularly for the separate marketing area in the northern part of West Pakistan where the project was to be located. This second survey confirmed our suspicions, and on the basis of its findings we were able to persuade the Pakistan Government to scale down its licensed expansion program, and thus avoid the installation of wasteful surplus capacity in the Pakistan cement industry.

IFC also hired independent consulting engineers to advise on the preparation, processing and selection of international bids for the supply of the equipment, and the value of introducing these experts to the company at a critical moment in the formation of the project was later recognized by the company when they contracted them on a consultative basis for the constructional and start-up period.

This is a success story, and is one that should be rightfully told in detail by PICIC itself. The original cost estimates, of rather more than $12 million, have proved to be reasonably accurate and the prospects for the success of the company, which is now about to begin operations, are entirely favorable. Shares offered at 50 rupees are now selling at 70 rupees.

The promotion of a project to fill an obvious gap in the economy offers certain special problems of its own. If the project is obviously needed in the economy, it is likely to be a big one—requiring the investment not of two or three million dollars, say, but more likely of 15 or even 50. If the project is a big one, then a whole range of other problems is likely to exist. For example, a big undertaking in these circumstances is probably going to have to have both foreign capital and foreign management, and one or the other of these may not be welcome. A big project may also require a good deal in the way of power and transportation facilities, and these may be inadequate. Or the project may involve a major natural resource, title to which is vested in

the government. In any case, the project may be of such size as clearly to involve the public interest, and thereby to raise the question of what interest the government ought to take in it. It often happens that the government wants a strong role, but in fact may not have the capital or the technical assistance to offer which would entitle it to that role.

We are at present considering two projects, in different areas of the world, which well illustrate the difficulties of developing large projects, particularly those in which government economic interests are involved.

In one of the American republics, the exploitation of a large forest, which would provide an attractive basis for a major pulp and paper industry, is largely dependent on the negotiation of satisfactory terms with the local government. The project was first given prominence by an FAO mission ten years ago; since then, the government has negotiated unsuccessfully with foreign firms interested in developing the project. It has now asked IFC to draw up proposals which would give the government a fair return and yet be acceptable to local and foreign interests.

The project is estimated to cost about $80 million, of which about $12 million would be for highways, ports, housing and community facilities. Such resources are far beyond those available in the country, and the venture is therefore dependent on outside assistance. However, the title of the land is vested in the government and the forest resource is an important economic asset for the country. The government therefore feels that it must negotiate terms that will not only meet financial requirements but also be acceptable from the standpoint of internal politics.

In another part of the world, we are negotiating with the local government on the terms for the establishment of a major fertilizer complex, to be constructed at an estimated cost of about $40 million. Again the government holds title to the natural resources, and in return for their use, wishes to have what it deems to be an appropriate share in the ownership of the proposed company. The development of this project has been further complicated by the government's decision, for social reasons, to employ a relatively high-cost method of producing sulphur through the utilization of local resources of pyrrhotine. It seems likely that the project will be developed only with external assistance, and then only with an experienced industrial partner. But agreements of this nature, which try to satisfy national and foreign interests and preserve the principles of economic and commercial viability, are plainly difficult to negotiate.

These, then, are a number of specific cases in which IFC has cooperated with others in trying to promote industrial projects. They indicate the areas in which we have had some experience, and they suggest the types of promotional activities which to me seem the most appropriate for an industrial financing institution to undertake.

I have here deliberately emphasized the difficulties, but it is not my intention to minimize the importance of promotional activities. Lack of finance is only one, and perhaps not the most important, of the barriers holding back industrialization in the developing countries. There are other handicaps which can be of equal importance. They include the technological gap existing between these countries and the advanced industrial economies, the unfamiliarity and inexperience of local entrepreneurs with modern managerial methods, and the hesitation often shown by local investors in grasping the new investment opportunities opening up to them.

By proper promotional activity, an individual financing institution can help to break down obstacles in the path of industrial progress. The institution's financial resources, its technical staff and its contacts with both domestic and international investors may give it some of the means of doing so. Its ability to originate ventures, to help prepare projects and to take the lead in modifying proposals submitted to it, are vital elements in its normal operations. I have argued that promotional activities should be directed to practical ends and kept under careful control. I would argue, too, that promotion has its proper role, and that on occasion, it can be a role of great importance in the strategy of industrial development.

INTERNATIONAL
FINANCE CORPORATION

HEADQUARTERS

1818 H Street, N.W.
Washington, D.C. 20433, U.S.A.
Telephone: EXecutive 3-6360

NEW YORK OFFICE

20 Exchange Place
New York, N.Y. 10005, U.S.A.
Telephone: WHitehall 3-5400

EUROPEAN OFFICE

4 Ave. d'Iéna
Paris 16e, France
Telephone: KLEber 25-10

LONDON OFFICE

New Zealand House
Haymarket
London S.W.1, England
Telephone: WHItehall 3886-7

Cable Address: CORINTFIN

CORPORACION FINANCIERA INTERNACIONAL
1818 H STREET, N.W., WASHINGTON 25, D. C.   TELÉFONO: EXECUTIVE 3-6360

PROMOCION INDUSTRIAL

Discurso pronunciado por el señor Martin M. Rosen,
Vice Presidente Ejecutivo de la
Corporación Financiera Internacional
ante la
Primera Reunión Internacional de Instituciones de
Financiamiento del Desarrollo
Caracas, Venezuela, 18 de febrero de 1964

Señor Presidente, Señores:

Me complace mucho tener esta oportunidad de encontrarme en Venezuela y participar en la reunión de instituciones de financiamiento del desarrollo. La Corporación Financiera Internacional y el Banco Mundial, del que somos una organización filial, han mantenido durante mucho tiempo estrechas relaciones con la mayor parte, si no con todas las instituciones aquí representadas. Esas relaciones han sido particularmente estrechas con nuestros anfitriones, la Corporación Venezolana de Fomento, y quisiera expresar mi reconocimiento a mi buen amigo Luis Vallenilla y a sus colaboradores por la excelente organización de esta reunión.

Hemos trabajado muy unidos con la CVF. Hace pocos meses, bajo su patrocinio y junto con una numerosa cantidad de inversionistas privados, venezolanos y extranjeros, nos unimos para organizar y suscribir el capital accionario de una nueva sociedad de financiamiento del desarrollo, la Compañía Venezolana de Desarrollo. Esta empresa, que encabeza nuestro distinguido presidente señor Mendoza, es de propiedad predominantemente privada. Este es un buen ejemplo de la manera en que una institución financiera gubernamental puede emplear sus recursos para apoyar al sector privado no solamente mediante préstamos directos a sociedades industriales privadas sino ayudando a crear y a apoyar sociedades financieras de propiedad privada. Este es un camino que se ha seguido en otras partes del mundo -- en las Filipinas, por ejemplo, donde la PDCP (Private Development Corporation of the Philippines) fue ayudada por el Banco de Desarrollo de las Filipinas, de propiedad del gobierno. Hay otros ejemplos y creo que se trata de un método provechoso que estamos dispuestos a apoyar en otras partes.

Se me ha pedido que mis comentarios de hoy giren en torno al tema general de la promoción industrial. Me agradaría sugerir respuestas a varias interrogaciones.

¿Cuál es el papel que corresponde a una institución de financiamiento del desarrollo para promover el desarrollo industrial? ¿Hasta qué punto puede una institución de desarrollo tomar la iniciativa para originar o perfeccionar proposiciones para proyectos industriales? Estas son preguntas pertinentes, pues creo que todos sabemos que ninguna institución de desarrollo puede limitarse a un papel pasivo frente al proceso de desarrollo. No podemos limitarnos a esperar que lleguen a nuestras manos proposiciones bien concebidas para evaluarlas y luego decir sí o nó al financiamiento.

Pero no puede negarse que la función de la promoción tiene importancia, y que en las regiones menos desarrolladas hay demasiado pocos empresarios para cumplirla adecuadamente. En muchos países se han concluído acuerdos institucionales de diversa naturaleza para compensar, en este estado de cosas, la debilidad del impulso empresario; y en algunas naciones se han establecido instituciones especiales con el fin específico de cumplir la función promocional.

Luego de decir que la actividad promocional tiene importancia, debo agregar inmediatamente que, en mi opinión, una institución de desarrollo cuyo objetivo primordial es el financiamiento, sólo puede desempeñar un papel restringido en aquella función. Por una parte es probable que la promoción sea costosa y que no produzca resultados inmediatos; una institución de financiamiento puede acometer esta empresa sólo en escala modesta, pues debe estar atenta a las cifras de su balance.

Por otra parte, la promoción entraña responsabilidades que las sociedades de financiamiento no están necesariamente capacitadas para cumplir. En la promoción de un proyecto propio, la institución de desarrollo debe estar aún más segura de las posibilidades de éxito de lo que necesita estarlo cuando se trata de apoyar un proyecto ajeno, y ésto implica tiempo y estudio adicionales para lo cual esa institución de desarrollo quizás no esté preparada. Existe también un grado más de responsabilidad, que muy bien puede extenderse hasta el período de iniciación de una nueva empresa. Si un proyecto presenta dificultades, el grupo promotor puede encontrarse íntimamente ligado a cuestiones de administración. Una compañía industrial por acciones, capaz de suministrar dirección administrativa, puede cumplir con esa responsabilidad; pero para que una institución de financiamiento pueda hacerlo, se requeriría un esfuerzo extraordinario.

Estos factores sirven también para explicar por qué en una sociedad de financiamiento del desarrollo la función de promoción debe estar bajo el estrecho control de la dirección. Esto es necesario para asegurarse que quienes participen en la promoción no se dejen llevar por excesivo entusiasmo. Por ejemplo, sería evidentemente erróneo que una sociedad de desarrollo comprometiera demasiado de sus recursos financieros y técnicos en sus propias promociones, a expensas de su capacidad para manejar de manera eficaz y sostenida sus funciones financieras. Se necesita una cuidadosa selección e insistencia en un juicio esmerado y objetivo para escoger la promoción.

Una institución de financiamiento no puede ser totalmente pasiva ni excesivamente promocional; debe fijar sus objetivos en un término medio. Como guía para la selección podría ser útil distinguir entre tres tipos diferentes de promoción en los cuales puede interesarse una sociedad de financiamiento del desarrollo. Uno de esos tipos deriva directamente de la naturaleza de la evaluación de proyectos que toda institución de desarrollo debería hacer. Consiste en el examen de una proposición y su modificación de manera que tome la forma más económica y más provechosa comercialmente. En este caso la institución de desarrollo hace la evaluación y toma la iniciativa para modificar el proyecto de la manera deseada. El segundo tipo de promoción es mucho más general: consiste en el estudio de una zona geográfica, o de un sector económico, para determinar qué clase de oportunidades existen para el desarrollo industrial, que puedan interesar a empresarios e inversionistas. Y el tercer tipo es, como el primero, muy específico: consiste en promover el establecimiento de una industria que llene un vacío importante y bien definido en la estructura económica del país.

Cada uno de estos tres tipos de promoción tiene aspectos y problemas peculiares que quisiera ilustrar más ampliamente con casos reales. Empezando con el primero, creo que en la evaluación y modificación de las proposiciones de un proyecto reside el punto en el que las sociedades de financiamiento industrial pueden, por lo general, contribuir de la manera más efectiva a la promoción de un proyecto.

La evaluación de proyectos comprende principalmente la investigación de cuatro aspectos importantes: el económico, el técnico, el administrativo y el financiero; y la investigación de cada uno de ellos puede resultar en modificaciones sustanciales de las proposiciones para un proyecto. La experiencia nos ha enseñado en la CFI que la debilidad de la administración es la causa más frecuente del fracaso tanto de las empresas nuevas como de las ya existentes. Y un aspecto de la administración al cual damos gran importancia es contar, en los proyectos nuevos, con el asociado técnico conveniente, particularmente en las industrias que utilizan procesos tecnológicos avanzados.

Por esta razón estimamos que una empresa industrial compleja requiere un asociado técnico, del extranjero si es preciso, que participe en capital de riesgo de la compañía y que se identifique con la suerte del proyecto. No basta con llegar a acuerdos de asistencia técnica o limitarse sencillamente a una participación de utilidades. El asociado debe ocupar una posición en la que pierda dinero si la empresa fracasa, y no solamente a recibir utilidades si tiene éxito. En los casos necesarios, una sociedad de financiamiento industrial, con sus amplias vinculaciones extranjeras y nacionales, debe estar en situación de ayudar a encontrar ese asociado.

De manera similar, la evaluación técnica de los proyectos resulta a menudo en revisiones de fondo de las proposiciones originales. Estas revisiones pueden originarse, por ejemplo, en las decisiones sobre la escala adecuada de operaciones del proyecto; o en las medidas necesarias para dar al proyecto el equilibrio técnico y la eficiencia de operaciones requeridos; o en las mejoras a los procesos técnicos propuestos para el proyecto. Tales modificaciones deben reflejarse de la manera apropiada en las estimaciones de los costos de capital del proyecto y de la estructura financiera de la empresa. Invariablemente requieren más dinero y, en ocasiones, encontrar un asociado técnico adicional. Al ayudar en esta labor, la institución de financiamiento está participando en un aspecto práctico e importante de la promoción industrial.

A guisa de ejemplo de este tipo de operación puedo citar una inversión que la CFI hizo en Túnez en 1962. Túnez no es un país rico; no tiene grandes industrias, cuenta con pocos empresarios industriales, escasa mano de obra especializada y una cantidad relativamente pequeña de capital privado. Uno de sus pocos recursos naturales es un rico yacimiento de fosforita.

En 1959 una compañía sueca, Forenade -- la más grande fabricante de fertilizantes de Escandinavia -- empezó a investigar la posibilidad de establecer una subsidiaria tunecina para fabricar superfosfato triple utilizando fosforita de Túnez.

La compañía concluyó con éxito las negociaciones preliminares con el gobierno tunecino, que acordó otorgar beneficios tributarios a la nueva sociedad, garantizar las remesas de divisas, dar seguridades contra la expropiación o la nacionalización, y hacer arreglos para el suministro de fosforita por parte de las minas controladas por el gobierno mediante un contrato de 25 años de duración.

Sin embargo, Forenade no disponía de todos los recursos necesarios para realizar en su totalidad el proyecto. La empresa sueca acudió a la CFI en demanda de ayuda.

La evaluación del proyecto por parte de la CFI resultó en tres modificaciones importantes de las proposiciones: refuerzo de los arreglos de comercialización; adición de una fábrica de ácido sulfúrico para afianzar la base económica del proyecto; e inclusión de un asociado técnico adicional.

La fábrica, diseñada para producir unas 150.000 toneladas de superfosfato triple anualmente, estaba destinada a abastecer mercados de ultramar. El estudio del proyecto por parte de la CFI indicó que aún cuando la producción estuviera en posición de competir con la de otros productores, las perspectivas del mercado serían inseguras. Nuestro estudio del mercado internacional de fertilizantes fosfáticos nos indicó que existía una gran demanda en los países de alta renta y un gran mercado potencial en los países de baja renta de Africa, Asia y Sudamérica. Era difícil predecir el crecimiento de estos últimos pero sabíamos que había otras proposiciones para lograr un aumento importante de la producción.

A fin de dar mayor fuerza a los arreglos de comercialización, y con ello reducir los riesgos comerciales contenidos en el proyecto, Forenade aceptó suscribir un contrato a largo plazo para la compra y distribución en Escandinavia de una parte importante del superfosfato que produciría la nueva fábrica. Forenade aceptó también garantizar, por un período inicial de las operaciones, un nivel mínimo de utilidades de la sociedad tunecina.

En el aspecto técnico la contribución de la CFI fue su insistencia para que se incluyera en el proyecto una fábrica de ácido sulfúrico. Nuestros estudios demostraron que en lugar de atenerse al ácido sulfúrico importado sería más barato producir el ácido necesario en el sitio del proyecto, utilizando azufre importado.

Se trataba, claramente, de una decisión técnica de alguna importancia que elevaba sustancialmente el costo de capital del proyecto. Más aún, introducía un proceso tecnológico separado en el proyecto que, en nuestra opinión, requería un asociado técnico más. Para satisfacer esta condición la CFI encontró un asociado norteamericano -- uno de los más grandes productores de azufre del mundo -- para que participase en el proyecto, suministrando a la sociedad tunecina una importante porción adicional de fondos en forma de préstamo y capital accionario. Recibía, en cambio, la oportunidad de vender azufre a la nueva compañía.

Así como resultado de la investigación y evaluación de la CFI, los riesgos de la comercialización se redujeron, el proyecto se hizo más viable desde un punto de vista técnico y económico, y la dirección técnica se vió reforzada.

Cuando ayuda a modificar proyectos, una sociedad de financiamiento industrial estudia proposiciones que, en el fondo, ya han sido consideradas detenidamente, y entra en tratos con patrocinantes que ya están comprometidos en cierto grado, ya sea psicológica o financieramente, a participar en el proyecto. Estas circunstancias contrastan con lo que he definido como el segundo tipo de actividad promocional -- la de tratar de identificar las zonas generales de necesidad dentro de la economía. En teoría ésto es algo útil, pues la preparación de estudios preliminares de viabilidad y de identificación de posibles áreas para el desarrollo parecerían ser la esencia de la promoción industrial.

No obstante, creo que los resultados prácticos de tales estudios no son muy alentadores, y nuestra experiencia en este aspecto no ha sido mejor que la de otros. En 1961 la Organización del Plan del Irán y el Banco de Desarrollo Minero Industrial del Irán, nos pidieron que organizáramos un estudio de la industria química irania. Nos ofrecimos para organizar el estudio nosotros mismos, en la creencia de que sería una valiosa experiencia en este campo. Esperábamos, además, que nuestros estudios tuvieran resultados prácticos, ya que si surgían oportunidades de inversiones como consecuencia, estaríamos preparados para apoyar su financiamiento.

En verdad, nuestro estudio indicó que había varias industrias que parecían promisorias. Sobre la base de estos indicios preliminares realizamos esfuerzos especialmente serios para atraer a intereses europeos y norteamericanos para establecer una fábrica mezcladora y empacadora de fertilizantes. Sin embargo, como a menudo ha ocurrido con este tipo de estudios, nuestros esfuerzos no tuvieron éxito alguno y, por lo que sabemos, el resultado directo del estudio ha sido nulo.

Es difícil explicar de manera precisa por qué tales estudios generales no logran despertar interés entre los inversionistas. A menudo son demasiado generales en su enfoque, perdiendo su utilidad específica; y pese a la tendencia a insistir más en las realidades potenciales que en las visibles el investigador más objetivo se ve obligado a limitar sus conclusiones mediante las advertencias necesarias. Fundamentalmente, es difícil redactar estudios de viabilidad en términos que convenzan a empresarios extraños.

El hecho es que las empresas industriales están constantemente tan preocupadas de las oportunidades de inversión que surgen dentro de sus propias organizaciones que un informe ajeno tiene que ser de verdad muy atractivo para merecer atención seria. Otro hecho es que la realización de estudios generales de viabilidad ofrece un grave problema a las sociedades de financiamiento del desarrollo que resuelvan efectuarlos. Ya hemos señalado que la promoción puede ser costosa en muchos casos. Los estudios generales de viabilidad pueden constituir un problema presupuestario más agudo que los corrientes. No solamente representan exigencias para los recursos de personal y financieros, sino que tiene repercusiones a largo plazo, ya que los primeros estudios pueden llevar posteriormente a estudios adicionales y más detallados. Es poco probable que duren mucho tiempo, pero es difícil recuperar los gastos que demanda su realización, ya que usualmente no es posible asignar su costo a una inversión determinada que pueda resultar.

Nuestra experiencia en el caso iranio y en uno o dos otros casos no ha sido particularmente alentadora, y hemos resuelto que ésta es una actividad que sólo emprenderemos en el futuro en contadas ocasiones y después del más detenido estudio.

El tercer tipo de actividad promocional que he mencionado se relaciona igualmente con el desarrollo de un proyecto casi desde sus comienzos, pero tiene una ventaja importante sobre el enfoque del estudio general por cuanto se relaciona con un proyecto destinado a llenar un vacío bien definido en la estructura industrial, para satisfacer una demanda precisa. Un ejemplo feliz de este tipo de operación fue la instalación de una fábrica de cemento en Pakistán, en 1961. Es un caso que pertenece realmente a la Pakistan Industrial Credit and Investment Corporation -- PICIC -- más bien que a nosotros, pero es también un buen ejemplo de una feliz cooperación entre dos instituciones de financiamiento del desarrollo. Es la historia de cómo PICIC logró cumplir una empresa para llenar un gran vacío, creado por sucesos políticos y de otra naturaleza, en la industria del cemento de Pakistán.

Después de la partición de India y Pakistán, quedaron solamente cuatro fábricas de cemento en Pakistán Occidental. Eran de propiedad de ciudadanos indios, y debido a las restricciones cambiarias vigentes entre los dos países, sus dueños no se sentían estimulados a ampliar su capacidad.

A fines de 1960 se presentó un nuevo e inusitado elemento en la situación con el arreglo formal de la disputa entre la India y Pakistán sobre la división de las aguas del sistema del río Indo. La ejecución de este acuerdo requería un vasto programa y obras públicas, incluso la construcción de una gigantesca presa y embalse y la construcción o rehabilitación de una amplia red de canales de regadío. El programa era el mayor de su naturaleza que se hubiera emprendido en el mundo.

En estas circunstancias excepcionales la demanda de cemento era clara y urgente. El gobierno pakistano pidió un estudio general de la industria y PICIC se ofreció para asumir la responsabilidad de su ejecución. Posteriormente, PICIC escogió a una firma norteamericana de consultores para que realizara el estudio.

En un informe presentado en 1960 los consultores estimaron la demanda anual de cemento en 2.000.000 de toneladas en 1959 y predijeron que esa cifra se elevaría a 3.000.000 hacia 1962. Para satisfacer esta proyectada demanda, recomendaban la expansión de dos de las fábricas existentes y la construcción de tres nuevas fábricas. La responsabilidad de promover el establecimiento de dos de estas nuevas fábricas recayó en PICIC que emprendió la tarea y pronto encontró a dos destacados industriales dispuestos a patrocinar e invertir en las compañías de cemento. Más adelante PICIC negoció ayuda financiera para una empresa con la Commonwealth Development Finance Corporation de Londres, y para la otra recibió ayuda de la CFI.

El proyecto que la CFI ayudó a realizar iba a estar ubicado cerca del río Jhelum, en Gharibwal, y su principal mercado a corto plazo iba a ser la Presa de Mangla. Sin embargo, es muy difícil calcular la escasez de productos, y sospechamos que el estudio del mercado había sido demasiado optimista. Por esta razón comisionamos a otra firma de consultores para que hiciera un nuevo estudio, particularmente de una zona separada de mercadeo en la parte septentrional de Pakistán Occidental, donde iba a estar ubicado el proyecto. Este segundo estudio confirmó nuestras sospechas y, basándonos en sus conclusiones, pudimos persuadir al gobierno pakistano que redujese el programa de expansión autorizado, evitando de esa forma la instalación de capacidad superflua en la industria pakistana del cemento.

La CFI contrató a ingenieros consultores independientes para que asesorásen en la preparación, estudio y selección de las propuestas internacionales para el suministro de equipo, y el valor de la introducción de estos expertos en la compañía en un momento crítico de la formación del proyecto fue reconocida más adelante por la empresa, al contratarlos como consultores para los períodos de construcción y comienzo de operaciones.

Esta es una historia feliz y que en propiedad debería ser relatada con todos sus detalles por PICIC. Las estimaciones iniciales de costos, de algo más de US$12 millones, han demostrado ser razonablemente acertadas y las perspectivas de éxito de la empresa, que ahora está a punto de iniciar sus operaciones, son totalmente favorables. Las acciones ofrecidas inicialmente a 50 rupias, se cotizan ahora a 70.

La promoción de un proyecto destinado a llenar un vacío evidente en la economía ofrece ciertos problemas especiales. Si el proyecto es de clara necesidad para la economía, probablemente será grande -- requiriendo inversiones nó de dos o tres millones de dólares sino, digamos, más bien de 15 y aún de 50. Si el proyecto es de gran tamaño, es posible que toda la gama de los otros problemas se haga presente. Por ejemplo, es probable que, en estas circunstancias, una gran empresa necesite tanto capital como administración extranjeros, y uno u otro de éstos puede no ser bien recibido. Además, un proyecto grande puede no ser bien recibido. Además, un proyecto grande puede requerir bastantes servicios de energía eléctrica y de transportes, y éstos pueden ser inadecuados. O el proyecto puede afectar un recurso natural importante cuyos títulos de propiedad posea el gobierno. En todo caso, el proyecto puede ser de tal tamaño que afecte claramente el interés público, surgiendo entonces la interrogante de la participación que debería tener el gobierno en él. A menudo ocurre que el gobierno desea una posición fuerte, pero en la realidad puede no tener el capital ni estar en situación de ofrecer la asistencia técnica que le dé derecho a esa posición.

En la actualidad estudiamos dos proyectos en diferentes partes del mundo, que ilustran de manera acertada las dificultades que ofrecen los grandes proyectos, particularmente aquéllos que envuelven intereses económicos del gobierno.

En una de las repúblicas americanas el proyecto para explotar un gran bosque, que proporcionaría una base atractiva para una importante industria de pulpa y papel, depende en alto grado de la negociación de condiciones satisfactorias con el gobierno local. El proyecto fue destacado inicialmente por una misión de la FAO, hace diez años; desde entonces el gobierno ha entrado en negociaciones, sin éxito, con firmas extranjeras interesadas en realizar el proyecto. Ahora ha pedido a la CFI que prepare proposiciones que den al gobierno un rendimiento equitativo y que, al mismo tiempo, sean aceptables para intereses locales y extranjeros.

Se estima el costo del proyecto en unos US$80 millones, de los cuales alrededor de US$12 millones serían para carreteras, puertos, viviendas y servicios comunales. Tales recursos están muy por encima de los que se dispone en el país y, por tanto, la empresa depende de asistencia externa. Sin embargo, la tierra es de propiedad del gobierno y el recurso forestal es una importante posesión del país. Por esa causa el gobierno considera que debe negociar condiciones que no solamente satisfagan las exigencias financieras sino que además sean aceptables desde el punto de vista de la política interna.

En otra parte del mundo estamos en negociaciones con el gobierno local respecto de las condiciones para establecer un importante complejo de fertilizantes, que se construiría a un costo estimado en unos US$40 millones. Aquí también el gobierno tiene posesión de los recursos naturales y desea, a cambio de su uso, contar con lo que considera una participación adecuada en la propiedad de la empresa propuesta. La realización de este proyecto se ha complicado debido a la decisión del gobierno, basada en razones sociales, de emplear un método de relativamente alto costo para producir azufre mediante la utilización de recursos locales de pirrotina. Parece probable que el proyecto se realice sólo con ayuda externa, y únicamente con un asociado industrial experimentado. Pero los acuerdos de esta naturaleza, que tratan de satisfacer los intereses nacionales y extranjeros y preservar los principios de viabilidad económica y comercial, son evidentemente muy difíciles de negociar.

Estos son algunos casos específicos en los cuales la CFI ha cooperado con otros para tratar de promover proyectos industriales. Indican los campos en los que hemos tenido alguna experiencia y sugieren los tipos de actividades promocionales que me parecen los más apropiados que una sociedad de financiamiento industrial puede emprender.

He subrayado deliberadamente las dificultades, pero no es mi propósito restar importancia a las actividades de la promoción. La falta de financiamiento es solamente una, y tal vez no la más importante, de las barreras que limitan la industrialización de los países en desarrollo. Hay otros obstáculos que pueden ser de igual importancia. Entre ellos se cuentan el vacío tecnológico que existe entre esos países y las economías industriales avanzadas, la carencia de familiaridad y la inexperiencia de los empresarios locales frente a los métodos modernos de administración, y la vacilación que a menudo muestran los inversionistas locales para aprovechar las nuevas oportunidades de inversión que se les presentan.

Con una actividad promocional adecuada, una sociedad de financiamiento puede ayudar a salvar estos obstáculos al progreso industrial. Sus recursos financieros, su personal técnico y sus contactos con inversionistas nacionales e internacionales pueden dar a la institución algunos de los medios para lograrlos. Su capacidad para promover nuevas empresas, para ayudar a preparar proyectos y para asumir la iniciativa en la modificación de las proposiciones que se le presenten, son elementos vitales de sus operaciones normales. He sostenido que la función de promoción debe estar encaminada a fines prácticos y mantenerse bajo cuidadoso control. Sostendría, además, que la promoción tiene su papel propio y que, en ocasiones, puede ser un papel de enorme importancia para la estrategia del desarrollo industrial.

INTERNATIONAL FINANCE CORPORATION
1818 H STREET, N.W., WASHINGTON 25, D. C. TELEPHONE: EXECUTIVE 3-6360

Address by Martin M. Rosen, Executive Vice President of the International Finance Corporation at the First International Meeting of Financial Institutions for Development
Caracas, Venezuela, February 18, 1964

Mr. Chairman, Gentlemen:

I appreciate very much having been given this opportunity to come to Venezuela and to participate in the meeting of development financing institutions. The International Finance Corporation and the World Bank, of which we are an affiliate, has long had a close relationship with most if not all of the institutions represented at this meeting. That relationship has been particularly close with our host organization, the Corporacion Venezolana de Fomento and I would here like to pay tribute to my good friend Luis Vallenilla and to his staff for the wonderful job they have done in organizing this meeting.

We have worked closely with the CVF. A few months ago, under their leadership, and together with a large number of private investors, both Venezuelan and foreign, we joined in organizing and subscribing the share capital of a new development financing company, Compania Venezolana de Desarrollo. This company, of which our distinguished chairman, Sr. Mendoza, is President, is predominantly privately owned. This is a good example of how a governmental financial institution can use its resources in support of the private sector, not only by direct loans to private industrial companies but by helping create and support privately-owned financieras. This pattern has been followed elsewhere in the world -- the Philippines for example, where the privately owned PDCP was assisted by the government-owned Development Bank of the Philippines. There are other examples and I believe this is a useful pattern which we stand ready to support elsewhere.

I have been asked to concentrate my comments today on the general subject of industrial promotion. I would like to try to suggest answers to several questions.

What is the proper role of a development financing institution in promoting industrial development? How far should such an institution go in taking the initiative for originating or perfecting proposals for industrial projects? The inquiry is a pertinent one, for it is clear to all of us, I think, that no development financing institution can play a merely passive role with respect to development. The projects which simply walk in the front door and present themselves across the counter are usually rather shopworn and not particularly attractive. We cannot simply wait for well conceived proposals to come to us, then check them out and say yes or no to the financing.

It cannot be denied, either, that the promotional function is an important one, and that in the underdeveloped areas, there are too few private entrepreneurs to discharge it adequately. Many countries have made institutional arrangements of one kind or another to compensate for the weakness, in the present state of things, of the entrepreneurial impulse; and some countries have established special institutions for the particular purpose of carrying on promotional activity.

Having said that promotional activity is important, I must immediately add that in my opinion, a development institution whose primary purpose is financing can play only a limited role in promotion. For one thing, promotion is likely to be expensive and unlikely to produce an immediate return; it can be undertaken only on a modest scale by any financing institution which must be attentive to its own balance sheet.

For another thing, promotion entails responsibilities which finance companies are not necessarily well equipped to discharge. To promote a proposal of its own and to induce others to join in it, a development institution must be even more sure of the prospects of success than it needs to be when it is financing someone else's project. This implies a degree of investigative, analytical and organizational work for which a development finance company is not necessarily well prepared. There is also an extra degree of continuing responsibility, very likely extending well into the start-up period of a new enterprise. When projects run into difficulties, the promoting group may have to become intimately involved in the management. An industrial holding company, able to provide managerial direction, can discharge such a resposibility; a financing institution to do so would require extraordinary effort.

These factors also serve to explain why, within a development financing institution, the promotion function must be under the close control of top management. This is necessary to make sure that those involved in promotion do not become overly enthusiastic. It obviously would be wrong, for instance, for a development company to commit too much of its financial and technical resources to its own promotions, at the expense of being able to handle its financing functions in an effective and expeditious manner. What is needed is careful selectivity, and an insistence on a careful and objective judgment of what is selected for promotion.

A financing institution cannot be entirely passive, nor can it be predominantly promotional; it must set its sights somewhere in between. As a guide to selectivity, it may be useful to distinguish between three different kinds of promotion with which a development finance corporation may be concerned. One kind arises directly from the kind of project analysis that any development institution ought to do. It consists of examining a proposal and modifying it so that it takes the most economic and most commercially profitable form. In this case, the development institution does the analysis, and takes the lead in re-shaping the project in the desired direction. A second kind of promotion is much more general; it consists of surveying a geographic region which may be economically backward or an economic sector, to see what kind of opportunities exist for industrial development that may be of interest to entrepreneurs and investors. And a third, like the first, is quite specific; it consists of promoting the establishment of a particular industry to fill an important and well defined and well known gap in a country's economic structure.

Each of these three types of promotion has features and problems particular to itself, which I would like to illustrate more fully by actual cases. To begin with the first type, it is in assessing and modifying project proposals, that industrial financing institutions can in my opinion usually make their most effective contribution to project promotion.

The appraisal of projects consists principally in investigating four main aspects -- economic, technical, managerial and financial -- and the investigation in each of these fields can lead to substantial modifications in project proposals. Experience has taught us in IFC that weakness of management is the most common cause of failure in both new and existing companies. And one aspect of management to which we attach great importance is that of having an experienced technical partner in new projects, particularly in those industries using advanced technological processes.

We believe, therefore, that a complex industrial undertaking requires a technical partner, from abroad if necessary, and that the partner must participate in providing part of the share capital of the company, thus identifying itself with the fortunes of the project. It is not enough to have technical assistance arrangements or simply a profit sharing basis. The partner should be in a position where it loses money if the venture fails and not merely profits if it succeeds. Where necessary, an industrial financing company, with its wide foreign and domestic connections, should be prepared to give assistance in finding such a partner.

Similarly, the technical evaluation of projects often lead to substantial revisions of original proposals. These revisions may arise, for example, from decisions on the appropriate scale of operations of the proposed project, or from measures necessary to give the project proper technical balance and operating efficiency, or from improvements in the proposed technical processes to be employed in the project. Such modifications must be properly reflected in the estimated capital costs of the project and the financial structure of the company. Invariably they require extra money and sometimes the finding of an additional technical partner. In assisting in this work, the financing institution is engaging in a practical, and important, field of industrial promotion.

An example of this type of operation is illustrated by an investment that IFC made in Tunisia in 1962. Tunisia is not a rich country; it has no major industries, few industrial entrepreneurs, little skilled labor and a relatively small amount of private capital. One of its few natural resources is a rich deposit of phosphate rock.

In 1959, a Swedish company,Forenade -- one of the largest fertilizer companies in Scandinavia -- began to explore the possibility of establishing a Tunisian subsidiary to manufacture triple superphosphate from Tunisian rock phosphate.

The company successfully concluded preliminary negotiations with the Tunisian Government, which agreed to grant tax benefits for the new Tunisian company, to guarantee remittances in foreign exchange, to give assurances against expropriation or nationalization, and to arrange for supplies of rock phosphate to be obtained from government-controlled mines under a 25-year contract.

Forenade alone, however, did not have available all the financial resources required to carry out the entire project. The Swedish company turned to IFC for assistance.

IFC's evaluation of the project led to three important modifications in the existing proposals: a strengthening of the marketing arrangements, the addition of a sulphuric acid plant to increase the profitability of the project, and the bringing in of an additional technical partner.

The plant, designed to produce about 150,000 tons of triple superphosphate annually, was to supply overseas markets. IFC's survey of the project indicated that while production would be competitive with that from other producers, the market prospects were good but uncertain. Our survey of the international market for phosphatic fertilizer indicated that there existed a large demand in high income countries and a great potential market in low income countries of Africa, Asia and South America. The rate of growth of these latter markets was difficult to predict and we knew there were other proposals for substantial increase of production.

In order to strengthen the marketing arrangements, and thereby reduce the commercial risks involved in the project, Forenade itself agreed to enter into a long-term contract for the purchase and distribution in Scandinavia of a sizable portion of the superphosphate to be produced by the new plant. Forenade also agreed to guarantee, for an initial period of the plant's operations, a minimum level of profits for the Tunisian company.

On the technical side, IFC's contribution was to urge the inclusion of a sulphuric acid plant in the project. Our studies showed that instead of relying on imported sulphuric acid it would be cheaper to produce the acid required on the site of the project, using imported sulphur.

This clearly was a technical decision of some importance, and substantially raised the capital cost of the project. Moreover, it introduced a separate technological process into the project and one, which in our view, required an additional technical partner. To meet this requirement, we found a U.S. partner -- one of the world's largest producers of sulphur -- to participate in the project, providing the Tunisian company with substantial additional loan and share capital, in exchange for the opportunity to sell sulphur to the new company.

Thus, as a result of IFC's investigation and evaluation, the marketing risks had been reduced, the project had been made more viable from a technical and economic point of view, and the technical management had been strengthened.

In assisting to modify projects, an industrial financing institution is considering proposals which, in essence, have already been thought through, and it is dealing with sponsors who already have some commitment, psychologically or financially, in the project. These circumstances are in contrast to what I have defined as the second kind of promotional activity -- that of endeavoring to identify general areas of need in the economy. In theory, these are useful exercises, for the preparation of preliminary feasibility studies and the identification of possible areas for development would seem to lie at the heart of industrial promotion.

Yet the practical results of such studies are not, I think, very encouraging, and our experience in this field has been no better than that of others. In 1961 we were approached by the Plan Organization of Iran and the Industrial Mining Development Bank of Iran to arrange a survey of the Iranian chemical industry. We volunteered to organize the survey ourselves, in the belief that it would be valuable experience for us in the field. We hoped it would lead to practical results, since if investment opportunities came to light through the survey, we would be ready to join in financing them.

In fact, our survey did point to several industries which appeared to show promise for their development. On the strength of these preliminary indications, we made particularly serious attempts to interest European and American interests in the establishment of a fertilizer mixing and bagging plant. However, as has often been true of this sort of survey, our efforts were entirely unsuccessful and, insofar as we are aware, the direct yield of the survey has been nil.

It is difficult to explain precisely why such general surveys fail to arouse interest among investors. Often they are too general in their approach to be of particular usefulness, and despite their tendency to dwell more on the potential than on stern realities, any objective investigator must qualify his findings with the necessary reservations. Fundamentally, it is difficult to draw up feasibility studies in terms that make them convincing to outside entrepreneurs.

The fact is that industrial organizations are constantly so preoccupied with investment opportunities originating within their own organizations that an outside report has to be very compelling indeed before it can attract their serious attention. The further fact is that making general feasibility studies offers a serious problem to development financing institutions that may choose to undertake them. We have already remarked that promotion in general may be expensive. General feasibility studies may present a more than ordinarily acute budget question. They not only call on both staff and financial resources, but they have long-term implications, since the first studies may possibly lead to additional and more detailed studies. They are not only likely to stretch over a long period of time, but it is difficult to recover the expense of making them, since it usually will not be possible to allocate their cost to any particular investment that may result.

Our experience in the Iranian case and in one or two other cases has not been especially encouraging, and we have decided that in the future this is a kind of activity we will undertake seldom if at all and only after the most careful consideration.

The third kind of promotional activity that I have identified is also concerned with developing a project almost from its foundations, but it has one important advantage over the general survey approach, inasmuch as this kind of promotion concerns a project designed to fill a well defined gap in the industrial structure to meet a clear-cut market demand. A successful example of this type of operation was the installation of a cement factory in Pakistan in 1961. It is really a story that belongs to the Pakistan Industrial Credit and Investment Corporation -- PICIC -- rather than to us, but it is also a good example of a successful cooperation between two development financing institutions. It is the story of how PICIC successfully carried out an undertaking to fill a major gap opened up in Pakistan's cement industry by political and other developments.

After the Partition of India and Pakistan, there were only four cement plants located in West Pakistan. These were Indian owned, and because of the exchange restrictions in force between the two countries, their owners had no incentive to expand their capacity.

A dramatic new factor in the situation was the formal settlement, late in 1960, of the dispute between India and Pakistan over the division of the waters of the Indus River system. The execution of the settlement involved a huge public works program, including the construction of a giant dam and storage reservoir and the building or rehabilitation of a wide-flung web of irrigation canals. The program was the largest of its kind ever to be undertaken anywhere in the world.

In these exceptional circumstances, the demand for cement was a clear and urgent one. The Pakistan Government called for a general review of the industry and PICIC volunteered to be responsible for the study. PICIC subsequently chose an American firm of consultants to undertake the survey.

In a report presented in 1960, the consultants estimated the annual demand for cement at 2 million tons in 1959 and forecast that this figure would rise to 3 million tons by 1962. To meet this projected demand, it recommended the expansion of two of the existing plants and the construction of three new plants. Responsibility for promoting the establishment of two of the new plants fell to PICIC, which set about and soon found two prominent industrialists willing to sponsor and invest in the cement companies. For one company, PICIC subsequently negotiated for financial assistance from the Commonwealth Development Finance Corporation in London, and for the other it received assistance from IFC.

The project which IFC helped to establish was to be near the Jhelum River, at Gharibwal, and in the short term its main market was to be the Mangla Dam. However, shortages of products are notoriously difficult to estimate, and we suspected that the market survey had been over-optimistic. We therefore commissioned another firm of market consultants to make a fresh survey, particularly for the separate marketing area in the northern part of West Pakistan where the project was to be located. This second survey confirmed our suspicions, and on the basis of its findings we were able to persuade the Pakistan Government to scale down its licensed expansion program, and thus avoid the installation of wasteful surplus capacity in the Pakistan cement industry.

IFC also hired independent consulting engineers to advise on the preparation, processing and selection of international bids for the supply of the equipment, and the value of introducing these experts to the company at a critical moment in the formation of the project was later recognized by the company when they contracted them on a consultative basis for the constructional and start-up period.

This is a success story, and is one that should be rightfully told in detail by PICIC itself. The original cost estimates, of rather more than \$12 million have proved to be reasonably accurate and the prospects for the success of the company, which is now about to begin operations, are entirely favorable. Shares offered at 50 rupees are now selling at 70 rupees.

The promotion of a project to fill an obvious gap in the economy offers certain special problems of its own. If the project is obviously needed in the economy, it is likely to be a big one -- requiring the investment not of two or three million dollars, say, but more likely of 15 or even 50. If the project is a big one, then a whole range of other problems is likely to exist. For example, a big undertaking in these circumstances is probably going to have to have both foreign capital and foreign management, and one or the other of these may not be welcome. A big project may also require a good deal in the way of power and transportation facilities, and these may be inadequate. Or the project may involve a major natural resource, title to which is vested in the government. In any case, the project may be of such size as clearly to involve the public interest, and thereby to raise the question of what interest the government ought to take in it. It often happens that the government wants a strong role, but in fact may not have the capital or the technical assistance to offer which would entitle it to that role.

We are at present considering two projects, in different areas of the world, which well illustrate the difficulties of developing large projects, particularly those in which government economic interests are involved.

In one of the American republics, the exploitation of a large forest, which would provide an attractive basis for a major pulp and paper industry, is largely dependent on the negotiation of satisfactory terms with the local government. The project was first given prominence by an FAO mission ten years ago; since then, the government has negotiated unsuccessfully with foreign firms interested in developing the project. It has now asked IFC to draw up proposals which would give the government a fair return and yet be acceptable to local and foreign interests.

The project is estimated to cost about \$80 million, of which about \$12 million would be for highways, ports, housing and community facilities. Such resources are far beyond those available in the country, and the venture is therefore dependent on outside assistance. However, the title of the land is vested in the government and the forest resource is an important economic asset for the country. The government therefore feels that it must negotiate terms that will not only meet financial requirements but also be acceptable from the standpoint of internal politics.

In another part of the world, we are negotiating with the local government on the terms for the establishment of a major fertilizer complex, to be constructed at an estimated cost of about \$40 million. Again the government holds title to the natural resources, and in return for their use, wishes to have what it deems to be an appropriate share in the ownership of the proposed company. The development of this project has been further complicated by the government's decision, for social reasons, to employ a relatively high-cost method of producing sulphur through the utilization of local resources of pyrrhotine. It seems likely that the project will be developed only with external assistance, and then only with an experienced industrial partner. But agreements of this nature, which try to satisfy national and foreign interests and preserve the principles of economic and commercial viability, are plainly difficult to negotiate.

These, then, are a number of specific cases in which IFC has cooperated with others in trying to promote industrial projects. They indicate the areas in which we have had some experience, and they suggest the types of promotional activities which to me seem the most appropriate for an industrial financing institution to undertake.

I have here deliberately emphasized the difficulties, but it is not my intention to minimize the importance of promotional activities. Lack of finance is only one, and perhaps not the most important, of the barriers holding back industrialization in the developing countries. There are other handicaps which can be of equal importance. They include the technological gap existing between these countries and the advanced industrial economies, the unfamiliarity and inexperience of local entrepreneurs with modern managerial methods, and the hesitation often shown by local investors in grasping the new investment opportunities opening up to them.

By proper promotional activity, an individual financing institution can help to break down obstacles in the path of industrial progress. The institution's financial resources, its technical staff and its contacts with both domestic and international investors may give it some of the means of doing so. Its ability to originate ventures, to help prepare projects and to take the lead in modifying proposals submitted to it, are vital elements in its normal operations. I have argued that promotional activities should be directed to practical ends and kept under careful control. I would argue, too, that promotion has its proper role, and that on occasion, it can be a role of great importance in the strategy of industrial development.

INTERNATIONAL FINANCE CORPORATION

Article prepared for

INDUSTRIEKURIER

Düsseldorf, Germany

by Martin M. Rosen

Executive Vice President

February 9, 1965

The international flow of private risk capital has historically been one of the prime agents of economic development. Although this role has been overshadowed by the rise in the flow of public funds for international lending, private capital remains a precious ingredient for the balanced economic growth of developing countries: in particular, by facilitating the transfer of scarce technological, managerial and other skills from the developed world. It is in this sector of economic development that the International Finance Corporation (IFC), an affiliate of the World Bank, has played an unusual and in some ways unique part since it was established in 1956. The Corporation itself is unusual in that it is an international institution whose sole task is to assist private enterprise in developing countries; it is unique among international organizations in that it can provide equity capital to the enterprises in which it invests.

Membership of IFC -- open to all countries that belong to the World Bank -- has risen from 31 countries in 1956 to 78 today. IFC's subscribed capital, paid in by member countries, now stands at close to $100 million. Since the Corporation made its first investment -- in Siemens do Brasil, in 1957 -- its gross commitments have risen to more than $127 million in 30 different countries. It is an indication of the quickening pace of IFC's operations that it made more commitments in more countries during the calendar year 1964 than in any previous year in its history. In all, commitments of $25.4 million were made in 18 enterprises in 14 different countries, a sharp increase from the previous year's total of 14 commitments, amounting to $14.5 million, in 11 countries.

In its efforts on behalf of private enterprise in developing countries, IFC has established four main methods of operation: direct investment in industrial companies, with the participation of domestic or foreign private investors and entrepreneurs; assistance to privately-owned development finance companies engaged in industrial financing; stand-by and underwriting commitments; and, lastly, the sale of investments from portfolio to other financial institutions.

As far as direct investment is concerned, IFC provides financing in a number of ways, most frequently on a mixed loan and equity basis, but also in the form of straight equity or loans with stock option or other equity features. The bulk of its direct investments have been made in manufacturing and processing industry. In some cases, the investments have been concerned with the expansion of existing enterprises which, for one reason or the other, have been unable to raise sufficient funds on reasonable terms in the local capital market. Other investments have been made in companies planning to enter new lines of business. IFC has also been called on to assist in promoting new companies -- sometimes representing new types of industry in the countries concerned.

Sponsorship of projects has been equally diverse. Sometimes IFC has assisted projects sponsored solely by local investors or entrepreneurs, but more frequently the sponsors have represented financial and technical partnerships between domestic and outside interests. In Pakistan, for instance, IFC has made an investment in the Steel Corporation of Pakistan Ltd., a producer of a variety of rolled steel products. A share interest in the company -- control of which rests in Pakistani hands -- is held by Kloeckner Industrie Anlagen GmbH. In India, IFC has invested in KSB Pumps Private Ltd., a manufacturer of special purpose pulps, whose principal shareholder is Klein, Schanzlin & Becker AG, in partnership with Indian interests. IFC has also invested in and helped to underwrite the shares of Forjas de Colombia, S.A., a new company formed under local sponsorship to build and operate a steel forgings plant in Colombia. Rheinstahl Industrie-Planung GmbH, a subsidiary of Rheinische Stahlwerke of Essen, is a substantial investor in the company.

IFC's recent operations give some idea of the diversity of its investments. During 1964, the Corporation assisted Mexican and French interests in establishing a new enterprise in Mexico to produce a range of heavy construction equipment, under license from European and U.S. manufacturers. In Nigeria and the Sudan, IFC helped the financing of textile companies sponsored by local and Japanese interests; while in Honduras, a group of local businessmen secured financing from the Corporation for a new leather tanning industry. Other commitments were made to assist the expansion and modernization of already established companies, including a major producer of pulp and paper in Argentina and a leading textile company in Ethiopia. In Peru, IFC helped to finance a cement company which had earlier been helped by a loan from the World Bank. In several other cases, additional commitments were made in companies in which the Corporation already has made investments -- among others, in an automotive equipment manufacturer in Spain and a sugar producer in Tanzania.

Under its charter, IFC is permitted to make investments only in the territories of its member countries: in practice, those which can be considered to be less developed. These terms of reference exclude investments in the highly industrialized countries of Western Europe, as well as North America and Japan, but they have not excluded such countries as Finland, Greece, Spain and Turkey, where commitments have been made recently.

This diversified and geographically widespread pattern of operations has provided a unique opportunity to gain insights into the problems of private industrial enterprise and private investment in developing countries. Technical feasibility, the availability of markets, the adequacy and suitability of the financing, the competence of management: all of these factors, which have a direct bearing on the success of an enterprise, must be carefully weighed before an investment decision can be reached. Basic problems which exist everywhere in the financing and management of industrial enterprises can often be aggravated under the conditions of developing economies. Shortage of equity capital, overruns on construction and start-up costs, overoptimistic profit projections and deficiencies in accounting procedures or cost control systems serve to increase the margin of error in an enterprise and affect the prospects of profitable operation. This makes it all the more important to temper enthusiasm with realism.

To conduct appraisals of projects, IFC draws primarily on its own staff of financial analysts, engineers, accountants and lawyers. It can also draw on the resources of the World Bank, or, where necessary, on outside consultants. Staff appraisals of projects have, in some cases, led to substantial alterations in financial and other plans. Experience has shown, too, that where advanced technology is involved in a project, the chances of success are often materially improved by locating suitable foreign technical partners for domestic entrepreneurs. In such cases, IFC requires that the foreign partner should have a continuing interest in the success of a project, represented by an investment commitment rather than simply a licensing agreement or management contract.

The provision of capital and other resources to privately-owned development finance companies has become a major phase of IFC's operations. Institutions of this kind, geared to providing long-term investment capital to industrial enterprises, can help to stimulate the development of local capital markets. They can help to finance existing enterprises in the process of expansion as well as play a promotional role in identifying investment opportunities, financing new companies and attracting foreign private capital.

IFC has taken the lead for the World Bank group in assisting development finance companies, in some cases in conjunction with Bank loans or credits provided by the Bank's affiliate, the International Development Association (IDA). The assistance has extended well beyond the provision of share capital: the Corporation has stood ready to help existing development finance companies and to organize new institutions, acting as a consultant in establishing policy, drafting statutes, locating management and a wide range of other functions. Subsequently, IFC sometimes acts as a partner in assisting enterprises whose needs are too large to be met entirely from the resources of the local institution or the domestic capital market.

By the end of 1964, IFC had made commitments to provide approximately $17 million in share capital to 13 development finance companies in 11 countries. These investments have been made alongside commitments by domestic investors (including governments), foreign banking and financial institutions, as well as the World Bank and IDA. In IFC's most recent fiscal year, ending June 30, 1964, its own investment of $6.2 million in seven development finance companies was made in conjunction with $64.5 million in loans (including World Bank loans) and share subscriptions by other investors. Banking and financial institutions in a number of countries -- including Germany, Britain, France, Holland, Italy, Japan and the United States -- have taken part in providing capital to development finance companies, along with IFC. For example, when the Nigerian Industrial Development Bank was established in 1964, the IFC investment was made simultaneously with investments by an international group of institutions, including the Commerzbank A.G. Last year, too, the Commerzbank was a member of the group of institutions which joined with the World Bank and IFC in expanding the capital resources of the Industrial Finance Corporation of Thailand (IFCT), which had previously been the recipient of a foreign exchange loan of DM 11 million from the Kreditanstalt für Wiederaufbau. On several other occasions, the Deutsche Bank A.G. has provided capital to development finance companies in which IFC has an interest, including the Banque Nationale pour le Developpement Economique of Morocco, the Banco del Desarrollo Economico Espanol, the Private Development Corporation of the Philippines and The Pakistan Industrial Credit and Investment Corporation.

Stand-by and underwriting commitments represent another aspect of IFC's operations in assisting private industrial enterprise. Commitments of this kind have also helped in the long-haul task of broadening local capital markets. At the end of 1964, IFC's stand-by and underwriting commitments totaled approximately $16.6 million. Its largest commitments have been made in the case of a leading Mexican steel producer, Compania Fundidora de Fierro y Acero de Monterrey, which has had to raise substantial amounts of capital publicly in order to complete the financing of major expansion programs. In 1962 and again last year, IFC organized and led the underwriting groups which made it possible for the company to issue new shares, and thus was instrumental in helping Fundidora raise a total of over $16 million. Last year's underwriting represented not only IFC's largest single commitment but also the largest share offer ever made in Mexico by a privately-owned company. In the case of another Mexican company, Tubos de Acero de Mexico, S.A., IFC undertook a stand-by arrangement, under which it conditionally agreed to purchase part of a convertible debenture issue, should the issue not be fully taken up by other investors.

IFC has placed particular emphasis on securing the participation of other financial institutions in its investments. To the extent that it has been able to do so, it has achieved its objective of stimulating the flow of private capital to developing countries. In turn, the participation of other institutions has made it possible for IFC to revolve its own funds and undertake new commitments elsewhere. In some cases, institutions have joined IFC at the outset in its investments. In other cases, they have purchased portions of loan and equity investments from IFC's portfolio. By the end of 1964, the total amount of investments which the Corporation had sold or agreed to sell to other institutions had risen to approximately $25.5 million. Institutions domiciled in a number of countries -- including Britain, Holland, Switzerland, Kuwait and the United States -- have taken part in IFC investments. German institutions which have made purchases from IFC's portfolio include Bankhaus Burkhardt & Co. and the Dresdner Bank A.G.

IFC's experience has made it apparent that there are few -- if any -- short cuts to successful investment in industrial enterprises in developing countries. Success often rests on a complex of factors. On occasions, IFC has been the catalyst in bringing together investment opportunities, domestic and foreign capital and experienced management. In order to understand what is involved, it is worth looking more closely at the case of Forjas de Colombia. The company was conceived and established to meet the demand in Colombia for forgings -- such as tractor track parts -- and a range of other products. The history of the project goes back to 1961, when a group of private investors in Colombia engaged a technical consultant to prepare a feasibility study on the project. On the basis of his report, the group decided to go ahead. After reviewing several offers, contracts were placed for the design, construction and initial technical management of the plant -- together with the supply of machinery and equipment -- with Rheinstahl Industrie-Planung, which also took a substantial share interest in the project.

The original sponsors had always realized that the project required more capital than they could hope to raise themselves, and accordingly other investors were brought in. The group approached two Colombian development finance companies to which IFC has provided investment capital. Other investors -- both in Germany and Colombia -- were brought in, including a government agency, the Instituto de Fomento Industrial, which had supported the project from the start. The development finance companies subsequently approached IFC to provide the capital required to complete the financing of the project. IFC conducted its own appraisal of the project and while it was favorably impressed in nearly every respect, it felt that the project was undercapitalized and that insufficient provision had been made for possible overruns on construction costs. It therefore advised that the capitalization should be increased, by raising the proportion of equity. IFC's role was the vital one of ensuring completion of the equity financing. It achieved this in two ways: by agreeing to make a direct investment equivalent to $1 million in Forjas shares and, in addition, to underwrite the placement of a further $1-1/2 million in shares in conjunction with the two Colombian development finance companies.

The Forjas investment fulfills IFC's objectives in a number of respects. For a start, it represents a commitment in an enterprise of high economic priority to the country concerned. The existence of the plant -- a substantial one by Colombian standards -- is expected to help to broaden the base of the country's metal working industries. The arrangement with Rheinstahl provides assurance of expert technical assistance at a crucial period of the new company's existence. Rheinstahl will not only be providing supervision of the construction and start-up of the plant but will also be training local staff in Germany to assist in running the operation. Finally, the underwriting agreement is -- in a real sense -- a pioneering effort in developing the capacity of the Colombian market to provide risk capital for industrial enterprise.

IFC's experience in the last eight years has provided support for the World Bank's belief that assistance to private industrial enterprise can play an important part in economic development. The expansion of the private sector represents a logical outgrowth from the infrastructure of power, transportation and other basic facilities which World Bank lending has helped to establish in many developing countries. Since it came into existence, the World Bank itself has made $1.2 billion in loans, with government guarantee, to private industrial enterprises. But the requirement of a government guarantee is frequently not compatible with the most effective means of providing assistance to the private sector. In many countries, there is a natural and understandable reluctance on the part of private entrepreneurs to seek a government guarantee on funds they borrow. In other countries, there is an equal degree of reluctance on the part of governments in providing such guarantees.

The resources available to IFC obviously are not of a magnitude that would make it possible for the Corporation to take over the bulk of the financing of private industry which the World Bank has been doing. Moreover, despite the Corporation's success in revolving its funds, the rate at which new commitments have recently been undertaken indicates that additional resources would be required within the next two years or so, if the present pace of activity is to be maintained. In considering how this replenishment could best be achieved, consideration was given to a number of proposals. The proposal which has been adopted -- and which won unanimous support at the annual meeting of the Governors of the Bank and IFC in Tokyo this year -- involves extension of a line of credit by the Bank to IFC, for re-lending to private industrial enterprises without government guarantee. IFC would be permitted to borrow up to four times its unimpaired subscribed capital and free reserves, or a total of approximately $400 million. The proposal requires amendment of the Articles of Agreement of both the Bank and IFC, and formal approval of member countries is now being sought.

These new resources are likely in time substantially to change IFC's activities. They would, for example, make it possible for IFC to enter into much larger loan commitments to individual companies than has up to now been the case. They would free the entire present capital and reserves of IFC for equity investments. IFC would still require that its financing in large-scale projects would in partnership with local and foreign partners and would expect that a substantial part of loan moneys would continue to come from the outside sources, such as the European Investment Bank and the Inter-American Development Bank, as has previously been the case. Experience has shown, however, that the fact that IFC itself would be in a position to enter into a substantial commitment would make it possible for financial arrangements to be completed more quickly, thus accelerating the pace of development of the private sector in the less developed countries, than if a number of different financial institutions all must agree simultaneously on the provision of capital.

IFC is, by any standards, a young institution, an institution still in the process of evolution. Its significance to date has been the exploratory nature rather than the scale of its operations in new and often unfamiliar territory. The proposed expansion of IFC's resources reflects the growing maturity of the Corporation. With greater resources available to it, IFC can be expected to make fuller use of its experience in the field of development financing.

Jan 26, 1965

Outline prepared for M. M. Rosen
for a talk to the Financial Editors
Washington, D. C.

I. Introduction

A. Mr. Woods was saying last night, I understand, there has been a considerable evolution in the World Bank group in the last four years or so. This is particularly true of the International Finance Corporation, and this is mainly what I want to talk to you about this afternoon.

B. Not all of you, however, may be familiar with IFC, so first let me sketch briefly something about its history and purposes.

II. IFC is sometimes referred to as the private enterprise arm of the World Bank, and this does convey the basic idea of the Corporation's business.

A. Bank itself, of course, lends to private enterprises - over the years has lent over a billion dollars to private companies. But there are a number of things Bank does not or cannot do in its financing of private companies.

1. Cannot lend without guarantee. Many companies don't like guarantees; some governments don't like them, even constitutionally able to give them.

2. Bank makes only fixed-interest investments; it does not provide risk capital of kind necessary to new or expanding businesses.

III. It was to make good these two gaps in Bank's capabilities that IFC was created in 1956.

A. IFC does not seek or accept government guarantee.

B. It does provide other than fixed-interest investments.

C. Might add, parenthetically, that unlike the Bank, it is better able to deal with investments of modest size. IFC commitments range from around a quarter of a million up to $6.1 million dollars, as compared to average Bank loan of $20 million or so.

IV. The emphasis in IFC, as in the case of the Bank, is not merely on what IFC can invest, but also on what other capital it can help to mobilize.

A. IFC exists to invest money on its own. Has commitments now of $137 million.

B. But much more of the value of IFC, up to now, has lain in its ability to muster investment by others.

a. by attracting other capital to come into industrial projects in the underdeveloped countries. If you look at our last year's Annual Report, for example, you will see that IFC's own investment in industrial companies were joined by more than five times that amount of investment from other sources.

b. by stimulating capital markets within the underdeveloped countries themselves. Underwriting and standby operations - Fundidora and TAMSA.

C. This is not simply a finders' business. Involves a good deal in the way of technical investigation, covering technology, market prospects, management, resulting eventually in financial plan.

V. Also has involved overcoming certain difficulties. I am not talking about well-known difficulties involved in setting up new industries in the underdeveloped countries, but some which particularly faced IFC.

A. Originally, inability to make straight equity investment. Removed in 1961.

1. simplified operations. Made IFC participation simpler to negotiate, made it easier to attract participations by others, and 33% of IFC portfolio is now in equity investment.

B. Basic difficulty of dealing with prospective clients at great distances, difficulty of having adequate knowledge of local conditions.

1. Relations with local development banks. Took over responsibility for dealing with development banks for entire World Bank group in 1962. This has now become major line of activity.

2. Investments in 14 development banks.

a. Some cases. Morocco or Nigeria.

3. Investments originating with development banks or carried out in company with them.

a. Forjas

b. Mahindra-Ugine.

C. Also the question of the size of IFC's own resources. IFC is a $100 million corporation, although by turning over its investments actually been able to commit $137 million. But tempo of operations been increasing steadily, and also more work to be done.

1. IFC is authorized to borrow in market, could have augmented funds in that way. But in fact, this would have involved competition with World Bank itself, so this possibility finally discarded.

2. IFC also could have turned to its 78 member governments to subscribe more capital. But this would have involved competition with the Bank's other affiliate, IDA, which must rely on member governments for periodic additions to its financial resources.

3. So decided on loan from World Bank.

a. amount

b. procedure - charter amendments, now in process, may be finished around turn of year

c. implications - larger transactions, new class of customers, replacing IFC loan investments made out of capital

D. Concurrently, certain organizational changes have been carried out between the Bank and IFC. Industry division of Bank been transferred to IFC, and IFC now carries the responsibility of evaluating all proposals made to the World Bank group for investments in industry or in industrial finance companies. In that sense, an evolution has been completed, and IFC is now in fact, as well as in concept, the chief industrial-financing arm of the World Bank group.

Graves
May 26, 1965

INTERNATIONAL FINANCE CORPORATION

Its Policies and Operations

Article prepared for
EUROPEAN BUSINESS REVIEW
Paris, France

by
MARTIN M. ROSEN
Executive Vice President

September 1965

THE GROWTH of domestic industry has provided a strong base for the economic expansion recorded by the developing countries in recent years. According to United Nations estimates, manufacturing output in these countries rose at an average annual rate of well over 7% during the period 1960-1964, following a substantial advance in the previous five years. This achievement reflects a combination of factors, of which perhaps two deserve to be singled out: the key role given to industrialization in the development plans of most countries, and the substantial direct investment of foreign private capital, estimated by the Development Assistance Committee of the OECD at well over $1,600 million last year. It is nonetheless a remarkable achievement in view of the many problems encountered—problems such as the inability to make full use of productive capacity due to foreign exchange shortages, the general lack of entrepreneurial skills and the frequently inadequate institutional means of mobilizing domestic savings, to mention only a few.

The challenges faced in financing development in this sector of economic activity are of particular concern to the International Finance Corporation (IFC), an affiliate of the World Bank established in 1956. As an international institution whose share capital of $99 million is subscribed by its 79 member countries, IFC is unusual for several reasons: its operations are concerned with private enterprises in the less developed of its member countries, it makes share as well as loan capital available to the companies it finances and, unlike the World Bank, its investments are made without government guarantee.

By June 30, 1965, at the end of its latest fiscal year, IFC had made investment commitments totaling over $137 million in 32 countries. The fact that its commitments are in excess of its share capital reflects primarily the extent to which the Corporation has been able to revolve its investments, thereby increasing the funds available to undertake new commitments. Although the bulk of IFC's commitments are in Latin America, followed by Asia and Africa, the Corporation has made commitments totaling nearly $11 million in Europe. Thus, during the 1964/65 fiscal year, IFC made new investments in a pharmaceuticals manufacturer in Finland and a cement company in Greece; it also made additional investments in a manufacturer of automotive electrical equipment and a development finance company in Spain.

IFC has established four principal methods of operation in seeking to fulfill its objectives of assisting private productive enterprises and stimulating the flow of private capital to the developing countries. Firstly, the Corporation makes direct investments in association with private investors and management, generally either by subscribing to the share capital of an enterprise or by providing a combination of loan and share capital. These investments are concerned with the financing of specific projects, including the provision of working capital, and may cover local expenditures as well as foreign exchange costs. IFC does not engage in direct financing of imports or exports, nor are funds provided by the Corporation tied to the purchase of specific equipment or to any particular country. Secondly, the Corporation extends financial and technical assistance to local development finance companies, geared primarily to assisting medium-sized enterprises. Thirdly, IFC makes standby and underwriting commitments in sup-

port of public offerings of corporate securities. Finally, it seeks the participation of private investors in the capital-exporting countries in its investments, whether at the time of the original commitment or subsequently by making sales of more seasoned securities from portfolio.

Since the Corporation made its first investment in 1957, in Siemens do Brasil Companhia de Electricidade, the Brazilian subsidiary of Siemens of Germany, it has made commitments in a wide range of manufacturing industries: iron and steel, engineering, pulp and paper, construction materials, chemicals, textiles, electrical goods and others. IFC has also invested in processing industries (such as sugar refining and leather tanning), in mining and, more recently, in a service industry—warehousing. In making an investment, IFC considers the total cost of the project, the contribution it can make to the economy of the country, as well as the priority attached to the enterprise. The question of priority can only be determined within the context of the economy of a specific country. In the case of countries still in the early stages of industrialization, the priority may be represented by the need to provide for economic substitution of imports of consumer goods such as textiles or of light engineering products. In countries in which consumer goods and light engineering industries are already established, the priority may be to expand the industrial base by establishing domestic production of capital goods that will not only substitute for imports but also encourage the growth of subsidiary and supplier industries.

IN THIS PROCESS of industrialization, the progress of the developing countries is still heavily dependent on the transfer of scarce technological and other skills from the industrialized countries: a transfer made possible largely by direct investment of private capital. It is no coincidence that

IFC has in its operations worked closely with both industrial companies and financial institutions in most of the countries of Western Europe, as well as in the United States and Japan. A substantial proportion of IFC's commitments have in fact been made to companies in which there has been some direct participation by European interests or which have purchased European-made machinery and equipment. European companies have acted both as industrial partners and investors in projects which IFC has helped to finance in a number of countries, including Argentina, Brazil, Colombia, India, Mexico, Pakistan, Peru and Tunisia. In India, for instance, IFC is an investor in a new alloy steel producer, Mahindra Ugine Steel Company Limited, established by Indian interests in conjunction with Société d'Électrochimie, d'Électrometallurgie et des Aciéries Electriques d'Ugine of France. Again, in Peru IFC has invested over $4 million in a fertilizer company, Fertilizantes Sinteticos, S.A., sponsored by Montecatini of Italy in partnership with Peruvian business interests.

Partnerships of this kind are particularly important for the success of new projects where advanced technology is required. An example of this occurs in Colombia where IFC—in conjunction with local business interests and government and private financial institutions—is a shareholder in Forjas de Colombia, S.A., which is at present constructing what will be the first modern forge plant in the country. Here the foreign partner, Rheinstahl Industrie-Planung GmbH, a subsidiary of Rheinische Stahlwerke of Germany, is not only supplying the machinery and equipment but is also providing supervision of the construction and start-up of the plant and is training Colombian staff in Germany to assist in the running of the operation. Rheinstahl is also a substantial investor in the project. In an arrangement of this kind, it is clear that both the local and foreign interests have a long-run concern in the success of the project.

In a number of other cases, European companies have either acted as technical collaborators or as licensors in projects which IFC has helped to finance. In India, IFC has made an investment in Fort Gloster Industries Limited, a leading jute manufacturer which has been diversifying its opertaions by expanding into the manufacture of electric cables, under license from British Insulated Callender's Cables Limited of the United Kingdom. Another important, if less frequent, form of participation occurs in the case of Kilombero Sugar Company Limited, a Tanzanian sugar producer and refiner in which IFC has invested, where HVA International of the Netherlands provides management services for the company.

Because of the kinds of problems encountered, there must of necessity be a large proportion of technical assistance involved in the consideration of industrial projects in the developing countries. Technical assistance is in fact an important part of IFC operations, whether in the form of a feasibility study on a specific proposal or—more frequently—a detailed review to see whether a proposal can be strengthened in any way and made to contribute more to the development of a country's economy. In considering a project, IFC pays particular attention to the soundness of the technical concept, the adequacy of the financial plan, the caliber and experience of management, the existence of a market for the company's products and the prospects of profitable operation. This kind of technical appraisal may, for instance, lead to the conclusion that additional marketing studies need to be made, that a foreign partner is needed to provide the technology required by a company trying to enter a new line of business, or that a project needs to be reduced in scale in order to improve the return on invested capital.

More frequently, IFC has discovered through technical and financial appraisal that projects need to be expanded in size and scope in order to be economically viable. One example of this is a Tunisian company in which IFC has invested, NPK-Engrais S.A.T. NPK was organized under the sponsorship of a leading Scandinavian fertilizer producer, Aktiebolaget Forenade Superfosfatfabriker (Forenade) of Sweden, to construct a triple superphosphate fertilizer plant at the port of Sfax in Tunisia. Forenade was not in a position to commit all of the funds required to complete the plant and turned to IFC for assistance. IFC conducted its own review of the project and recommended modifications in the marketing arrangements and on the technical side. In particular, the IFC review established that there would be a definite cost advantage to the company in producing its own sulphuric acid, using imported sulphur, instead of purchasing sulphuric acid abroad. The recommendation, which was accepted by Forenade, meant that a new technical process had to be introduced, leading in turn to an increase in the project's cost. It was at this stage that Freeport International Inc., a subsidiary of a leading U.S. sulphur producer, undertook to provide the technology required by NPK and to subscribe the additional capital needed to meet the needs of the expanded project. The NPK plant was completed on schedule last year and is now operating successfully, its output going to export markets to meet the strong world demand for fertilizer.

ANOTHER IMPORTANT facet of IFC's operations concerns assistance to privately owned development finance companies. This is an area in which the Corporation acts on behalf of the whole World Bank Group in fostering new institutions, assisting existing ones and appraising requests for financial assistance from them, whether directed to the World Bank, to the Bank's affiliate, the International Development Association, or to IFC itself. Development finance companies have become an important means of channeling both domestic and foreign private capital into industrial investment: a fact recognized by the World Bank Group in providing more than $420 million to 19 institutions of this kind in 17 countries. It is a measure of the success of the development finance companies associated with the World Bank Group in attracting other foreign capital and in mobilizing domestic resources that their total volume of business now exceeds $1,000 million. Through their operations, these companies are helping to fill some of the gaps that at present exist in the capital markets of most development countries. Among their main functions are the provision of investment capital in the form of medium or long-term loans or equity; the underwriting of public offerings of corporate securities; and promotional activities in identifying new opportunities for investment and establishing new companies. In these respects, development finance companies supplement rather than compete with local commercial banking systems.

IFC is now a shareholder in 14 institutions of this kind in 12 countries, its commitments amounting to over $17 million. In several of its operations, IFC has joined with European, U.S. and Japanese investors in providing share capital to new development finance companies or to institutions that have been reorganized. Foreign investors had, as of the end of 1964, provided approximately 27% of the aggregate paid-in share capital of development finance companies associated with the World Bank Group, with 62% being provided by domestic shareholders and the remaining 11% by IFC. In the Philippines, for example, IFC and the World Bank assisted in the establishment of the Private Development Corporation of the Philippines in 1963. Nearly a third of the share capital of the new institution was subscribed by a group of 18 foreign investors, including The Chartered Bank, Deutsche Bank A.G. and The Hongkong and Shanghai Banking Corporation. Similarly, when IFC joined with Nigerian interests in reorganizing an existing British-sponsored institution, thus creating the Nigerian Industrial Development Bank Limited, among the investment institutions helping to provide new capital were Istituto Mobiliare Italiano, Commerzbank A.G. and Société Financière pour les Pays d'Outre Mer S.A. Similar examples of this kind of partnership can be found in several other countries, including Colombia, Finland, Malaysia, Morocco, Pakistan, Spain and Thailand.

The close working relationship established between IFC and many of the local development finance companies is largely responsible for the trend to joint financing in IFC's operations. Through this means, IFC has been able to assist in financing enterprises whose capital requirements outrun the capacity of the local institution or the local capital market. In its most recent fiscal year, IFC undertook joint financing of six ventures, three of them in Pakistan in conjunction with the Pakistan Industrial Credit and Investment Corporation Limited (PICIC), in which IFC is a shareholder. The mobilization of domestic resources is an integral part of joint ventures of this kind. For example, when IFC and PICIC made a joint investment recently in Packages Limited, a leading local producer of paperboard containers and packages established by Akerlund & Rausing of Sweden and its associates and by the Wazir Ali group of Pakistan, the sponsors agreed to convert Packages from a

private limited company into a public limited company as part of the financial plan, and subsequently made an offering of shares to private investors in Pakistan.

To date, IFC has also made standby and underwriting commitments totaling more than $16.5 million in six countries. Commitments of this kind are a useful means of helping to develop local capital markets and to broaden the ownership of industry. The largest single commitment made by the Corporation was in the form of an agreement to underwrite a new share issue made in 1964 by the leading privately owned steel company in Mexico, Compania Fundidora de Fierro y Acero de Monterrey, S.A. The share offer, amounting to $12.5 million, was the biggest ever to be attempted by a privately owned enterprise in the Mexican capital market and was a key part of a plan to raise over $50 million needed to finance an expansion program. IFC had made a similar underwriting agreement with the company in 1962 to finance an earlier program, and last year—as on the previous occasion—the Corporation joined with a Mexican financial institution, Credito Bursatil, S.A., in forming and managing an underwriting syndicate to handle the issue. IFC's commitment, in which Handelsfinanz A.G. of Zurich and two U.S. institutions participated, came to $6.1 million. The success of the underwriting was such that the syndicate was required to take up less than 1% of the issue, and these shares too were subsequently sold on the Mexican market. Since the time of the first IFC underwriting of Fundidora shares in 1962, the number of shareholders of the company has risen from 700 to well over 3,000.

Under its charter, IFC is directed to seek to stimulate the flow of private capital into productive investment in the less developed countries.

One of its principal methods of doing so is by securing the participation of others in its investment. For example, when IFC made its first investment in Uganda, in Mulco Textiles Limited, a cotton textile producer, it was joined by investors in the United Kingdgom and Kuwait. The Standard Bank Limited of London, which had expressed an interest in the project from an early stage, arranged to acquire a participation in the IFC investment through a subsidiary, The Standard Bank Finance and Development Corporation Limited. Subsequently, participations were also made by Barclays Overseas Development Corporation Limited, a subsidiary of Barclays D.C.O. of London, and by the Kuwait Investment Company of Kuwait. Over one-third of the IFC investment was taken up by these three institutions.

By securing participations of this kind, by making sales of more seasoned securities from its portfolio, and by turning over its standby and underwriting commitments, IFC has been able to revolve nearly one-third of its commitments to date. Other investors have so far taken or agreed to take over \$42.5 million of IFC's investments and standby and underwriting commitments. Participations in IFC investments and purchases from portfolio have been made by European financial institutions domiciled in Belgium, France, Germany, Luxembourg, the Netherlands, Sweden, Switzerland and the United Kingdom. In all, these institutions have taken up a total of more than \$7.9 million of IFC's investments.

THE GROWTH OF IFC's responsibilities and its operations has been a notable feature of the Corporation's recent history. Earlier this year IFC acquired the responsibility of acting on behalf of the entire World Bank Group in the technical and financial appraisal, preparation and

supervision of industrial and mining projects. The responsibility is similar to that which it has exercised on behalf of the Group since 1962 in the appraisal of development finance company projects. Its operations in this respect may lead either to an IFC investment, a World Bank loan, an IDA credit, or a combination of these. This administrative move is intended to enhance the effectiveness of the World Bank Group in financing industrial development: an area in which the Group has to date provided capital resources totaling more than \$1,600 million.

There has, too, been a marked rise in the level of IFC's operations. In its most recent fiscal year, the Corporation's total commitments amounted to \$26 million, more than in any single previous year. Through these commitments, IFC made it possible for projects involving some \$150 million to go ahead in 11 countries of Latin America, Africa, Asia and Europe. In the last few years, the growth of IFC's commitments has outpaced the rise in the funds available to it for investment, whether from its own capital, from the sale of its investments to others, from repayments or from profits credited to its reserve against losses. The result is that the amount of uncommitted funds available to IFC has been steadily reduced. During 1964, it became evident that if the pace of IFC's activities was to be sustained, let alone expanded, it would be necessary to add to the Corporation's resources within two to three years. In order to expand IFC's resources, it was proposed that the charters of the World Bank and IFC be amended to permit the Corporation to borrow from the Bank and re-lend the proceeds of its borrowings to private enterprises, without government guarantee. The proposal has received general support from member countries of IFC and the World Bank, and the necessary steps required to make the proposal effective are now nearly complete. When the proposal takes effect, it will increase IFC's resources by about $400 million. This would free the entire present capital of the Corporation for making equity investments. It would also enable IFC to participate in larger, capital-intensive projects and make bigger loan and equity commitments to individual enterprises. In these ways, IFC can expect to become a more significant factor in financing the needs of private enterprise in its member countries.

THE DEVELOPING COUNTRIES today are set on the same path to industrialization on which Europe set out in the 19th century. Many of the classic European policies, such as the use of tariffs to protect "infant" industries, are now being employed by the developing countries in their efforts to deal with problems of raising living standards and reducing unemployment. The social, economic and political obstacles to industrial growth they face are often more complex and more deep-rooted than in the case of Europe, yet despite this the progress of the last two decades has been considerable. It is notable, too, that many of the developing countries are becoming increasingly aware of the importance of creating a suitable climate for the expansion of private industry and, in particular, of maintaining the confidence of foreign investors. Under these conditions, the range of opportunities for investment in the developing countries open to IFC and to private foreign capital could grow considerably over the next few years.

INTERNATIONAL FINANCE
CORPORATION
1818 H Street, N.W., Washington, D. C. 20433 U.S.A.
Telephone number: *EXecutive* 3-6360
Cable address: CORINTFIN

EUROPE OFFICE
4, Avenue d'Iéna, Paris 16e, France
Telephone number: *KLEber* 25-10
Cable address: CORINTFIN PARIS

Text of Remarks by Martin M. Rosen,

Executive Vice President, International Finance Corporation

to Plenary Session of the Committee for Industrial Development

United Nations, New York

May 28, 1965

Mr. Chairman, Mr. Speaker, Delegates:

It is a great pleasure for me and for the International Finance Corporation to be present at this meeting of your Committee. The World Bank group, the International Finance Corporation in particular, has been following with very close interest the continuing work done by the Center for Industrial Development and by this Committee, and has welcomed the opportunities for cooperating with you and with the Center. We have been represented at the Center's training course on industrial development for African administrators which was held in Cairo earlier this year; and we were pleased to participate in the very interesting inter-regional conference on Petrochemical industries at the meeting held in Tehran last November under the sponsorship of the Center.

Mr. Chairman, the financing of industrial development is a subject in which the World Bank group is particularly concerned, and in which it has become particularly and increasingly active over recent years. This is simply a logical development in the whole process of economic progress. In the numerous studies which have been made of the means by which economic development can be accelerated and advanced, there has always been a consensus that the best type of development requires what is called balanced progress -- that is, sectors of economic activity moving forward in harmony with each other in simultaneous progress. This means there must be development of the infrastructure, of power, of transportation; there must be development of basic resources, agriculture, human resources; there must be development of the final products which contribute to the wellbeing and to the increased standards of living of the peoples of the developing countries.

The progress in achieving these final products -- the end products which basically measure the improvement in standard of living which is the fundamental purpose of economic development -- is largely dependent upon manufacturing and industrial undertakings. So for these reasons we have found the need to pay increasing attention to the process of industrialization, in the International Finance Corporation where we are primarily devoted to the industrial sector, and in the rest of the World Bank group where we are concerned about the whole process of development.

In quantitative terms a great deal of capital has already been made available for industrial development. Up to the present, over $1,450 million has been made available to industry through the World Bank group. This figure includes over $325 million made available to intermediary lending institutions -- development banks, development finance corporations, financieras -- for relending for industrial purposes. This total is approximately 15% of the total amount of resources which have been made available for the development process by the World Bank, the International Development Association, and the International Finance Corporation.

This rate of activity is a continuing and an accelerating one. There is about to be signed in half an hour another loan agreement between the World Bank and the Government of India making available an additional $50 million for industrial requirements of India. This is money which is going through one of the intermediary institutions for relending to medium sized industry in India, and constitutes the largest single loan ever made to such an intermediary institution.

The interest of the World Bank group in industrial development was itself responsible for the creation of the International Finance

Corporation, almost 10 years ago. The creation of the International Finance Corporation developed out of the recommendations of the Economic and Social Council. It came about because the World Bank had found in its earlier days of operation that it was limited in its ability to assist industry by the requirement in its Charter that there should be a government guarantee for any loan that was given. Consequently, a new institution, a new international organization, the International Finance Corporation, was created in order to eliminate the need to have governmental guarantees for industrial financing.

IFC operates primarily in the industrial area -- manufacturing, processing, mining -- and in the area of distribution and services connected with industrial activity. Finance companies, development banks and financieras are also the recipients of IFC assistance. As an investor, IFC operates in close collaboration with private investors both in the developing countries and in the industrialized countries which are capital exporters. We make particular efforts to recruit capital from developed countries for industrial development in developing countries. We have been quite successful, actually, in this effort; over the 9 years of its operations, IFC has revolved approximately one third of its portfolio by reselling commitments to private investors, particularly in the capital-exporting countries.

Technical assistance is also an important part of IFC operations. It sometimes takes the form of preliminary assistance in preparing feasibility analyses on the basis of which projects may go forward, but more frequently it is done in the form of careful, detailed review of individual proposals as they are put forward for financing, to see if they could be made more attractive and contribute more to the economic development of the member country.

Technical assistance is an expression which sometimes is used to explain that an additional study needs to be made or that a project is too large and needs to be reduced. In fact, however, the review of projects which the International Finance Corporation has done has more frequently been directed at the problem of whether the project fits the minimum economic size for viability; and this appraisal has often resulted in expanding the size and scope of the project rather than in attempting to reduce it because resources were not available to finance it.

Another important objective of IFC is the stimulation of local capital markets. I think in the meetings of this Committee and in other bodies of this sort the importance of obtaining finance locally for the purpose of channeling capital for industrial development has been a problem which has received great emphasis. This is a problem to which we particularly attempt to devote our attention. We seek to assist in this problem through the techniques of underwriting the offers of securities made in local capital markets, of being willing to assure an enterprise that it can secure the capital it needs by entering into a standby commitment to provide the money if it cannot be raised locally; and part of these arrangements is an understanding that the acquisition of the investment by IFC will lead to the ultimate disposition of the securities to local investors, as they become willing to purchase the securities.

This has been successfully done in a number of cases. In Mexico several years ago IFC was responsible for underwriting the largest offering of securities by a privately owned enterprise that had ever been made in that country up to that time. The offering was not taken up in whole by the local market; IFC and the group of private investors which we brought into the transaction purchased the securities and over the next year were able to distribute them to Mexican investors, thus ensuring the maintenance of the Mexican ownership of the enterprise, ensuring that the funds would be available to permit the expansion to take place when the expansion was needed, and helping develop the capital market. Two years later, as a consequence, that same company was able to float an issue three times as large as the other one and have it successfully taken up by the local market.

IFC investments often are accompanied by local share offerings within the country where the project is located. This has taken place in India, in Pakistan, as well as in a number of Latin American countries. In the case of Tunisia, IFC financed a project for the manufacture of fertilizers at a time when local Tunisian capital was not available to enter into the project. The project is now completed, is in operation and is progressing well. Consequently, the shares which IFC purchased, as well as the shares which foreign investors purchased, are being made available in the Tunisian market to Tunisian investors as part of the effort of developing the capital market and obtaining a local interest in the company.

I have already indicated that one of our very important activities is the stimulation of development banks, development finance companies and financieras. IFC has joined in the ownership of 14 of these institutions in 12 different countries. These companies are of fundamental importance because they make possible a channel whereby foreign capital can be made available to medium sized and smaller scale industries. These industries are not themselves large enough to be able to undertake the burden of cost and effort required to obtain finance directly from abroad. Instead, they are served by local finance companies which obtain the finance on a wholesale basis and then retail the money as needed by the smaller sized industry.

The role of these development finance companies in mobilizing domestic private savings and channeling domestic capital is also important. These companies moreover play a very significant part in sponsoring and promoting new industries. Together with IFC, two financieras in Colombia, in both of which IFC is a shareholder, have been responsible for promoting and sponsoring an important metal working project in Colombia. This project will be the first major plant in the area to produce forged metal products, and it will make an important impact on the entire metal working industry of the country. IFC and the development finance companies have provided basic capital to permit the project to go forward; at the same time, we have undertaken the role of promoting the venture. The role of development finance companies in sponsoring ventures like this is a widespread one, and we find that almost all the development finance companies with which we are involved are actively engaged in such sponsorship.

IFC's role is not only that of providing finance but serving as a catalyst in helping to bring additional finance into projects of industrial development. Perhaps two figures can best show these results. To date in the present fiscal year of 1964/65, IFC's own commitments have been approximately $25 million. The projects for which this amount has been made available, however, involves a total investment of $150 million, which means that for each dollar invested by IFC, other investors both in the country and outside the country have put up an additional five dollars. Although IFC started as a $100 million corporation, its ability to revolve its funds, to make sales out of its portfolio, to distribute the securities which it acquires in local capital markets, has meant that the total resources available to IFC have reached $170 million.

At this point we are in process of foreseeing a considerable expansion in the total amount of resources available to IFC for financing industrial development. There is a proposal before the governments which are the participants in the World Bank and in the IFC to make the necessary Charter changes in the statutes of both institutions which will permit the World Bank to lend up to $400 milion to IFC to provide additional finance for industrial undertakings. We foresee this increase in resources making possible a considerable expansion of IFC operations. We foresee that there would be larger individual loan and equity commitments for individual companies as well as a broader range of activities in the field of underwriting and standby commitments. We expect that this will mean that significant large projects which now find difficulty in having their total capital resources made available may well be able to move forward.

We expect to proceed in this direction, subject to governmental approval of the necessary Charter changes, without departing from our present policy of cooperating closely with existing international sources of finance for industrial development. Many of the investments which IFC has made have been in conjunction with funds made available from other sources of international financing, such as the Inter-American Development Bank, the European Investment Bank and various national programs of development finance and export credit financing.

As part of this general process of expanding the scope of IFC activities, we have within the World Bank group reorganized the responsibility for consideration of all industrial activities so that the International

Finance Corporation will now serve as the technical arm to study, appraise, propose financial plans and technical structures for industrial projects, whether they would be financed from the resources of the International Finance Corporation itself, or the resources of the World Bank, or of the International Development Association. As a result of this we are expecting to have a single group of people who would act as financial and technical advisers in the whole area of industrial development. We anticipate that this will lead to an even closer, more continuing relationship with the Commission for Industrial Development, and we are looking forward to the accomplishment of the goal which that Commission, this Committee and the World Bank group all jointly share.

Thank you, Mr. Chairman.

Office of Information

FORM NO. 337D
(12-61)

Rosen Speeches
Dec 2, 1965

Mr.	Eliason
Room	461

IFC WILL HAVE MORE FUNDS FOR ENCOURAGING
PRIVATE INVESTMENTS IN DEVELOPING COUNTRIES.

At a Press Conference on December 2nd, 1965, Mr. Martin M. Rosen, Executive Vice-President of the International Finance Corporation, who came to France at the invitation of the French National Council of Employers (CNPF) stated what IFC's activities are.

Mr. Marcel Demonque, Chairman of the Economic Cooperation Committee of the CNPF, in introducing Mr. Rosen, mentioned that, while the IBRD is well-known in French industrial circles, the International Finance Corporation, one of its affiliates, is practically unknown. Moreover, in the past few years the IFC has developed considerably in the direction of greater flexibility in its assistance and an increase in its means of action. It is of the greatest importance to all French enterprises that are interested in one way or another in investments in developing countries to be aware of the assistance that IFC can give them to carry out their plans. The main passages of Mr. Rosen's statement are reproduced below:

There are, I believe, two reasons why this appears to be an extremely well chosen moment to consider the possibilities of cooperation between IFC and French enterprises.

The first of these reasons is concerned with the fact that up to now IFC has not had as many contacts with French enterprises as it would have wished. At the present time, it has collaborated with only three French industrial groups on joint investment projects; the first with Ciments Lafarge, eight or nine years ago for an investment in the Companhia Mineira de Cimento Portland, S.A.; the second with Ugine to establish an enterprise in India in 1962; lastly, the third with the Alsthom & Neyrpic Companies to establish a Mexican Company, Industria del Hierro. We therefore wish to establish new associations with French industry.

The second reason why this Press Conference seems particularly opportune is concerned with the fact that IFC is at present about to enter into a new phase of activity. Its Articles of Agreement and those of the IBRD are about to be amended so as to place greater resources at IFC's disposal. The studies

TRANSLATION SECTION 176/66		
Translated From: French 2/8/66	By:	GA/jd

needed on this point are now in progress; when they are finished, in the near future, it will be possible for IFC to borrow from IBRD as much as 400 million dollars.[1] These new funds will then be able to be used to supply additional funds to industrial enterprises which IFC is assisting.

THE TERMS OF IFC'S ASSISTANCE AND ITS AIMS

Before going into these new prospects, it is well to make a few remarks on what IFC is.

It is an international institution, an affiliate of the IBRD; its capital of 100 million dollars was subscribed by its stockholders, which are the governments of 80 countries. The aim of IFC is to encourage the establishment of productive private investments in developing countries. IFC has been operating for more than nine years. Its commitments, which amount to about 150 million dollars, are the result of more than a hundred different operations effected in 34 countries.

Some of these operations have been successful; others, on the contrary, have failed. Nevertheless, from these operations at the end of these nine years, has come a net profit of 25 million dollars. IFC has not been content to participate in the operations to which it was contributing. It also renewed its portfolio by transferring 150 million dollars of its participations to private financial institutions throughout the world.

Three criteria govern IFC's assistance: The first condition is that the investment must be made in an enterprise that is of priority economic importance for the development of the country in which the investment is made. The second condition concerns the profitability of the investment: it must be a well-conceived, well-managed project and have a production with assured markets. To these is added the need for the enterprise to be created to be able to operate under normal conditions. The third condition to be met is that IFC's participation is indispensable. This last condition might be stated otherwise by saying that the private capital needed to carry out the project is lacking, but I have purposely not used that expression because IFC often is associated with very large industrial companies and it is difficult in that case to allege a lack of private capital.

These criteria are applied with flexibility. It may happen that all of the conditions are met but that IFC cannot, for one reason or another -- for example because of other commitments -- contribute to the operation. Conversely, IFC's assistance may very well be motivated not so much by financial considerations as by the desire of private investors to benefit from the moral support represented by an international institution, so as to limit the various risks that the investment might incur in the host country.

1/ The amendments to the Articles of IBRD and of IFC enabling such loans to be made became effective on December 17, 1965.

Going on now to consider the general objectives governing IFC's investment policy, we find that there are three.

- to accelerate economic development by supplying credits for new investments that could not be made without IFC's participation;

- to stimulate the flow of international private capital;

- to encourage a call on local capital.

To clarify the general statements above, several examples will be considered.

Investors usually get in contact with IFC directly, whether they are local or foreign. Thus, in India, Ugine concluded an association agreement with a large Indian industrial group, the Mahindra Group, in order to establish a steel mill in the country. Generally, it is the promoters of an investment who get in touch with IFC whether they are local or foreign promoters. Thus, in India, the Ugine Company decided to set up a steel mill and concluded an agreement of association with an industrial and commercial group, the Mahindra Group. This project was prepared by a consortium, and financing of the order of 13 to 14 million dollars appeared necessary. An application for financing was submitted to IFC by Ugine and by the Mahindra Group. The Indian Government was prepared to assist the two groups to find the necessary rupees but required that the necessary foreign exchange should be available from the outset. An Indian Development Bank (the Industrial Credit and Investment Corporation, which had already received loans from the World Bank) was prepared to supply part of the foreign currency, but its size prevented it from contributing all of the foreign exchange that was needed. Finally, it was necessary to increase the capital stock of the new company formed in India. Finally, the assistance of IFC took the form of a loan of 2,300,000 dollars, i.e. in foreign exchange, and a subscription in shares of the company for an amount equivalent to 850,000 dollars.

On this occasion it is worthwhile to point out a general principle that is followed by IFC in carrying out its operations. It avoids making capital subscriptions that place it in a position where it becomes the largest stockholder. It believes that it is essentially a financial institution and that it is not its place to be concerned with the management of enterprises. We therefore requested the Mahindra Company and the Ugine Company to be the majority stockholders.

This example will also clarify another principle which guides us in our operations. IFC's experience taught it that the total cost of the project to be carried out ultimately exceeded the evaluation made at the beginning. It therefore usually became necessary to conclude agreements at a given moment to find additional financing that had not been anticipated initially. In those cases in which IFC has financed some of the initial operation, it can then assist in the additional financing in proportion to the participation it has already taken.

Often, foreign promoters of an investment appeal to the IFC, This was the case with a project of a fertilizer plant in Tunisia carried out by a Swedish firm NPK-Engrais SAT. The total investment needed was larger than the Swedish group was prepared to commit it then turn to IFC. IFC has exceeded its strictly financial role because it has been led to propose changes in the project which make it a larger and better integrated affair; particularly, the addition of a sulfuric acid plant was suggested in order to improve profitability. As in the case of the Mahindra Group, some of the contribution of IFC was supplied in the form of loans (2.5 million dollars) and another part in the form of participation in the capital stock (1 million dollars).

Sometimes, also the initiative is taken by the country where the investment is to be made. This was the case with the Compañía Industria del Hierro in Mexico, an industrial complex producing various types of equipment which was seeking additional credits in order to develop its activities. This Mexican group includes foreign interests, since the Neyrpic-Alsthom establishment are stockholders and contribute to its management. IFC made a capital participation representing a subscription of shares amounting to 1.6 million dollars, the Inter-American Development Bank, for its part, granted a loan of 3 million dollars (in contrast to IFC, the Inter-American Development Bank does not participate in the capital of a company but merely grants loans).

<u>TERMS OF FINANCING</u>

<u>In a number of cases we have acted in conjunction with other international institutions</u>, such as the Inter-American Development Bank, the European Investment Bank and also with purely national financial lending agencies such as the Import-Export Bank of the United States, Import-Export Bank of Japan, etc.

<u>Another type of assistance worthy of note is that by which IFC provides capital subscriptions through firm commitments or "standby" or guarantee commitments</u>. Here are two examples. The first concerns the Compañía Fundidora de Fierro y Acero de Monterrey, a Mexican steel company which needed additional capital and was having difficulty finding it on the market. IFC acted as leader and established a syndicate of bankers to guarantee an issue of shares. The commitment by IFC amounted to 4 million dollars for a first tranche issued two years ago and 12 million dollars for a second tranche issued last year.

Sometimes the granting of a guarantee comes at the time of the creation of a new enterprise, in order to find local stockholders. The second example concerns a case of this type. A paper mill is now under construction in Ethiopia. The operation is being carried out on the initiative of an American industrial group, but the Ethiopian government is very keenly interested in the project and its participation in the capital will be 25%. The Ethiopian government and the American group desire that part of the capital should be subscribed by Ethiopians. But, since the financial market in that country is not very well developed, it was difficult to offer shares under normal conditions. IFC concluded an agreement providing that the shares to be issued would be offered on the Ethiopian market for a period of three months; if the shares found no takers, IFC would be obliged to take them up, and in this case the guarantee would be changed into a direct investment.

When local financial support is being sought for a project and it is difficult to find, IFC can intervene in the form of "standby" commitments, which means that at the outset it subscribes a certain part of the shares to be issued, so that the investment committed can be carried out without delay; this does not prevent a call on local capital to be pursued gradually.

One last mode of intervention by IFC consists in acting as a business bank to promote certain investments. Two examples of the efforts it makes in this direction can be given. As these are operations now being started there is no assurance that they will succeed but they will supply an interesting illustration of procedures used by IFC.

The first business is located in Jordan where IFC proposes to finance an installation for producing potash. IFC expects to be the chief, from the banking point of view, in order to put into place the financial structure of the company so that the foreign associates will be encouraged to take over the management of the business in Jordan and, of course, to supply capital.

The other example is a fertilizer enterprise in East Pakistan. In this case it is the Pakistan government that is taking the initiative in the matter. Its proposal was accepted by IFC which has set up a financing plan. IFC thought it indispensable to provide, beyond its own participation, ∧ and that of a foreign industrial group responsible for managing the business.

In both cases, IFC's intervention came at the beginning of the project, when it was merely an idea to be carried out. IFC then concerns itself with everything that a commercial bank ordinarily would do.

To summarize the principles of our policy, it is advisable to emphasize that in all its operations IFC's principal concern is to give the maximum flexibility to its commitments. It is also necessary to stipulate that IFC loans are not tied; the expenditures financed by its capital contributions must be made in the best interests of the borrower. The funds supplied by IFC can be used either for local expenditures or for purchases of equipment, or even to ensure a better working capital for the enterprise. In Argentina, a few years ago, IFC supplied the credits needed by a paper plant to complete the installation of certain equipment, for which financing had been provided for earlier by other credits. The equipment had been purchased and delivered, but the Argentine company did not have sufficient funds to finance their installation. IFC granted the credits needed for that purpose and thus enabled the investment, which required expenditures in local currency, to be completed.

I also stress the fact that IFC absolutely desires not to be the largest stockholder. As a general rule, it wants its participation not to exceed 25% of the capital. IFC is not a member of the board of directors and it relies for the mangement of the business on the industrial competence of its associates. Consequently, and by virtue of this principle, IFC attaches the greatest importance to the competence of its associates and excludes any operation that causes reservation on its part as to their qualifications, whether they are foreign groups or local enterprises.

∧ that of the government, that of a private Pakistan financial institution

If IFC finds another financial institution prepared to join it in carrying out an operation which it has prepared and before the transaction is signed, that institution then participates in the investment on the same terms as IFC. IFC does not require a commission of any kind for this type of assistance. When the investment is made, it desires to sell its participation at a normal price.

Before concluding, I should like to say a few words on the prospects of our institution. I have already pointed out that we were about to conclude with the IBRD an agreement that will enable us to considerably increase our funds. Up to now the largest investment we have made was 5 million dollars. Thanks to the additional funds that we will have at our disposal the ceiling of our assistance will be raised considerably. This ceiling has not yet been stipulated precisely, but at present one might say that IFC is prepared to contemplate investments that would amount to 15 or 20 million dollars; it will henceforth be able to play a dominant role in the carrying out of an important project.

Generally speaking, I think that, in the more important transactions that we are contemplating, we will follow the same philosophy and the same principles that have guided us up to now. In particular, IFC will continue to keep its assistance very flexible.

In conclusion I shall mention two other activities of IFC. On the one hand, it is becoming more and more an agent of assistance of the IBRD on the industrial plane; even in IBRD loans for financing an industrial project, consideration of the dossier is entrusted to IFC, which also supervises the execution of the project when it is carried out. On the other hand, another function of IFC consists in supporting the development banks, which themselves are distributors of financial assistance to small and medium enterprises. In fact, below a certain level, operations cannot be carried out except by a local financing institution. In this spirit, IFC has contributed to the expansion of 16 lending establishments belonging to 14 different countries, for the specific purpose of financing industrialization within those countries.