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FUCHS

FINANCING INDUSTRIAL DEVELOPMENT IN LATIN AMERICA

Text of Remarks

by

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to

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I welcome the opportunity to take part with you in this conference sponsored by the University of Louisville and to discuss some of the factors involved in financing industrial development in Latin America. The expansion of industry is an important part of the balanced economic growth which Latin American and other developing countries are trying to achieve. In one way or another, it is also a major concern of the World Bank Group of institutions, consisting of the Bank itself, and its affiliates, the International Finance Corporation (IFC) and the International Development Association (IDA).

The Group's total commitment in Latin America has risen steadily over the past few years and now amounts to over $2,500 million. A large part of this commitment has been made in financing public sector projects which are often the prerequisite of general economic growth. Most of the financing has been provided by the Bank, on normal commercial terms, with IDA funds supplementing those of the Bank in cases where more concessionary terms have been appropriate. This volume of lending has influenced industrial growth, both directly and indirectly. To function effectively, industry depends, among other things, on an assured supply of relatively low-cost power as well as dependable and efficient transportation and communications systems. Since 1948, World Bank loans have helped to double the power generating capacity of the major Latin American countries; they have also financed major modernization and expansion programs for railways, highways and ports. There are other ways of influencing industrial prospects.

For example, in many of the developing countries one of the big handicaps to industry is the lack of skilled labor. This is one reason why the Bank made a loan to Chile, earlier this year, to help build and equip vocational training centers to produce skilled industrial workers. Many of the developing countries, too, are now finding that agriculture is lagging behind the growth in population. As a consequence, scarce foreign exchange that could be used to purchase machinery, equipment and spare parts for industry is being spent instead on importing food that could be grown at home. This again is one of the reasons why the Bank is becoming increasingly involved in financing projects that will raise productivity in agriculture.

But if this investment in economic infrastructure is to yield a proper return, there must be industry to make use of it. The World Bank has itself made loans to industrial enterprises in Latin America, specifically to the steel industry in Colombia and to the coal and pulp and paper industries in Chile. In some other countries, such as Costa Rica and Mexico, it has taken a different approach, by making resources available to national financial institutions for relending to smaller and medium-sized local enterprises.

The member of the World Bank Group which is now most directly concerned with the appraisal and financing of projects in the industrial field is the International Finance Corporation. IFC can in a real sense be regarded as the private enterprise arm of the Group, since under its charter it is required to assist only enterprises that are privately controlled and managed. There is another reason for looking on IFC as the private enterprise arm: it takes much the same kind of risks as a private investor would do, in making its investments. Unlike loans made by the Bank, IFC loans do not carry a government guarantee. Furthermore, about one-third of IFC's portfolio consists of share investments.

IFC has three basic objectives: to accelerate the industrial growth of its less developed member countries by assisting projects of high economic priority; to encourage the international flow of private capital, and to help develop local capital markets. Let me just outline how IFC operates. Firstly, it makes direct investments, whether in the form of loan or equity capital or a combination of both. Secondly, it makes standby or underwriting commitments. Thirdly, it provides capital and other assistance to local development finance companies. And finally, it encourages private investors to participate in its investments.

In almost all of these respects, Latin America has provided greater scope for IFC than any other developing area. I hesitate to inflict figures on you, but they bear out the point I am making. The total of resources that have been available to IFC since it was first established amount to about $180 million, consisting of nearly $100 million in share capital subscribed by the Corporation's 80 member countries, approximately $55 million in funds revolved through repayments and the sale of investments to others, and about $25 million in a special reserve and from miscellaneous operations. Of the total, slightly over $140 million has been committed, with $80 million, or nearly 60 per cent, going to twelve of the countries of Latin America: chiefly Argentina, Brazil, Chile, Colombia, Mexico and Peru. Over the next few months, we expect to make new commitments in a number of Latin American countries, perhaps most notably in Brazil where IFC will soon be making its first commitment in six years.

The diversity of IFC's operations has probably been far greater than anyone could have foreseen at the time the Corporation was founded: diversity both in terms of the kinds of projectsfinanced, as well as the kinds and amounts of financing provided. Commitments ranging from as low as $140,000 to over $6,000,000 have been made to help private enterprises expand and modernize their existing operations or to finance new enterprises. In Brazil, for example, IFC made a loan some years ago to help finance an expansion of Willys-Overland do Brasil, a local subsidiary of Kaiser Industries and a company that is not only one of the leading auto producers in the country but also one whose shares are widely held by Brazilian investors. A feature of this investment is that IFC is entitled to a portion of the profits, which can be turned into shares of the company. In Chile, IFC has helped to finance a Chilean-owned enterprise that is the largest pulp and paper producer in Latin America, Compania Manufacturera de Papeles y Cartones -- in this case, through a loan with a stock option attached. A different kind of commitment -- involving both a share investment and an underwriting commitment -- was made by the Corporation last year when it undertook to provide part of the financing required by Forjas de Colombia, a company building the first modern forge plant in the country. While IFC is interested primarily in the industrial field, its interest is not exclusive. One of its most recent investments, for instance, took place in what is essentially a service industry -- private warehousing. And if suitable opportunities occurred, IFC would be ready to finance agricultural projects or to undertake investments in the field of distribution.

IFC's outlook is more that of an investor concerned with long-term risks than of a creditor concerned with how much security there is behind a loan. This means that IFC is chiefly concerned with such questions as the technical feasibility of a project, the competence of management and the existence of a market for the company's product or products. Again, potential profitability is only one of the tests to be applied. IFC also must consider the economic priority of a project. By definition, a good project is one that is both profitable and of economic priority. There is another factor to consider: a project must also be studied from the point of view of trying to increase the benefits to the economy of the country concerned, and this may require considerable reworking of the proposal originally submitted across the table. This kind of financial engineering is often the only way of determining the right kind -- and amount -- of financing required.

It is tempting but also, I must add, somewhat dangerous to generalize about industrial development when talking about a region as large as Latin America. What one is really looking at is a number of countries at different stages of development, with different resources, different economic conditions and different problems. In Argentina, for instance, industry accounts for over 31 per cent of Gross National Product; by contrast, in Peru, it represents closer to 18 per cent. Growth within the region, too, has been highly uneven. Countries such as Mexico or Peru or Nicaragua have enjoyed consistently high growth rates in recent years, while others have undergone stagnation, if not actual contraction. Again, while some countries have experienced extreme conditions of inflation, others -- such as Ecuador or Venezuela -- have had strong, stable currencies.

The one factor that has probably been consistent for most countries in the region is the priority given to industrial growth. In the 1930s, the common problem was the contraction in world trade, to which the Latin American countries responded by pressing import substitution, behind tariff and other protective barriers. More recently, the problem has resulted from the over-dependence of many economies on earnings from a single commodity export or, at most, two or three commodities. And diversification through the establishment of industry has appeared to be the most feasible solution.

These policies have helped to give Latin America an industrial structure that is relatively advanced compared with other developing regions. Industry not only accounts for a greater proportion of gross national product, but there is also a broader base, covering many branches of heavy industry as well as the light industry which by tradition provides a starting point for import substitution. But if these policies have worked well in the past, there is now a growing feeling -- particularly in countries with a relatively mature structure of industry -- that import substitution has reached or is reaching its viable limits. There is increasing awareness, too, that the cost of import substitution can be heavy when the domestic market is not large enough to justify or support industries that can realize economies of scale. These problems are likely to become greater as the more advanced economies diversify into capital-intensive industry -- steel, petrochemicals and machinery and equipment, to name only a few.

This is one of the reasons why more importance is now being attached to finding broader markets for locally-produced manufactured goods through export trade within the Latin American region, and also to greater specialization. The trend is evident in the attempts to strengthen the Latin

American Free Trade Association and the Central American Common Market. It is equally evident, in a pragmatic sort of way, in day-to-day business decision-making. It indicates that in a real sense, industrial development in Latin America has arrived at a cross-roads and that if industrial financing is to take account of the new economic priorities, it must recognize the need to establish large-scale, outward-looking and competitive industries.

What is this likely to mean for the individual business enterprise? It will require, first of all, greater attention to productivity and efficiency. Only by finding ways of lowering costs and improving quality will it be possible for many of the industries in Latin America to develop the broader consumer markets they need. This indicates that another key objective will be to help the more traditional industries expand and modernize so that they can become more competitive and at the same time keep pace with the growth of their markets. The challenge to management will be severe in many cases. It will require a more ruthless approach to cutting costs and identifying and discarding unprofitable lines, as well as a more aggressive attitude to marketing. To achieve improved results, management will have to rely increasingly on effective accounting systems and inventory controls, among other things. And this in turn suggests that technical assistance will become an even more vital component of industrial financing.

From what I have said, it should be clear that the role of private foreign capital in industrial financing in Latin America will be far from a residual one. The industrial growth of recent years has led to a small but gradual increase in the interest shown by American companies in investing in Latin American industry. New investment opportunities have opened up a variety of ways of sharing in the industrial growth of the region: whether through direct investment, through the sale of machinery and equipment, through collaboration and licensing agreements, or through the provision of accounting, engineering and other services.

For a development financing institution such as IFC, the marriage of local and foreign interests in business partnership represents an important approach to establishing new enterprise, particularly in industries involving advanced technological processes. In Latin America, it is noticeable that entrepreneurs who have accumulated capital -- or can tap capital accumulated -- in the more traditional industries are looking for new investment opportunities, often in partnership with foreign industrial enterprises or with the assistance of foreign technology. In Mexico, for example, the high rate of investment in recent years has created a growing market for capital goods. The local demand for heavy construction and other equipment persuaded a consortium of leading Mexican companies to establish a jointly owned subsidiary to manufacture items such as soil compacting machinery, mechanical shovels and tower cranes under license from American and European companies and in partnership with a French enterprise. Last year, IFC and the Inter-American Development Bank joined forces to complete the financing needed to establish the company's new plant.

In addition to direct investment, another method of participation is through portfolio investment; and IFC has on a number of occasions secured the participation of American and other financial institutions in its own investments in a number of countries. Out of the $55 million of its funds which IFC has revolved to date, approximately two-thirds has originated in Latin America. Through arranging participations of this kind, IFC has been able to acquaint private investors outside the region with specific opportunities for investment, at the same time as accomplishing its aim of revolving its own funds.

In the final analysis, though, a great deal must depend on local effort and local initiative. Industry in Latin America has traditionally been financed for the most part from domestic resources, and in some countries shares of some of the leading industrial enterprises are quite widely held. In Colombia, for instance, the largest textile company in the country has more than 30,000 shareholders -- and the leading brewing concern has even more. But this tends to be more the exception than the rule. Generally, the base for industrial ownership is narrow, and the overall rate of investment in industry is low since many investors prefer to put their savings to work in the more traditional fields of real estate or commerce.

This makes the development of local capital markets a matter of considerable economic priority in Latin America. In filling some of the gaps that at present exist in the capital markets of most Latin American countries, one initiative taken by the World Bank Group has been to encourage the establishment of local privately owned development finance companies whose main aim is to serve industry in the private sector. In Latin America, IFC is itself a shareholder in four institutions of this kind -- three in Colombia and one in Venezuela. Our good friends at Bankers International, incidentally, are shareholders along with us in the Corporacion Financiera Nacional of Medellin, Colombia.

Institutions of this kind represent an approach that is primarily domestic rather than foreign to the business of channelling private long-term capital into industrial investment. For smaller or medium-sized enterprises, they can provide access to foreign capital and technology that would not otherwise be available to them. They are helping to mobilize local savings and, in some cases, to acquaint both investors and entrepreneurs with new and perhaps unfamiliar types of securities suitable for corporate financing. In a more promotional role, several are active in identifying new opportunities for investment and taking part in financing new enterprises. In these and other ways, development finance companies are helping to lay the groundwork for organized capital markets.

While development finance companies are in a position to take care of the needs of smaller or medium-sized local enterprises, there are often situations in which the requirements of a specific project may outrun the resources of the local institution and even of the local capital market, making outside participation desirable. Here the best way of raising a substantial block of capital may be through a public offering of securities to both domestic and foreign investors. IFC has in fact taken part on a number of occasions with local institutions in standby or underwriting agreements of this kind. Perhaps the best example of this kind of operation is IFC's role in helping to underwrite new share offerings made by the largest privately owned Mexican steel company, which has required substantial amounts of financing in order to carry out succesive stages of a long-term expansion program. In 1962 and again last year, IFC together with a leading Mexican financial institution joined in forming an underwriting syndicate that included Mexican, United States and Swiss institutions.

Let me close by mentioning some of the steps taken recently to increase the effectiveness of the World Bank Group in financing industrial growth in the developing countries. One move has been to concentrate in IFC the responsibility for appraising and supervising all industrial projects submitted to the Bank Group for financing. Another major move has been to expand the amount of financial resources available to IFC. In the near future, IFC's resources will be increased by a loan from the World Bank of about $400 million. The formal procedures involved in this move have now been virtually completed.

With these additional resources, IFC will be able to extend the amount of assistance going to private industry, including enterprises which cannot now get the financing they need because they are unwilling to seek -- or cannot obtain -- the government guarantee required for a loan from the World Bank. IFC will be in a position to undertake substantially larger investments, with the upper limit on a single commitment rising to somewhere between $15 million to $20 million compared with $5 million or $6 million at present. This will almost certainly open up new possibilities, particularly in capital-intensive industries such as petrochemicals or fertilizers or mining, to name only a few. IFC will also be in a position to free its entire present capital for making equity investments. In ways such as these, IFC -- and the World Bank Group as a whole -- can hope to play a bigger part in financing industrial development in Latin America and the other developing regions.

THE EXPERIENCE OF THE WORLD BANK GROUP IN FINANCING INDUSTRIAL DEVELOPMENT IN LATIN AMERICA

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The growing importance of industry has been a major feature of recent economic development in Latin America. In Argentina, Brazil and Mexico, industrial output now represents approximately 30 per cent of Gross National Product, while rapid industrial growth has also been recorded in several other countries in the region. This progress has been based on the development of a wide range of basic and light industries, essential to the objective of achieving balanced growth through economic diversification. This is an objective which the World Bank Group as a whole -- the World Bank itself, the International Development Association (IDA) and the International Finance Corporation (IFC) -- is seeking to assist, both directly and indirectly, through its operations in the region.

The relatively greater importance of industry in the economy of Latin America than in other developing regions reflects a number of positive features, including the existence of an active entrepreneurial class and the availability of skilled and semi-skilled labor and private capital. Despite the progress made so far, industrial development in the region nevertheless continues to face several problems. These include the gap in the technological environment between Latin America and the industrialized countries of North America and Western Europe; the weaknesses of local capital markets and, in particular, the distortions caused by inflationary conditions and the relative lack of institutional means of mobilizing and directing private capital into long-term industrial investment; and the shortage of professional managers acquainted with the techniques of controlling large-scale industrial enterprises. Other factors tending to hold down the level of capital investment in industry and to inhibit risk-taking include the inadequate size of the domestic markets of many Latin American countries, in terms of purchasing power, and the low level of export trade in manufactured goods within the region.

The operations of the World Bank Group in Latin America have been designed to assist industrial enterprises, both directly and indirectly, in surmounting problems of this kind and in making more effective contributions to the economies of the countries of the region. A number of distinct approaches can be identified: lending by the World Bank itself for major projects in the field of basic industry and infrastructure, generally requiring substantial blocks of capital; loan and equity investments by IFC in a wide range of basic, medium and light industries, in association with private investors and management; assistance to smaller and medium-sized enterprises through intermediaries, such as privately owned development finance companies; activities by the World Bank and IFC supporting the development of local capital markets and the international flow of private capital into industrial investment in the region; and lastly, technical studies in connection with specific investment proposals as well as entire sectors of industry.

Lending for infrastructure projects designed to improve power, transportation and other facilities for industrial and other users has attracted the bulk of the financing provided by the World Bank Group in Latin America. Approximately $2,220 million of the total of $2,585 million of the Group's operations in the region up to December 31, 1965 was represented by lending for electric power, roads, railways, ports and telecommunications projects. Operations in the field of industry (including mining) accounted for slightly over $170 million, or approximately 6.8 per cent of the total. Approximately $86 million of this was in the form of World Bank loans. (See Annex I.) Industrial lending represents a substantially lower proportion of World Bank operations in Latin America than in other regions, such as Asia, where the Bank has made sizable loans for privately owned iron and steel enterprises (in India and Japan), or Africa, where the Bank has assisted large-scale mining projects (in Mauritania and Gabon). (See Annex II.) Among the general factors limiting lending in this field in the region has been the relatively greater availability of private capital for the kind of large-scale industrial or mining projects the Bank has helped to finance elsewhere; the existence of conditions limiting the creation of development finance companies of the type assisted by the Bank in other regions; and the shortage of adequately prepared large-scale projects suitable for Bank financing. Currency instability may have deterred some potential borrowers from assuming foreign exchange risks; while the requirement of a government guarantee on Bank loans to private enterprises has almost certainly acted as an inhibiting factor, in view of the reluctance of many Latin American governments to provide such guarantees and the unwillingness of private business interests to seek them. Bank lending for basic industry, and particularly steel, has also been influenced by the existence until recently of unsettled financial conditions in some of the largest countries in Latin America and by problems encountered in financing government-owned enterprises, a subject discussed in more detail later in this paper; the Bank has in fact so far financed steel production in only one country (Colombia).

The operations of the International Finance Corporation in Latin America present a contrast to the experience of the World Bank. The Corporation's investments in Latin America account for substantially the largest proportion of its operations: approximately $86 million or 57 per cent of its total commitments (See Annex III). This record reflects the fact that the broad industrial base of the region has provided a wide range of projects of a kind and on a scale suitable for financing by the Corporation in association with private investors and management. While the Bank's industrial lending in the region has been concentrated in such basic industries as steel, coal and pulp and paper, IFC's operations have been more diverse. In some cases IFC has provided financing for basic industries (steel, cement, pulp and paper, chemicals). It has also helped to finance a broad range of medium and light industries, including textiles, electrical goods, automotive components and food processing, as well as privately owned development finance companies. Unlike the Bank, IFC does not require a government guarantee on its investments. IFC's operations in the region have also been assisted by the fact that it is able to provide general purpose financing on a flexible basis, through share investments as well as loans and through standby and underwriting commitments. IFC financing has been available to meet local currency expenditures and to provide working capital as well as to meet foreign exchange costs and to cover the acquisition of fixed assets.

Industrial financing by the World Bank and IFC in Latin America has been geared to a number of objectives. A frequent objective has been the modernization of traditional, labor-intensive industries representing a starting point of the industrialization process. Examples of this include IFC investments in the food processing industry in Chile or the textile industry in Ecuador. Another important objective has been to make existing investments more effective through fuller utilization of plant, as in the case of the World Bank loan to the steel industry in Colombia or the IFC investment in the pulp and paper industry in Argentina. Yet another important objective has been the establishment of new enterprises or new kinds of industry, as in the case of the World Bank loan to a company establishing the first cement plant in northern Peru (followed by an IFC investment) or the IFC investment in a new construction and industrial machinery plant in Mexico.

In undertaking investment activities in the field of industry, both the World Bank and IFC require that certain criteria be met in establishing the eligibility of projects and their suitability for financing. Chief among these are economic priority and potential profitability. The issue of economic priority is sometimes fairly straightforward. The financing provided by the World Bank (and subsequently by IFC) to a leading Chilean pulp and paper producer, to assist the company in establishing and later expanding output of chemical pulp and newsprint, made possible fuller use of thinnings from the insignis pine forests, a unique Chilean natural resource that might otherwise have gone to waste. It also strengthened the company's position in exploiting its comparative advantage in order to replace imports and to create export markets within the Latin American Free Trade Association, thereby contributing to the Chilean balance of payments. A somewhat different priority was represented by the investment made by IFC in a major automobile producer in Brazil, recognizing that motor vehicle manufacturing has played a central role in the industrialization of that country by stimulating the establishment of local components manufacture and supplier industries.

In other cases, the question of priority may be more complex. The establishment of steel production, often regarded as one of the first objectives of industrialization, may clearly be justified in some countries on the basis of the availability of raw materials, the existence of a suitable location for the industry, a substantial market permitting economies of scale and finally competent management. In other cases, however, it is not always possible to justify the substantial investment required. Even in the case of a country affording a large market for steel, shortages of investment funds may result, creating strains on the balance of payments. Whether or not investment in steel-making facilities constitutes an economic use of resources depends in part also on other factors, including the cost of capital and the terms on which it is made available.

Different issues of priority may be raised in the case of a declining industry, where substantial investments may be required to keep the industry alive but where the prospects are such as to have little attraction for private investors. In a basic industry such as coal, continued operations may be justified in terms of foreign exchange savings and other objectives, such as maintaining a labor force with specialized skills and low adaptability. Even the reluctance of private investors to make new investments may perhaps be overcome by certain minimum price and market guarantees by government. These were some of the factors considered when the Bank agreed to lend funds to expand and modernize the operations of two major coal companies in Chile, where coal still accounts for a significant proportion of total energy resources.

It is a condition for financing by the World Bank Group that projects should be viable without requiring excessive tariff or other protection against imports. In evaluating the degree of protection that would be acceptable under given circumstances, attention is paid to the present and prospective cost structure of the industry which is seeking finance, taking into account the possible under or over-valuation of the currency. It is also necessary to make allowance for various indirect economic benefits (foreign exchange savings, the creation of additional employment and new skills and the establishment of new auxiliary industries) which might accrue in the long run from the development or preservation of a given industry. The issue of protection is one faced by the Bank Group not only in project financing but also in determining what degree of preference should be given to domestic suppliers in procurement for projects financed by the Bank. The experience of the Bank has indicated that a moderate degree of preference is sometimes justified after individual circumstances, such as a possible overvaluation of the currency, have been considered.

Once the economic priority of a project, including the existence of an adequate market for the company's output, has been established, it is necessary to appraise the prospects from a number of other points of view. There should be assurance that the technical concept of the project is sound and that suitable and sufficient raw materials and other inputs are available. Management should have a record of capability and experience, both on the technical and the financial side. Finally, the plan for financing the project should be realistic and there should be evidence of the financial strength of the sponsor or sponsors.

A close examination of these factors may help to throw light on situations where projects encounter difficulties. For instance, technical problems frequently arise from the fact that the local sponsors may have neglected to secure the assistance of an experienced partner capable of formulating and planning the project, providing the designs and supervising the construction and initial operation of the plant. This form of partnership is especially important when establishing a new enterprise or when an established company considers branching out into new lines of production, particularly where sophisticated technology is involved. It is in these respects that the partnership of a qualified foreign industrial enterprise may be particularly valuable. Where the local sponsor has experienced technical management, it may be sufficient to make technical assistance agreements or licensing arrangements. Frequently, however, more direct participation by the foreign technical partner may be desirable, covering such phases as the construction of the plant, start-up of machinery, training of local staff as well as the installation of management control systems for running the operation and arrangements for marketing the output. In such cases, it is the experience of IFC that both the local sponsor and the foreign technical partner should be substantial investors in the project, thereby creating a common incentive for the long-term success of the operation.

Another area requiring close attention concerns the terms on which financing is provided for industrial projects, and in particular the need to prepare realistic financial plans. The shortage of long-term investment capital, particularly risk capital, is often reflected in the under-capitalization of new ventures as well as of plans for expanding or diversifying established companies. Without a satisfactory equity base, a company may find that it is unable to incur extra debt that may be required to meet various contingencies. Another common problem concerns over-reliance on short-term as opposed to long-term debt: this may place too heavy a burden on an enterprise at a time when it is unable to generate sufficient earnings to service its debt. Other problems may arise when, as frequently happens, a company finds that it has incurred an overrun on the costs of its fixed assets, whether as a result of price increases, changes in the scope of a project or other reasons. Provisions to meet overruns of this kind should be made at the time the original financing agreement is drawn up. Yet another matter requiring attention is the provision of adequate working capital, whether in the case of a new or of an expanding enterprise, in order to support the expected level of production and sales. In its investments in Latin America, as in other regions, IFC has been prepared to provide funds for working capital purposes as well as to finance the acquisition of fixed assets, whether local currency or foreign exchange is required. In general, the experience of IFC has indicated the desirability of providing long-term capital in different forms adapted to meet the specific needs of enterprises. IFC most frequently provides financing in the form of a combination of loan and share capital or by providing equity capital alone. It also makes loans with equity or other special features. In exceptional circumstances, IFC may provide loan capital on conventional terms, where a company's equity base is sufficiently strong. It has also been the experience of IFC in Latin America that continuity of relationship between an investment institution and its clients can be of considerable importance, whether in overcoming subsequent problems that may be incurred or in providing the additional financing required when an enterprise is successful and needs new capital to cover expansion of its operations.

An analysis of industrial projects financed by the World Bank and IFC in Latin America indicates that the key factor in the success or failure of a project is frequently the strength of the management and its ability to make sound investment and operating decisions through the use of modern management tools, including accounting, cost control and inventory systems. The challenge to management may be measured in various ways. It may be considered in terms not only of effectiveness in carrying out a project for the expansion of an existing enterprise or the establishment of a new enterprise but also in terms of effective marketing, distribution and sales programs once the new capacity has been created. The challenge may also be considered in terms of securing greater productivity and efficiency of operations and obtaining sufficient knowledge of costs to identify and, if necessary, discard unprofitable lines of production. These are general problems faced by most enterprises, but they are likely to be accentuated in an inflationary climate, where it may be difficult to measure costs and to establish a pricing mechanism that will provide an adequate return on capital and allow for adequate depreciation and other policies.

Yet the problem of management is not exclusively, or even primarily, one of securing the necessary expertise. More profoundly, it tends to be rooted in the existing system of traditions, institutions and motivations, which may or may not succeed in producing a spirit of competitiveness and an incentive to achievement. An example of one favorable conjuncture of circumstances is offered by the Colombian textile industry. Here a small number of producers have risen to pre-eminence and have been able to overcome the limitations of a relatively small domestic market by rationalizing their production, thereby attaining lower unit costs and significantly lower prices than other textile industries in Latin America. This in turn helps to explain the fact that per capita consumption of textiles in Colombia is higher than elsewhere in the region and that the Colombian industry is able to compete successfully in export markets.

The management factor is particularly important with respect to government enterprise in the manufacturing field. Government operations are most likely to occur in large, capital intensive and technically complex industries, such as steel, oil and heavy chemicals. Management of industries of this kind and scale requires both experience and professional competence;

considerable delegation of authority and freedom to operate with a minimum of outside interference is also required if management is to operate effectively. Experience shows that these goals are difficult to achieve in state-owned industries, where many of the decisions may be taken for reasons other than the need to secure competitive, viable enterprises. These factors may be reflected in the choice of management for reasons other than professional competence, the location of an industry for political rather than economic reasons and the tolerance of an excessive labor force, resulting in low productivity and high wage costs. Investment decisions as well as pricing may not always be based on market considerations, while financing may be subject to the availability of government resources. There are government enterprises which have avoided most, if not all, of these problems, but these shortcomings tend to be quite prevalent. For these reasons among others, the World Bank has been reluctant to finance industries under government control or management. Nevertheless there are situations in which government may, for reasons of national policy, be unwilling to allow control of basic industry or natural resources out of its hands. In such cases the answer may lie in establishing independent management, in order to remove operations from political control and influence. There are other situations in which, because of the substantial investment required, it is difficult to recruit sufficient private capital to obtain private ownership; here the solution may be first to set up management on an independent basis and then to arrange for the eventual transfer of ownership to private investors. This was the procedure followed in the case of Acerias Paz del Rio, the only integrated steel producer in Colombia, to which the World Bank made a loan in 1963. Originally a quasi-government corporation, control of Paz del Rio now rests with private shareholders; a small residual interest still held by the Banco de la Republica is gradually being transferred to private ownership.

The lack of soundly conceived and adequately prepared industrial projects remains a major obstacle to a higher rate of industrial investment in Latin America and has been a restraining factor on World Bank Group operations in the area. Preparation of projects -- particularly in the case of major projects -- is both difficult and costly. Projects involving the utilization of local agricultural or mineral resources will normally require a long period of exploration, tests and studies. The same holds true to some extent in the case of fertilizers, where the market may need to be examined through field tests and subsequently exploited by educating agricultural producers in the use of fertilizers. The slow start in fertilizer production in several Latin American countries does in fact reflect weaknesses both in market studies and in project preparation. Development and planning in the case of the steel industry has also often been frustrated by the lack of objective market studies, making it difficult to establish effectively what amount and kind of capacity needs to be created.

Loans by the World Bank and investments by IFC in industrial enterprises in Latin America have as a rule been preceded by a comprehensive study of the technical, financial and economic aspects of the projects in question. It is the experience of both the Bank and IFC that studies of this kind are not only essential to the success of a project: the general approach and specific techniques used will often set a pattern for the future investment planning of the companies in question and will possibly also influence management in other enterprises and possibly in other sectors of industry.

In addition to these studies relating to specific projects, the Bank has on other occasions undertaken broader surveys. In its capacity as executing agency for the UN Development Programme (including the former UN Special Fund), the Bank undertook, through private consultants, to examine the coal industry in the Cauca Valley of Colombia and to establish the prospects for increased production and export. This type of general survey may be required before a more specific feasibility study can be undertaken. Another type of approach is involved in the study now being carried out of the Brazilian steel industry, under the sponsorship of the World Bank and the Government of Brazil. The study, organized with the assistance of IFC, was prompted by the findings of a Bank economic mission which visited Brazil in December 1964. The mission recommended that a comprehensive study be made by independent consultants before any major projects for increasing the present capacity of the industry are undertaken, with the objective of establishing the most economical pattern of expansion for the sector as a whole. For this purpose, the study will include a review of the gap between the supply and demand of steel products in Brazil between 1966 and 1972, together with feasibility evaluations of the expansion programs of the more major producers.

Another important condition of attaining a higher rate of capital investment in industry in Latin America is likely to continue to be the need for more effective mobilization of private domestic savings. Industrial growth in the region has historically been financed for the most part out of domestic resources. In recent years, it is estimated that the international flow of private capital of all types to Latin America (direct investment, reinvested earnings of subsidiaries, bank loans, portfolio investments and suppliers' credits) has accounted for only about eight per cent of the total annual net investment within the region of $7,000 million. This fact makes the development of local capital markets and the direction of private savings into long-term investment in industry objectives of continuing importance. The World Bank has organized studies by independent consultants of the capital markets of Chile, Colombia and Peru. Economic missions from the World Bank have in addition surveyed conditions in local capital markets, helped to identify some of the existing gaps and made recommendations on how these gaps might best be filled. In Chile, Colombia and Venezuela, recommendations of this kind played a part in the subsequent passage of legislation permitting the establishment of privately owned development finance companies whose main objectives are to make loan and share investments in local industries, carry out underwritings and take part in the promotion of new enterprises.

The experience of the World Bank Group has been that the kind of development finance companies most likely to be successful are institutions which are privately owned and shareholder controlled, with special assistance from government in the form of low-cost, long-term subordinated loans. The climate for such government assistance to private development finance companies has so far not existed in Latin America. In Colombia and Venezuela, however, the existence of an active industrial climate has made it possible for privately owned development finance companies to operate profitably without special loan funds on concessionary terms from government. These institutions have developed on somewhat different lines from institutions elsewhere, which have been able to rely primarily on medium and long-term lending, using their high gearing in order to achieve profitability. By contrast, the institutions in Colombia and Venezuela have relied primarily on rapid turnover of funds, underwriting operations, promotional activities and other fee operations. IFC itself is a shareholder in four of these institutions, three in Colombia and one in Venezuela. In addition to its direct financial participation in these institutions, IFC is responsible within the World Bank Group for providing a broad range of technical assistance for development finance companies, including guidance in the promotion of new institutions, help in selecting management, the preparation of chartered and policy statements, and the provision of training for staff in Washington.

IFC has on a number of occasions taken part with local institutions in financing large-scale projects where the capital requirements could not be met entirely within the local capital market. This type of joint financing has proved effective in establishing new enterprises or in assisting already established enterprises no longer able to finance their growth out of internal resources alone. One example of this kind of activity is the underwriting of share offerings made by industrial enterprises. Operations of this kind may be instrumental in securing public participation in family-held or other closely-held enterprises or in broadening the existing ownership of a publicly held company, in order to facilitate future recourse to the market. In Mexico, for instance, IFC has joined on two separate occasions with a local institution, Credito Bursatil, S.A., a subsidiary of the Banco Nacional de Mexico, S.A., in underwriting share offerings made by the largest privately owned steel company in the country, Compania Fundidora de Acero y Fierro de Monterrey, S.A. In 1964, IFC and Credito Bursatil, with the participation of Mexican, U.S. and Swiss financial institutions, underwrote a share offering of $12.5 million made by the company as part of the total financing of $50 million it then required for a major program to increase its productive capacity. This was the largest offering of its kind ever made by a private enterprise in Mexico. The underwriting made possible an expansion in the company's equity base, thereby permitting it to support substantial borrowings, including a loan of $28 million from the Export-Import Bank of Washington. Despite the size of the Fundidora offering, nearly all of the shares were subscribed almost immediately by investors in Mexico, and the underwriters were required to take up less than one per cent of the issue. These shares were also subsequently sold on the Mexican market.

Although foreign private capital may account for a comparatively small part of total capital investment in Latin America, its role nevertheless is a significant one for a number of reasons. The flow of foreign private capital represents perhaps the most direct means of transferring technology, managerial and other skills from the industrialized countries to Latin America and other developing regions. An example of this is the establishment, within a relatively short period of years, of the automobile industry in Brazil with a substantial proportion of domestic content. Foreign investors have played a key part in several of the projects financed by IFC in the region, generally through direct investments in partnership with local sponsors. Experience suggests that the role of this kind of investment should be measured in qualitative as well as in quantitative terms, in view of its contribution to national objectives in the region, such as the expansion of exports of manufactured goods.

A different form of capital flow is represented by the portfolio investment undertaken by foreign investors in Latin American industrial enterprises. This kind of investment, again comparatively small in terms of volume, represents a valuable means of supplementing the availability of scarce long-term capital for investment in industry in the region. Both the World Bank and IFC have followed a policy of encouraging such portfolio investment through participations in Bank loans or IFC investments, thereby acquainting outside investors with specific investment opportunities in the region. U.S. and Canadian financial institutions have acquired participations totaling \$3.4 million in World Bank loans to industrial enterprises in Latin America, while in the case of IFC, some \$22 million in participations have been sold in loan and equity investments made by the Corporation in Latin America. Through such sales, IFC has helped to channel private capital into the region from a number of countries, including the United States, Belgium, France, Germany, Italy, Luxembourg, Switzerland and Kuwait.

Two recent initiatives have been taken to enhance the activities of the Bank Group in industrial financing. One concerns the review of industrial projects submitted to the Group for financing. Responsibility is now centered in IFC, which acts on behalf of the entire Group in the technical, financial and economic appraisal, preparation and supervision of industrial and mining as well as development finance company projects. The second initiative concerns the expansion of the resources available to IFC for financing private industrial enterprises. Late last year, amendments were completed to the Articles of Agreement of the World Bank and IFC, to permit the Bank to lend up to $400 million to IFC. The relending of these Bank funds by IFC will not require a government guarantee, thus removing one factor inhibiting Bank Group operations in the industrial field in Latin America. The four-fold expansion of IFC's resources is likely to affect the overall operations of the Group in other ways. It will, for instance, permit the Corporation to take part in financing a larger number of projects as well as making larger individual commitments. IFC will be in a position to use Bank funds to reimburse it for the loan portions of investments it has already made, thereby freeing its own capital for making equity investments. These developments are likely to further increase the flexibility of the World Bank Group's assistance to industrial enterprises in Latin America.

Information Department

ANNEX I

WORLD BANK LOANS TO INDUSTRY IN LATIN AMERICA

March 1, 1966

Country and Borrower	Amount (U.S. dollars)
CHILE	
Compania Manufacturera de Papeles y Cartones S.A. (pulp and paper)	$20,000,000
Carbonifera Lota-Schwager S.A. (coal mining)	21,800,000
Corporacion de Fomento de la Produccion (meat, milk processing equipment etc.)	5,000,000
COLOMBIA	
Acerias Paz del Rio, S.A. (steel)	30,000,000
COSTA RICA	
Banco Central (industrial equipment imports)	6,800,000
MEXICO	
Nacional Financiera & bank consortium (industrial equipment imports)	500,000
PERU	
Cemento Pacasmayo S.A. (cement)	2,500,000
TOTAL	$86,600,000

WORLD BANK LOANS TO INDUSTRY, MARCH 1, 1966

(Millions of U.S. dollars,
initial commitments net of cancellations & refundings)

Industry	Area					Total
	Africa	Asia & Middle East	Australasia	Europe	Western Hemisphere	
Iron & steel	--	314.0	13.4	22.7	30.0	380.1
Pulp & paper	--	4.2	1.1	106.9	20.0	132.2
Chemicals (inc. fertilizers)	--	25.0	0.3	56.8	--	82.0
Mining	101.0	48.6	14.2	11.9	21.8	197.5
Development finance companies	19.0	324.7	--	61.9	--	405.6
General	20.5	5.2	23.8	171.0*	14.8	235.2
TOTAL	140.5	721.6	52.7	431.2	86.6	1,432.7

* Including general purpose loans to the Cassa per il Mezzogiorno of Italy

IDA CREDITS TO INDUSTRY, MARCH 1, 1966

(Millions of U.S. dollars, net of cancellations)

Industry	Area				Total
	Africa	Asia & Middle East	Europe	Western Hemisphere	
General industries*	--	221.5	--	--	221.5
Development finance companies	--	4.9	20.0	--	24.9
TOTAL		226.4	20.0		246.4

* Including industrial equipment imports

ANNEX III

INTERNATIONAL FINANCE CORPORATION

Gross Commitments in Latin America, March 1, 1966

Country and Borrower	Industry	Amount (U.S. dollars)
ARGENTINA		
Acindar Industria Argentina de Aceros, S.A.	Steel	$ 3,660,000
Papelera Rio Parana, S.A.	Pulp & paper	3,000,000
Fabrica Argentina de Engranajes, S.A.I.C.	Automotive components	1,500,000
PASA, Petroquimica Argentina, S.A.I.C.	Petrochemicals	3,050,000
Celulosa Argentina, S.A.	Pulp & paper	2,500,000
		13,710,000
BRAZIL		
Siemens do Brasil Cia. de Eletricidade	Electrical equipment	2,000,000
Olinkraft, S.A. Celulose e Papel	Pulp & paper	1,200,000
D.L.R. Plasticos do Brasil, S.A.	Automotive parts	450,000
Willys-Overland do Brasil, S.A., Industria e Comercio	Motor vehicles	2,450,000
CompanhiaMineira de Cimento Portland, S.A.	Cement	1,200,000
Champion Celulose, S.A.	Pulp & paper	4,000,000
Acos Villares, S.A.	Steel	5,051,068
		16,351,068
CHILE		
Empresa Minera de Mantos Blancos, S.A.	Copper mining & smelting	4,337,500
Fideos y Alimentos Carozzi, S.A.	Food products	1,653,846
Cementos Bio-Bio, S.A.	Cement	1,300,000
Compania Manufacturera de Papeles y Cartones, S.A.	Pulp & paper	3,000,000
		10,291,346
COLOMBIA		
Laminas del Caribe, S.A.	Fibre-board	500,000
Industrias Alimenticias Noel, S.A.	Food products	2,018,531
Envases Colombianos, S.A.	Metal cans	700,000
Berry Selvey y Cia., S.A.	Home furniture	170,000
Electromanufacturas, S.A.	Electrical equipment	500,000
Corporacion Financiera Colombiana	Development finance	2,023,730
Corporacion Financiera Nacional	Development finance	2,042,000
Compania Colombiana de Tejidos, S.A.	Textiles	2,000,000
Corporacion Financiera de Caldas	Development finance	701,403
Forjas de Colombia, S.A.	Steel forging	1,101,737
Almacenes Generales de Deposito Santa Fe, S.A.	Warehousing	1,000,000
		12,757,401

COSTA RICA		
Productos de Concreto, S.A.	Concrete products	589,552
ECUADOR		
La Internacional, S.A.	Textiles	1,997,778
ELSALVADOR		
Industrias Textiles, S.A.	Textiles	140,000
GUATEMALA		
Industria Harinera Guatemalteca, S.A.	Flour milling	200,000
HONDURAS		
Empresa de Curtidos Centro Americana, S.A.	Leather tanning	350,000
MEXICO		
Industrias Perfect Circle, S.A.	Industrial equipment	800,000
Bristol de Mexico, S.A.	Aircraft engine overhaul	520,000
Acero Solar, S.A.	Twist drills	280,000
Compania Fundidora de Fierro y Acero de Monterrey, S.A.	Steel	10,518,408
Tubos de Acero de Mexico, S.A.	Seamless steel tubes	1,000,000
Quimica del Rey, S.A.	Sodium sulphate	750,000
Industria del Hierro, S.A.	Industrial/construction equipment	1,601,281
		15,469,689
PERU		
Industrias Reunidas, S.A.	Home appliances	250,000
Luren, S.A. & Ladrillos Calcareos, S.A.	Bricks	280,000
Durisol del Peru, S.A.	Building materials	300,000
Fertilizantes Sinteticos, S.A.	Fertilizers	4,083,290
Cemento Andino, S.A.	Cement	2,400,000
Compania de Cemento Pacasmayo, S.A.	Cement	1,600,000
		8,913,290
VENEZUELA		
Siderurgica Venezolana "SIVENSA", S.A.	Steel	3,140,529
Diablitos Venezolanos, C.A.	Food products	500,000
C.A. Venezolana de Desarrollo (Sociedad Financiera)	Development finance	1,336,183
Dominguez y Cia., S.A.	Can manufacturer	510,000
		5,486,712
TOTAL		$86,256,835

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INTERNATIONAL FINANCE CORPORATION

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THE INTERNATIONAL FINANCE CORPORATION

A Speech by

Hans Fuchs
Deputy Director of Investments
Latin America, Europe and Australasia

to the

American Management Association, Inc.

New York, New York

October 3, 1967

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Tuesday, October 3, 1967

SCOPE AND METHODS OF OPERATIONS
(Multi National Investment Guarantees)

The International Finance Corporation is a member of the World Bank Group. IFC was founded in 1956 to supplememt the activities of the World Bank by assisting the growth of private businesses in low income member countries, and by increasing the flow of private investment to them. It is the only international and intergovernmental institution devoted to financing the private sector in the developing world.

IFC blends many of the operating methods of a private investment banker with the objectives of a development financing agency. Let me just enumerate some of IFC's main features, very briefly, as background for this talk.

-- IFC is a source of dollar financing, able to provide long term risk capital in the form of equity and loan investments.

-- In addition to providing capital IFC performs a number of services, both technical and promotional, to assist the development of private business in the low income countries.

-- IFC has become the main instrument of the World Bank Group -- the Bank, the International Development Association and IFC -- for dealing with private investors. In practice this means that any investment proposal concerning industry or mining referred to the Group will be appraised in the first instance by IFC, regardless of which member of the Group is to provide the financing.

-- Over a period of time, IFC has evolved in the direction of greater flexibility in its policies and in its operating methods, and has widened its geographic scope. This is marked in the variety of kinds of financing IFC provides, as well as in the growing range of enterprises it is prepared to assist,with increasing emphasis upon Africa and Asia as well as Latin America.

-- Since 1961, following an amendment to its charter, IFC has been free to invest in equities, opening up new possibilities in the field of direct investment as well as underwriting. The Corporation's use of equity financing has developed so far that in its 1966/67 fiscal year, ended last June 30, every IFC investment had an equity feature. The normal pattern of IFC financing is now a subscription to shares in conjunction with a long-term loan.

-- One of the Corporation's most active roles, and one that results in exceptionally prolific multiplication of the funds it invests,is as a shareholder in privately sponsored development finance corporations in low income countries. Here, some $12 of other investment has resulted for every $1 of IFC investment.

-- IFC's funds may be used to finance the acquisition of fixed assets as well as to meet what may be described as permanent working capital requirements. They are available in all cases on an "untied" basis.

During the Corporation's last full fiscal year, ended June 30, IFC increased the volume of its commitment of financial assistance to private businesses in less developed countries by more than a third, invested in tourism and in a public utility for the first time, gave new emphasis to Africa and Asia, and raised the average size of its investments. I will be giving you some highlights of these current activities. First, however, let me tell you something about the history and character of the International Finance Corporation.

IFC has 84 member countries and subscribed capital of $100,095,000. The Corporation's commitments in the process of making 143 investments during its first 11 years total over $221 million invested in a wide range of private enterprises in some 36 countries. Following changes completed late in 1965 IFC is now permitted to borrow up to $400 million from the World Bank, opening prospects of substantially larger operations. A first portion of $100 million of this line of credit has been activated but none has yet actually been used by IFC.

To qualify for IFC consideration, a project needs to meet three basic criteria. It must represent some economic priority to the country concerned, it must be potentially profitable, and the presence of IFC in the financing of the project must serve a constructive purpose.

The basic situation calling for IFC's help is one where sufficient private capital is not available on reasonable terms. In some instances, this may mean that IFC puts up the "last money" for a project. That is, IFC fills a gap after most of the financing has already been arranged. In other cases, by making a commitment as an "early money" investor IFC may make it possible to bring in other investors whose funds can complete the financing of a project.

IFC may be needed because it can help to secure local participation in an enterprise that would otherwise be foreign owned. Or, IFC's key function may be to help locate an experienced industrial partner from one of the industrially advanced countries.

Each investment proposal presents different features, but in general IFC needs to be satisfied that the project is sound in concept, that a market exists for the proposed products, that experienced, competent management is available and that the financial plan for the new company is realistic and allows for such contingencies as overruns in costs of construction and for the costs of starting up.

IFC's experience has identified a wide range of situations in which a joint venture between foreign and local investors is the most effective form of operation. In general, these are transactions in which the skill and resources of the partners complement each other. In such situations, the local partner is in the best position to provide knowledge of local market conditions, handle relations with labor and government, and help arrange local currency financing. The foreign partner can contribute industrial techniques as well as managerial and administrative experience.

This type of collaboration is particularly valuable in cases where industry new to the local sponsors is being established, or where advanced technology is involved. IFC expects both partners in such cases to have a meaningful equity stake in the enterprise indicating a long-term commitment to the success of the venture. Many of the companies which IFC has helped to finance are in fact joint ventures of this kind.

In its operations, IFC's basic posture is normally that of a financial investor. That is, the Corporation does not take part in management and is not ordinarily represented on the boards of the industrial companies in which it invests. As a matter of policy, also, IFC does not vote its shares, except in compelling circumstances. IFC limits its participation in the equity of an enterprise to 25 percent, and normally holds an interest of between 10 and 20 percent.

In much the same way as does a private investment banker, however, IFC looks to establish some continuity of relationship with the management of an enterprise. Members of the IFC staff normally pay periodic visits to a company as a follow-up procedure. IFC also expects the company to provide audited annual statements, as well as quarterly progress reports, that meet certain financial reporting requirements.

Since IFC expects private investors to put up the bulk of the funds needed, there are definite limits to the extent to which IFC will participate in a project. In financing a new enterprise, IFC will not go above 50 percent of the total capital cost, in terms of loan plus equity. In the case of an expansion program, however, IFC is prepared to finance more than 50 percent of the new capital needs. As I have said, IFC limits its equity holding to 25 percent or less.

Since it is uneconomical for IFC to handle investments that are too small, IFC will not normally finance projects in which the call on IFC funds is less than $1 million, but this limit is flexible according to surrounding circumstances. In the context of small economies, such as in Central America, for example, IFC might consider investment down to about $500,000. IFC's normal practice is to refer smaller investments to a local development financing institution to handle, wherever possible. Before additional resources were made available to IFC from the World Bank, the Corporation's largest single commitment was just over $6 million. Now IFC is prepared to consider single investments of up to $20 million.

One of IFC's major objectives is that of assisting the growth of capital markets in the less developed countries, in order to make possible broader local participation in the ownership of industry. As a consequence, IFC tends to finance only those companies in which there is already some participation by the public or where it may be possible to get public participation. In countries with reasonably well developed capital markets, such as Mexico or India, IFC may require that its investments be accompanied by a public offering of shares to local investors.

Since IFC is not a holding company or investment trust, it normally expects to be able to sell its investments and thereby revolve its funds. In making such sales, it is IFC's position that it will not give any undertaking - such as the right of first refusal - that may lessen its freedom of action. Nevertheless before making a sale IFC is guided by the legitimate interests of the sponsors of an enterprise.

For instance, when making sales of shares through a stock exchange, IFC would take care to do so without disturbing the market for the shares of the company. Again, if IFC were to transfer a substantial block of shares through a private sale, it would expect to consult with the sponsors of the Company to determine that there were no objections to the sale for valid business reasons. A valid objection in these circumstances would, for example, be that the proposed purchaser had connection with a competitive business.

With this background, let us look briefly at the current operations of IFC. These show how the work of the Corporation is both growing and diversifying, and the strong emphasis being given to the Corporation's role as a mobilizer of capital other than its own, a function which tends to multiply the capital that flows from the Corporation to private business in the developing countries and lets the Corporation revolve its own funds repeatedly.

-- Net income and profits in 1966/67 came to $6.0 million.

-- In the first year of the second decade of its operations, the Corporation raised the size of its investments. There were three commitments - in Brazil, India and the Philippines - of $10 to $12 million each, compared to a previous high of approximately $6 million. The average size of principal commitments rose to $4.5 million, compared to $1.4 million in the first decade of operations.

-- IFC continues to diversify the kinds of businesses in which it invests. There were two firsts during the fiscal year just past: an investment in tourism, in Kenya and an investment in a public utility in the Philippines. In Kenya, IFC committed funds to the Kenya Hotel Properties Ltd., a new company formed to build an international class hotel in Nairobi and to participate subsequently in the construction of game lodge facilities in that country's national parks.

The overall project, requiring an eventual investment of about $6.7 million, is being supported by investors in the United States, the United Kingdom, Germany and Kenya. Together with other projects being undertaken in accordance with the Kenya Government's 1965-70 Development Plan, it will strengthen an industry - tourism - that has grown at an annual rate of 18 percent over the past six years and now ranks second only to coffee as a source of foreign exchange to Kenya.

IFC's investment in a utility - the Manila Electric Company - was also its largest ($12 million) commitment so far. Mercalco is the leading investor-owned power company in the Philippines, generating some 65 percent of the electricity requirements of that country. IFC's investment accounts for about 13 percent of total estimated financial requirements to install about 1.1 million KW of new generating capacity, plus the associated transmission and distribution works. This complements assistance already provided to the Philippine power industry by the World Bank (which has made loans totalling $70.7 million to the government-owned National Power Corporation). Participation in IFC's commitment amounts to nearly $2.0 million and includes U.S. and foreign investors.

-- IFC continues to diversify its investments geographically, backing business for the first time in Senegal and Kenya. This raised the number of countries in which it has invested to 36. The concentration during the year on projects undertaken in Asia and Africa changed the regional distribution of IFC's commitments. At the end of the past fiscal year, Latin America accounted for approximately 50.6 percent of IFC's total commitments to date, while commitments in Asia and the Middle East accounted for 27.7 percent. The most rapid growth in IFC commitments, as in membership, has taken place in Africa, where as recently as 1960 IFC had made only a single investment. Commitments made to enterprises in 11 countries of Africa now represent about one-seventh of the overall total amount committed.

-- As I have mentioned, during the past fiscal year, for the first time, IFC acquired stock in every business in which it invested. This raised the equity component of IFC's investment portfolio to approximately 40 percent. In most instances, investments also included a long term loan.

-- The Corporation intensified its efforts to strengthen the food and agricultural supply base for economic development by making more investments during the year for the expansion of fertilizer production in the low income countries than for any other objective. Financing arrangements were completed for three new fertilizer plants in Latin America, Africa and Asia. In

Brazil, IFC joined with Phillips Petroleum Company of the United States and Brazilian investors to finance what will be one of the largest nitrogenous fertilizer plants and distribution facilities in Latin America. In Senegal, IFC took part with French, German and Senegalese investors in establishing a plant that will utilize local rock phosphate and imported ammonia, potash and sulfur in producing triple superphosphate and a range of complex fertilizers. In India, IFC provided equity and loan financing for a nitrogenous fertilizer plant, sponsored by Imperial Chemical Industries Ltd. of the United Kingdom to help meet India's critical needs for more fertilizer. In line with its general policies, IFC's support for these projects was based in large part on the assurance of experienced management, on the substantial equity interest held by the sponsors and on the provision made for local sponsors to participate in the ownership.

The Corporation's Annual Report, just out, emphasizes the importance of sales by IFC from its investment portfolio in making it possible for IFC to continue expanding these investments in private enterprise in the developing countries. IFC revolves its funds by sales to other investors of loan maturities, and of the equity stock of business in which IFC has made underwriting commitments or equity investments.

As an illustration of the key role of this means of recapturing its funds from sound investments for reuse, let me draw the following to your attention.

The Corporation's operations in 1966/67 brought the cumulative total of IFC's gross commitments (less exchange adjustments) to $221.4 million. That is more than twice the Corporation's paid in share capital of approximately $100 million. At June 30, 1967, effective investments held in the IFC portfolio exceeded share capital for the first time, standing at $107.9 million. This growth of IFC's operations has been based in large part on IFC's ability to turn over its funds through the sale to other investors of securities covered by investment, standby or underwriting commitments. Approximately $60 million of funds have been revolved in this way, becoming available for IFC for entering into new commitments. Over the years, sales of investments, together with repayments and the growth of income credited to the reserve against losses, have helped to place IFC in a strong cash position.

Sales to private investors of participations in its holdings has not only helped keep IFC liquid for continued assistance to the economic growth and improvement of the low income countries, it has also added to the amount of non-IFC funds that the Corporation's investment activities have helped mobilize to finance new business or expand existing businesses in these countries.

The increased scale of IFC's business last year was reflected in the substantial amounts of capital provided by private investors for projects which IFC helped to finance. The total capital costs of projects (where IFC committed some \$49 million) in 1966/67 came to approximately \$330 million.

If we exclude investments in development finance companies, IFC has now taken part in financing projects with total capital costs in excess of \$1 billion. The 17 development finance companies to which IFC has made equity commitments totalling \$19.2 million have raised resources in share capital and loans of more than \$225 million.

This means that, overall, other investors have put \$6 into private businesses in the low income countries for every \$1 of IFC money, and, as I have already mentioned, in the case of development finance companies, nearly \$12 from other investors have followed every \$1 of IFC money.

Before turning to the matter of multinational investment guarantees, let me just cite a few details of IFC's financial record. As I have already mentioned, IFC had net income and profits on sales amounting to \$6.3 million in 1966/67. Sales of equity and loan investments amounted to \$7.3 million. Repayments of \$3.4 million and new capital subscriptions of \$0.5 million brought total funds generated during the year to \$17.5 million. IFC's portfolio of loan and equity investments in privately-owned businesses in the low income countries increased by more than a quarter in 1966/67 from \$84 million to about \$108 million. The annual average return over the life of these investments to date has been about 7.4 per cent.

Now let us consider the subject of multilateral investment guarantees as one means of improving the confidence of private capital in moving to developing countries. Much of the energy and resources of the World Bank family are devoted to the promotion of conditions conducive to rapid economic growth and to the creation of a favorable investment climate in the broadest sense of the term.

The flow of private capital into developing countries has been impeded by fear that it will be exposed to a number of risks arising not from commercial considerations but from political causes, such as expropriation without adequate compensation, and inability to convert local currency into foreign exchange.

In recent years there has been discussion of at least three approaches to the problem:

First, capital exporting and capital importing countries could attempt to reach agreement on a set of principles for the protection of foreign property. These principles could be embodied in a code to which Governments could subscribe and the provisions of which would be enforced or, perhaps, administered by an international tribunal or agency.

A good deal of work along these lines has been done. A committee of the Organization for Economic Cooperation and Development has produced a "Draft Convention on the Protection of Foreign Property". This convention would, among other things, obligate each party to ensure fair and equitable treatment to the property of the nationals of other parties, and it would provide for the submission of disputes to an arbitration tribunal.

Under another proposed approach, a multinational insurance or guarantee program would be established. This would ensure foreign investment against various non-commercial--that is political--risks.

The World Bank produced a report on this subject in 1962 at the request of capital exporting countries. At the UN Conference on Trade and Development, in 1964, the Bank was asked to continue its studies in this area. In consequence, a Charter for the establishment of such a program is being drawn up.

Any such program has to be undertaken in the light of the fact that a number of countries already have schemes in being designed to guarantee the foreign investment and their nationals. For example, under the United States program, guaranteed investments can be protected against several specific risks in countries with which the U.S. has agreed to institute its program. The program for guarantees against specific risks, that is risks arising from specific actions of a political nature, has been in operation for almost 17 years. Under it, guarantees are now available in more than 65 developing countries, against risks arising from inconvertibility, expropriation and war.

The U.S. program of a more general nature, known as the extended risk guarantee program, applies to certain priority investment situations. For these high priority investments, AID can offer eligible investors coverage against any and all risks except fraud and misconduct.

Under a Japanese scheme, which is administered by the Government, insurance may be purchased irrespective of the country in which the investment is to be made. In principle, there is no requirement that the country receiving the investment should have entered into an agreement with Japan. However, only such overseas investments are eligible that are made through acquisition of shares of foreign companies and are considered by the Government to contribute sufficiently to the balance of payment.

A German scheme provides that guarantees are only granted for productive investments and also only for those made in countries which have concluded an investment promotion and protection agreement with the German Government, or that offer an adequate legal security under their existing legislation. In the Japanese as well as in the German schemes the main risks covered are similar to those protected under the U.S. specific risk guarantee program. The duration of these guarantees for the above three examples runs up to a maximum period of 15 to 20 years.

The last approach that I will mention has the advantage of being already in existence as an international institution.

This is the International Center for Settlement of Investment Disputes arising between host country and foreign investor. As you may know, just about a year ago the Convention on the Settlement of Investment Disputes received the necessary number of ratifications and therefore came into force. The Center has been established, for the time being at least, at the headquarters of the World Bank in Washington D.C. By September 1967, 55 States had signed the Convention and 36 had ratified it. The wide interest shown by actual and potential investors, as well as by Governments and governmental agencies in developing countries, testifies to the potential usefulness of the Convention and the Center.

Let me close by saying that IFC's role in fostering private investment in the developing world and the maintenance of the confidence of foreign investors are very much interlinked. It is essential for this confidence to be nurtured and increased, so that the range of opportunities for investments in developing countries open to IFC--and to the private foreign capital that accompanies IFC investment--might continue in the next few years the vigorous growth that has marked the years just past.