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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

SOME PROBLEMS ENCOUNTERED IN THE ESTABLISHMENT OF DEVELOPMENT BANKS

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Some Problems Encountered in the Establishment of Development Banks

1. The IBRD has helped to establish development banks in Turkey, Ethiopia, India and Ceylon. The first two have been in operation about five years, the third two years, and the fourth nine months. It is the purpose of this memorandum to draw conclusions from the experience of these banks in a way that may provide guidance to those contemplating the creation of similar institutions. The memorandum will deal, firstly, with their purpose and functions; secondly, with their capital structure and other problems relating to their own finances; and thirdly, with operating policy, organization and management. There are also attached brief notes on each of the four banks summarizing their background and purpose, capital structure, powers and responsibilities of the board and management, and record of operations.

Purposes and Functions

2. It would be idle to attempt a narrow definition of the nature and functions of development banks; they have been established in almost every country to fulfil a variety of purposes, and no two are exactly alike. There are, however, certain strong similarities among the banks which the IBRD has helped to set up. The basic conception is of an institution with the purpose of putting life into the private sector of a nation's economy. This is carried out by providing long-term finance for private enterprise and by mobilizing private savings for this purpose.

3. It may be asked why private enterprise cannot be left to provide these services on its own account, if they are genuinely required for the healthy development of the private sector. It is however a matter of experience that the development of private industry may be impeded by obstacles which private enterprise is unable to overcome quickly. There may, for example, be deficiencies in the supply of finance on account of lack of confidence between potential borrowers and lenders, obsolete business laws and conventions, and sheer inability to create the necessary organization required for a capital market. A development bank may be able to supply money and organization to meet the deficiencies in the capital market; inspire the confidence both of borrowers and of potential private investors; work for the revision of legal obstacles to investment, and by its own example, lead the business community to abandon obsolete conventions and practices.

4. If it is accepted that a conscious effort should be made to meet deficiencies in the supply of capital for industry, it may still be asked whether and to what extent the task should be undertaken by the central government. In each of the four cases dealt with here, the government has provided the bank with a large proportion of its funds on exceptionally favorable terms. What justification can there be for governments to offer public money to private enterprise on terms more favorable than could be obtained in the market? Firstly, it should be borne in mind that governments have for centuries provided special assistance to private industry

by means of tariffs, quotas, subsidies, tax reliefs and cheap public services which do not differ from the provision of financial assistance in principle, and some of which, such as tax reliefs and subsidies, are very similar in their practical effects. Secondly, in some countries the bulk of savings available for investment has been preempted for the finance of public development programs, leaving little over for investment in the private sector, and the creation of a development bank provides a means by which the government can restore the balance of development. Finally, the main purpose of official assistance is to speed up development in the private sector. Once this is accepted as an aim of policy, then it is reasonable to employ means such as the provision of finance and technical services on inexpensive terms. In two out of the four cases dealt with here, official assistance has been granted from the counterpart in local currency of American aid. It is to this source that some other countries may well be able to turn in the future when establishing development banks, as it is now the policy of the United States to devote to the financing of private enterprise a proportion of counterpart funds arising from sales of surplus farm products. Counterpart funds as such do not represent a real addition to a country's capital, but they provide a convenient source of finance for a development bank. Their employment may not require legislative sanction; which may indeed have been received in advance if the conditions on which aid was offered and accepted included the allocation of a proportion of counterpart funds to the finance of private enterprise.

5. The four banks carry out the common purpose of providing industrial finance and of mobilizing savings in somewhat different ways, the emphasis being shaded differently in each case. While all engage principally in medium and long-term investment, the emphasis with the Industrial Credit and Investment Corporation of India is upon investment in stocks and of the Turkish bank upon direct lending. The Development Bank of Ethiopia is the only one of the four to own and manage a business enterprise. With regard to the mobilization of private savings, this is a process in which a development bank can participate in three ways. Firstly, it may sell to investors issues of its own stock or bonds; and private individuals or institutions have subscribed a majority of the capital stock of the Turkish, Indian, and Ceylonese development banks. Secondly, it may assist in selling the issues of industrial concerns, either by arranging their flotation upon the stock exchange, or by placing them privately with other institutional investors; only ICIC of India has so far engaged in this kind of operation, and in its first year of business had already made arrangements for the underwriting of five public issues. Thirdly, a development banks is likely to stimulate the investment of private savings as its loans will frequently finance only part of the cost of each project, the balance being made up out of the savings of the businessmen concerned; the IDB of Turkey has estimated that from 1951 through 1955 its clients have invested TL 246 million against the total TL 145 million which it has advanced to them. Part of this private investment would probably have been made in any case, but the total may well have been increased as a result of the activities of the IDB.

6. Although the governments of the countries concerned have played a major part in their promotion and financing, a majority of the common stock and voting control of the Turkish, Indian and Ceylonese banks is in private hands. The Ethiopian Bank is financed entirely by way of common stock, the

whole of which is held by the government. It is generally desirable that the management of a development bank should be as independent as possible from external pressures whether from public or private interests; and the best way to achieve this is to have common stock (which carries voting power) held entirely in private hands, and dispersed as widely as possible amongst different investors, thus ensuring that no single investor or group of investors can obtain control of the bank. In the case of ICIC of India this principle of maintaining the dispersal of voting power was accepted by the stockholders as part of the terms on which they would subscribe.

The Capital Structure of Development Banks and Other Problems Related to Their Own Finances

7. The use of a development bank as a means of passing government assistance on to industry has been mentioned in preceeding paragraphs. What this implies is that the bank offers finance to industry on easier and cheaper terms than are available elsewhere. This in turn implies that the bank must obtain at least part of its own finances on correspondingly inexpensive terms from official sources. The obvious method of doing this would be to obtain loans at low rates of interest, particularly if the common stock is held by private investors who will expect a dividend. There are, however, serious objections to capitalizing a development bank predominantly on the basis of loans. The bank has to bear the very heavy risks associated with long-term investment in industry, and must therefore have a reasonable proportion of risk capital in its own financing.

8. Various methods have been devised to provide government assistance to development banks in a form which is neither that of conventional debt nor conventional equity, and which improves the earning power and risk bearing ability of the bank, without giving the government voting control. The device employed in the capitalization of the Indian and Ceylonese Corporations is a long-term - 30 year - advance from the government on which no interest whatever is due. This money was subscribed in full at the time these two Corporations were established and consequently before they had found employment for it in development financing, and before their own organization and running expenses had reached any considerable magnitude. The Corporations are free to invest the proceeds in some profitable but almost liquid form, such as marketable securities or short-term paper: and the advances may therefore be regarded as being not merely free of interest but as carrying a subsidy equivalent to the rate which the Corporations can obtain on temporary investments in the interval before employing them for development financing. These advances partake of the nature of a deferred stock without dividend expectations; in the event of the liquidation of the Corporation they rank for repayment not only after the creditors, but also after the common stockholders. The device also permits of the provision of risk capital by the government without the voting power that would normally be attendant on a subscription to capital stock. The earning power of IDB of Turkey was strengthened by its assumption of the agency for administering the lending of Marshall Plan Counterpart Funds at a commission which amounts to 2½ per cent on the fully invested Fund. While this may seem less advantageous than the interest-free loans to the Indian and Ceylonese Corporations,

it should be noted that none of the risk of loss on the investment of the counterpart funds falls on the IDB of Turkey, and the commission therefore represents almost a pure profit (particularly bearing in mind that the administration of the Fund does not create a proportionate increase in the IDB's administrative expenses). The government advances to the Indian and Ceylonese Corporations, on the other hand, leave the risk of loss on the Corporations, as they have to be repaid.

9. To maintain the liquidity position and the profit margin of a development bank, it is necessary to establish some broad correspondence between the maturities at which it borrows and those at which it lends. It would clearly be undesirable for a bank with funds committed at fixed rates of interest for long periods ahead to have to meet at fairly short notice a demand from its own creditors either for repayment, or for an increase in its borrowing rate. This is a real problem as in many countries commercial banks represent one of the few sources of funds for the financing of a new development bank, and it is important that their contribution should be in a more permanent form than the short-term loans which constitute their normal method of investment. Commercial banks have assisted in the capitalization of the Turkish, Indian and Ceylonese banks, but in each case by way of subscription to the bank's common stock.

10. Borrowing from the IBRD raises the question of the exchange risk. The IBRD lends in foreign currencies, and if the local currency is devalued, the borrower has to repay in terms of local currency more than the amount of his initial loan. He will clearly not wish to get into this position of vulnerability to exchange fluctuations if he can obtain foreign exchange without at the same time incurring a long-term liability, the repayment of which is calculated in terms of the foreign currency concerned. If, for example, foreign exchange is readily available from the central bank, it would clearly be to his advantage to raise a long-term loan in local currency, using the proceeds to purchase foreign exchange; in this way he will be able to import what he requires, while his debt, being in terms of local currency, will not fluctuate in amount with future fluctuations of the exchanges. The question arises as to whether the ultimate borrower, the development bank, the government or some other central authority should bear the exchange risk. It may on the one hand be argued that the ultimate borrower should bear the risk both as a normal element in the cost of foreign exchange, and as a payment for the privilege of importing goods; and that to protect him from it amounts in effect to subsidizing the importation of goods. On the other hand there may be reasons, such as the desire to stimulate industrial development, why the government would wish deliberately to encourage the importation of capital goods. The solution of the problem in the case of Turkey was an arrangement between the IDB and the central bank whereby the risk was lifted from the ultimate borrower on the payment of a fee. In Ethiopia, the IBRD's loan was made to the government rather than directly to the development bank, the government assuming the exchange risk. With ICIC of India no arrangement has been made for the government to bear the risk, and it has not been decided whether it shall fall on the Corporation or the ultimate borrower; foreign exchange is, however, available from the reserve bank and there is no particular demand for the proceeds of the IBRD loan to ICICI, no part of which had in fact been used at the time of writing. In the case of Ceylon the provision was written into the act establishing the CDFCC that the government would assume the exchange risk on a loan of up to Rs. 24 million from IBRD.

Operating Policy, Organization, and Management

11. While operating policies will vary according to the circumstances of each development bank, it is possible to lay down certain principles with a fairly general application, that may provide guidance to the management. The principles, which may either be incorporated in the development bank's articles of association or other basic charter, or adopted as resolutions by its board of directors, are as follows:

(a) The character and maturity of investments should be broadly related to the bank's own capitalization. This is the obverse of the point mentioned in paragraph 9 above, which sought to relate the capitalization of the bank to the kind of investment that it was intended to carry out. It would, however, clearly be possible for a development bank to be capitalized in a manner appropriate to one kind of investment, and then carry out investment of a rather different kind. Sound principles of investment would therefore be as follows:

(1) The total amount of risky investments should not as a rough guide, exceed, and should preferably be rather less than the total amount of the bank's own risk capital. This may be defined as the total of its own issued common stock, plus reserves and surplus, plus other forms of capital which may in some respect be treated as equity (such as the government advances to the Indian and Ceylonese banks).

(2) Maturities for which the bank lends should not in general exceed the maturities at which it has borrowed, and repayments on its investments should be timed so as to leave it with liquid funds required to meet repayments on its borrowings as they fall due.

(b) This leads to the general principle that the bank's investment fund should be revolved. Loans should be repaid by regular instalments, and investments in stock should be sold whenever this can be done to advantage. As repayments from old loans accrue, the bank will be able to re-invest the money in other enterprises, thus stimulating investment on a wider front than it would otherwise be able to cover. This policy will also bring about an increase in the investment of private savings in industry, both on the part of the businessmen who have to find the money to meet repayments on loans, and on the part of investors who purchase investments from the bank.

(c) In order to ensure as wide a spread of risk as possible, the development bank should keep its investments diversified amongst types of undertakings as such, and amongst different undertakings in given regions of the countries concerned. This will help to protect the bank against the effect of a business depression or natural disaster that might fall heavily upon one particular industry, or industry in one particular region. The exception to this would be any temporary investments of liquid funds which might be held in the form of treasury bills, bank deposits, or marketable securities of high class that are listed in and traded upon the stock exchange.

(d) For the same motive of ensuring an adequate spread of risk a development bank should not normally commit more than a given maximum amount to any single undertaking. This should of course be set according to the circumstances of each case. With ICIC of India the upper limit is the equivalent of 10% of the Corporation's own issued common stock. It may also be desirable to set a minimum limit on the size of applications. ICIC of India has excluded applications of less than Rs. 200,000 (U.S. $41,885) which are dealt with by finance corporations established by the Indian provincial governments, and which would set an insoluble administrative problem to the ICICI on account of the sheer amount of work they would create.

(e) A development bank should not seek in any enterprise which it is financing either a controlling interest or any other interest which will give it primary responsibility for the management of the enterprise. The bank should rather leave the control of the enterprise in the hands of its management to the maximum extent consistent with the protection of its interests after satisfying itself that the management is satisfactory and will continue to remain so. The purpose of this rule is to avoid the severe difficulties of attempting to run a number of private businesses from the offices of a financial institution.

(f) While it is clearly necessary to provide some return to the stockholders, particularly if they are private individuals and institutions, the bank's policy in this respect should be extremely conservative at least until it has built up adequate reserves. The Indian and Ceylonese Corporations must put to reserve a proportion of their profits amounting to 25% and 20% respectively, until the amount of reserves is equivalent to the amount of the government advance outstanding.

12. Within these general limitations, a development bank should be free to invest in whatever form is most appropriate to the applicant's individual situation; it should not, for example, be restricted only to making loans with a specific kind of lien but should be free to make loans without security, to take common or preferred stock, and generally to devise whatever financial instruments may be most appropriate for the job it has to do. A frequent difficulty is that of investing in common stock in circumstances where business enterprise is owned and managed on a personal basis; the man who owns and runs his own business is normally jealous of parting with equity that carries with it voting power as well as an interest in future profits. It may be possible to meet this situation by means of a loan or a preferred stock, part of the return on which is linked to the profits of

the business, but which carries no voting rights. Participating preferred stock, part of the dividend on which is fixed, while part fluctuates with profits, has been employed by ICIC of India.

13. The general framework of business law and convention may, in some countries, accentuate the problems which the development bank has to meet. Loans with fluctuating rates of return for example, were considered but rejected by IDB of Turkey as being contrary to Turkish attitudes towards money lending. This sort of restriction on interest is frequently accompanied in the countries where it is to be found by a tolerant attitude towards profits; and this may therefore be another situation in which it is possible to employ participating preferred stock to advantage. In Ethiopia the development bank has found it difficult if not impossible to obtain secure liens on real property in certain parts of the country. Difficulties in the way of obtaining an enforceable claim on business assets may exist in many countries. A development bank may well be able to inspire changes in obsolete laws and business practices.

14. The absence of a tradition of investment in industry may present obstacles to a development bank in other ways. It is likely to meet a lack of familiarity with the investment procedures of a modern financial institution. For instance, the enterprises with which it will have to deal are often likely to be owned and managed on a family basis, and regarded by their owners with a lively and exclusive sentiment of personal property; and this may well result in an unwillingness on the part of applicants to the development bank to disclose information, to accept advice, and, as has been mentioned above, to allow the bank to take an interest in the equity. It is a condition of the successful undertaking of long-term investment that there should exist a high degree of confidence between borrower and lender, and this is something that the development bank may well have to create on its own account.

15. The business of running a development bank cannot, therefore, be confined to rule of thumb procedures. The higher management must be capable of dealing not only with the tricky business of long-term "frozen" investment, but also of handling relations with the business community on the one hand, and the government on the other. The staff must be so organized as to be able not merely to judge applications in the form in which they are presented, but also to investigate the applicant's situation thoroughly, and advise him in the formulation of his investment plans. For such purposes a development bank will require engineers and accountants who are able to visit an enterprise on the spot, extract information from records which may very well be inadequate, and present their findings in a manner which will give a clear picture of the situation for those who have the responsibility of making the decision to invest. It will also require economists who are able to make a rapid appraisal of the market prospects for a product, or of national economic trends, and lawyers to draft financial documents, and assist in the devising of financial schemes. Furthermore, as investments once made cannot readily be liquidated or disposed of, the only way to provide against the future hazards and emergencies that may affect the borrower is to keep a watch upon his progress in order to take remedial action in time. Part of the organization of the bank should therefore be devoted to obtaining regular accounting information from the

bank's clients and to keeping in touch with them by visits and other personal contacts. As the amount of the bank's investments increases the administration of existing loans may well take up more time and trouble than the assessing of new applications.

16. Public relations are an aspect of the operation of a development bank which it cannot afford to ignore. As the bank may well be offering assistance of a kind that is relatively novel it may have to publicize itself in order to start a flow of applications; and, as a new and untried institution, it will have to make itself acceptable to the business community, and to the general public. The most important occasion for attracting attention is that of the publication of the bank's annual report and accounts. This should contain not only a clear financial statement but also as much information as possible about investment operations as is consistent with the discretion required between a banker and his individual customers. This limitation does not however, preclude the publication of statistics showing the number of applications received and of investments made; and of the distribution of investments by size groups, by regions and by form (i.e., common stocks, preferred stocks, loans, etc.). Of the four banks dealt with here, the annual reports of the IDB of Turkey are notable for the amount of information that they contain; those of the Ethiopian bank are less complete but still adequate; ICIC of India has produced one report which is reasonably informative, but its experience was perhaps too limited to be worthy of detailed analysis. At the time of writing the Ceylonese bank has not been in operation sufficiently long to produce a report. There are a number of long established development banks in other countries with reports that may be taken as models of their kind, such as the Industrial Development Bank of Canada, and in the U.K., the Industrial and Commercial Finance Corporation.

17. The standard scheme of management of the development banks, in all our four cases, has been to leave the responsibility for operating the bank in the hands of a Manager, working under the general direction of a Board of Directors which sets and approves the general line of policy. In the designing of the managerial structure the intention should be to leave as much responsibility as possible with the Manager, who is a full time official, rather than with board members, who meeting only at intervals, should not try to deal with too much detail. At its meetings the Board will have time to make final decisions on the applications which the Manager and staff consider to be creditworthy; but there is no need for them to be concerned with the business that will take up most of the time of the staff, which is the elimination of the unsound applications that would normally constitute a majority of the total. In the case of Turkey, for example, the IDB has made only 340 loans out of a total of 1818 applications received from 1951 through 1955. While the Board should limit the extent to which it deals with the internal administration of the bank, this is not by any means the only sphere in which it can assist its operations. Directors should be selected from those who have high positions and recognized reputations in finance and industry, and they should be able to use their influence and connections to further the interests of the bank. They may also be expected to consider that one of their principal functions is to protect the management of the bank against outside pressures.

THE INDUSTRIAL DEVELOPMENT BANK OF TURKEY

I. Background and Purpose

As soon as the IBRD became active in Turkey, it was clear that one of the most significant contributions to be made was in the field of promoting private industrial development. To meet the double needs of stimulating private enterprise and industrial activity and of fostering a capital market by which private industry could finance itself, a proposal was worked out between the IBRD and the Turkish Government and business community to establish the Industrial Development Bank of Turkey, which was done in June 1950, with private management and private equity capital to assure its independence of political influence.

The purposes of the IDB are laid down in its statutes as follows:

> To support and stimulate the establishment of new private enterprises and the expansion and modernization of existing private enterprises in Turkey; to encourage and assist the participation of private capital, both domestic and foreign, in industry established in Turkey; and to encourage and promote the private ownership of securities pertaining to Turkish industry and to assist in the development of a securities market in Turkey.
>
> For these purposes, the Bank is empowered to make loans of any duration with or without any guarantee; to take participation in private industrial enterprises; in exceptional cases to establish new enterprises; and to provide technical and administrative assistance to its clients.

Particulars of the Bank's capitalization, management and operational record are given below.

II. Capitalization

1. At effective date of loan agreement with IBRD, February, 1951	Turkish Lire	Equivalent in U.S.$
Issued common stock in T.L.	12,500,000	4,464,285
Loan from Central Bank in T.L.	12,500,000	4,464,285
Loan from IBRD	25,200,000	9,000,000
	50,200,000	17,928,570

	Turkish Lire	Equivalent in U.S.$
2. <u>After obtaining agency for administration of Marshall Plan Private Enterprise Fund in August, 1951</u>		
Issued common stock in T.L.	12,500,000	4,464,285
Loan from Central Bank in T.L.	12,500,000	4,464,285
Loan from IBRD in foreign exchange	25,200,000	9,000,000
Marshall Plan Private Enterprise Fund in T.L.	54,500,000	19,464,285
	104,700,000	37,392,855
3. <u>Situation at end of 1955 after second stock issues, second IBRD loan, further borrowings in Turkey and additional resources of Marshall Plan Funds.</u>		
Issued common stock in T.L.	25,000,000	8,928,570
Reserves and surplus in T.L.	5,670,915	2,025,326
Two loans from Central Bank in T.L.	25,000,000	8,928,570
Two loans from IBRD in foreign exchange	50,400,000	18,000,000
Marshall Plan Private Enterprise Fund in T.L.	74,000,000	26,428,571
	180,070,915	64,310,967

The original common stock issue of T.L. 12.5 million was taken up by 13 commercial banks and 5 business corporations; the second issue, also of T.L. 12.5 million was subscribed by 214 individual and institutional investors, and as a result of market trading, is now held by over 400 investors. The success of the issue may be attributed to the financial success of IDB's operations, and to the promise before the issue was made that dividends would be raised from 6% to 12%.

The ratio of borrowings to equity (capital stock plus reserves) was initially limited to 3 - 1, but in order to permit an increase of earnings attributable to the issued capital, the limitation was raised to permit a ratio of 4 - 1 before the second stock issue took place. The Bank has not in fact borrowed up to this limit (the Marshall Plan Private Enterprise Fund is not counted as debt since no liability falls on IDB). The terms of borrowings have been as follows: both IBRD loans were for 15 years, the first at 3 3/4%, and the second at 4 7/8%; the loans from the Turkish Central Bank were for 15 years at 5%.

Following negotiations between the U.S. and Turkish Government, the IDB contracted with the Turkish Government in August 1951 to manage the lending of that part of counterpart funds in Turkey that had been allocated to the finance of private enterprise, under the title of the Marshall Plan Private Enterprise Fund. Ther terms of the contract are as follows:

(a) The Fund is to be managed exclusively by the IDB for a period of fifteen years. (As the IDB is only an agent for the management of the Fund, it bears no liability whatever for losses arising out of loans made from the Fund);

(b) For this service the IDB receives a commission, calculated as follows: (1) until the resources of the Fund were fully invested, a flat commission of T.L. 500,000 per annum, plus a proportional commission of 1 1/4 percent on the loans outstanding from the Fund; (2) After the Fund was fully invested (and became a revolving fund) the IDB receives a commission of 2 1/2 percent of the amount of loans outstanding, representing an important addition to its earnings;

(c) Certain criteria not exclusively commercial in character are laid down for deciding loan applications; after an application had met these criteria, it was to be assessed in accordance with sound banking standards, on the same lines that IDB would follow in investing its own funds.

III. Management

Board of Directors. Seven directors are elected by the general assembly of shareholders in conformity with the provisions of Turkish commercial code. One member is selected by the Central Bank from candidates selected from amongst the stockholders and belonging to the banking profession, and the rest are elected from among the other shareholders. The term of office is three years and members can be re-elected. The Board elects a president and a deputy president every year from among its members. The title of presidency does not confer upon the president any other privilege than that of ensuring the regularity of proceedings and presiding over the meetings of the general assembly of shareholders.

Powers of the Board. The Board has absolute authority in administering the business of the Bank, and representing it vis-a-vis third parties. It may, however, delegate a certain portion of its powers to one or more of its members or to the general manager.

The General Management. The general management consists of the general manager and assistant general managers and is selected by the Board of Directors either from amongst the members of the Board or from outside. The general manager and assistant managers may be invited to participate in Board meetings without, however, having the right to vote.

IV. The Bank's Record

The IDB, which had been established in June 1950, did not start active operations until March 1951. In August the Bank took over the responsibility of the lending of the Marshall Plan Private Enterprise Fund, totalling T.L. 54.5 million, of which T.L. 17.3 million was already invested. During 1951 the Bank received the very large number of 664 applications totalling T.L. 230,284,995. The work of assessing these proved slow and burdensome, on account of the difficulty of obtaining information from businessmen who either did not keep adequate records or who were unaccustomed to dealing with a modern financial institution and were, therefore, reluctant to reveal particulars of their affairs.

There was, in addition, some delay in employing the proceeds of the first IBRD loan partly on account of the problem of the exchange risk. The Turkish Government had refused to assume this risk; IDB was not in a position to do so, as it was conceivable that a fluctuation in the exchange might impair its capital; and ultimate borrowers were unwilling to bear the risk, particularly where dollars were to be used for the purchase of equipment from European countries. This stalemate was broken in 1953 when the ultimate borrower was relieved of the risk, by arrangements made between the IDB and the Central Bank, the borrower paying a fee for this service; the knowledge that this agreement was being negotiated permitted the employment of some of the proceeds of the IBRD loan in 1952. The employment of the loan at the end of 1955 is shown in the following table, which gives the sources of the funds which the Bank had invested at that date.

Table I

Sources of Funds Invested up to December 31, 1955

	T.L.	U.S. $
The Bank's own resources in T.L.	30,753,353	10,983,340
From the IBRD loan in foreign exchange	44,344,302	15,837,250
From the Marshall Plan Private Enterprise Fund in T.L.	69,800,952	24,928,911
Gross total of investments	144,898,607	51,749,501

It was also in 1952 that the Bank took its first equity participation but it has not done a great deal of business of this kind over the succeeding years. Subscriptions to equity at the end of 1955 amounted to T.L. 1,089,500 or less than 1% of the gross total of the Bank's investments (though the Bank has agreed a further T.L. 2,609,000 of equity participations). The balance of the Bank's investments are in the form of loans. The rate on the Bank's industrial lending was formerly 6% and is now 7%. Of the Bank's total investments outstanding at the end of 1955, 75% were long-term, and the balance short-term advances against documents, bills of exchange, etc.

The Bank has been very active, and it would appear that Turkish enterprise was about to enter a period of expansion at the time of its establishment. IDB is a relatively large source of finance in the Turkish economy, and it has been estimated that the enterprises which it has financed will increase the industrial income of Turkey by at least 10% annually. It is not, of course, possible to tell how much of this increase in production would have taken place without the Bank's investments; but it cannot be questioned that it has played a significant role as a catalyst for economic development. It has fulfilled its purpose both in this respect and as a channel for foreign exchange from IBRD into the field of private enterprise. It has also acted as a mobilizer of private capital by way of its own stock issues, the second of which was taken up by over 200 individuals and institutions.

The growth of the Bank's business is shown in the following table, which shows the fate of applications received from the start of its operations in 1951, to the end of 1955, which is the date of the Bank's most recent report and accounts.

Table II

Fate of Applications Received from 1951 through 1955

Applications	1951		1952		1953		1954		1955		Total to December 31, 1955	
	Number	Amount in TL	Number	Amount in TL	Number	Amount in TL	Number	Amount in TL	Number	Amount in TL	Number	Amount in TL
Total	664	230,284,995	427	145,516,373	244	79,564,574	225	100,595,384	258	88,115,607	1,818	664,076,933
Cancelled or Rejected	239	46,670,339	364	115,280,984	210	66,494,292	59	13,742,646	166	67,154,613	1,038	309,342,874
Approved	66*	32,983,305	73	47,730,200	76	19,911,810	78	32,515,983	17	11,757,312	310	144,898,610

*Note: This includes 8 loans totalling TL 17,255,000 which had been advanced by the Marshall Plan Private Enterprise Fund prior to August 1951, when the Bank took over the administration of the Fund. The loans actually approved by the Bank during 1951 were 58 in number, totalling TL 15,728,305.

Table III shows the growth of the profits of IDB, from a deficit in its first year, before it started lending, to a sizeable profit in recent years. The increase in dividends from 6% to 12% took place following the Bank's second stock issue.

Table III

Net Profits

	T.L.	Dividend %
1950	- 107,378	
1951	106,557	6
1952	681,767	6
1953	980,549	6
1954	2,811,143	12
1955	4,810,017	12

Table IV shows the distribution of loans by size groups, and Table V their distribution by individual categories, both as of December 31, 1955.

Table IV

Distribution of Loans by Size Groups as of December 31, 1955

Size Group of Loans			Number of Loans	%	Amount in T.L. 1,000	%
T.L.	0	50,000	111	35.9	2,142	1.5
T.L.	50,001	100,000	33	10.6	2,677	1.8
T.L.	100,001	500,000	96	31.2	25,768	17.8
T.L.	500,001	1,000,000	24	7.7	17,572	12.1
T.L.	1,000,001 -	and over	46	14.6	96,739	66.8
			310	100.0	144,898	100.0

Table V

Distribution of Investments by Industry as of December 31, 1955

	Number of Borrowers	Amount in T.L.
Food products	52	22,278,334
Wines	3	1,186,920
Textile production	49	53,631,988
Timber and wood products	6	2,981,217
Wood pulp and its manufactures	3	568,940
Leather and leather products	3	118,500
Rubber products	1	42,592
Chemical and pharmaceutical products	28	12,367,183
Stone, earthenware, glass and ceramics	29	30,388,938
Smelting	6	7,955,671
Metal goods	9	3,119,566
Machinery	8	1,729,950
Transportation	6	1,916,090
Repair and maintenance shops	87	2,527,126
Mining and mineral processing	5	1,323,571
Other industries	15	2,762,024
	310	144,898,610

THE DEVELOPMENT BANK OF ETHIOPIA

I. Background and Purpose

The lack of private sources of long-term finance provides the background for the establishment by Imperial Charter in March 1951 of the development Bank of Ethiopia. The only institution in the country that was able to make even medium-term loans was the Central Bank, which was however reluctant to do so at the time, though its attitude has since changed. The government-owned Agricultural and Commercial Bank, an institution with a capital of Eth. $1 million which made loans to small farmers within the province of Shoa, was merged with the Development Bank when the latter was created.

The entire resources of the Development Bank are provided by the government, partly in local currency, and partly in the form of the proceeds of a loan made to the government by IBRD. Its purposes are set out in its Charter as follows:

(a) to assist in the development of industrial and agricultural production;

(b) to foster the investment of private capital for productive purposes.

To enable it to carry out its purposes, the Bank has the following powers: to make loans; to purchase stocks or other "evidence of ownership" and to manage enterprises. Its Charter also lays down that "in the conduct of all its affairs the Bank shall act prudently. In making, guaranteeing or participating in loans it shall pay due regard to the prospects of repayment, and in making other investments it shall pay due regard to the prospects that such investments will have value and yield returns commensurate with the amounts invested".

II. Capitalization

The authorized capital is Eth. $13 million (equivalent to U.S. $5.2 million) of which Eth. $11 million represents the common stock and Eth. $2 million the preferred stock (which is to be offered for sale under conditions to be determined by the Board). The common stock (of which Eth. $8,287,678 (U.S.$3,314,671) had been paid up at December 31, 1955) is for subscription by the government as follows:

(a) Eth.$2 million (U.S.$800,000) payable in cash immediately upon the formation of the bank;

(b) Eth.$1 million (U.S.$400,000) issued to the Ethiopian Government in exchange for the assets of the Agricultural and Commercial Bank;

(c) Eth.$3 million (U.S.$1,200,000) payable in cash by the government as and when called by the Board (and of which Eth.$2 million had been paid up at December 31, 1955. The Bank was sufficiently liquid at that time not to require the balance of the government's subscription).

(d) Eth.$5 million (U.S.$2,000,000) representing the counterpart of the loan made to the government by IBRD and passed on by the government to the Development Bank. As the Bank draws upon proceeds of the loan so it credits the Ethiopian Government with equivalent amounts of paid-up stock, the total of which now outstanding amounts to Eth.$3,287,678 (U.S.$1,315,071). Of the balance of Eth.$1,712,322 (U.S. $684,929), Eth.$833,333 (U.S.$333,333) represents part of the IBRD loan that will become available only after payment of the balance of the Ethiopian Government's subscription, amounting to Eth.$1 million which the Bank has not called for, the reason given in para.(c).

III. Management

Board of Directors

The Board must consist of not less than five nor more than seven directors, all of whom are appointed by the Emperor, who also appoints a president and a vice-president from amongst them.

Powers of the Board. All corporate powers reside with the Board.

Management. The Emperor also designates a managing director, with whom the Board must enter into a contract of employment. The managing director is a member of the Board. His functions are as follows:

(i) He is the chief executive of the Bank and directs its management and operations subject to the general direction of the Board;

(ii) He has authority to employ and dismiss all the staff of the Bank.

IV. The Bank's Record

The Bank appears to have carried out the injunction of its Charter, to act with prudence in circumstances which may well not have been entirely favorable to its operations. Progress has been slow, but the Bank has managed to make a profit. Difficulty has been experienced in getting repayments on some of the small agricultural loans. It should be noted that this Bank differs from the IDB of Turkey which was established contemporaneously, in that it found itself engaged in a considerable amount of agricultural business. A major problem that it appears to have met is a lack of opportunities for what may be called development financing proper. In order to find an outlet for its funds the Bank has engaged in a certain amount of non-development financing in the form of short-term loans to traders and medium-term loans for the development of urban real estate. These transactions

Table I

Number and Amount of Investments made from 1951 through 1955

Category of Investment	1951 No.	1951 Eth.$	1952 No.	1952 Eth.$	1953 No.	1953 Eth.$	1954 No.	1954 Eth.$	1955 No.	1955 Eth.$	Total 1951-1955 No.	Total 1951-1955 Eth.$
Industrial	4	72,400	22	3,139,608	2	389,198	25	1,541,525	32	1,538,822	85	6,678,554
Agricultural Development loans	8	78,200	7	64,433	19	158,500	36	485,000	34	301,030	104	1,087,163
Coffee loans by Jimma branch	-	-	-	-	-	-	55	105,500	76	170,750	133	276,250
Small agricultural loans	88	83,175	69	85,550	106	100,575	108	129,700	116	135,750	487	534,750
Total	96	161,375	76	149,983	125	259,075	199	720,200	228	607,530	724	1,898,163
Other	-	-	-	-	31	483,990	23	58,200	25	108,007	79	650,197
TOTAL	100	233,775	98	3,289,591	158	1,132,263	247	2,319,925	285	2,254,359	888	9,226,914

are covered by the category "other loans" in the Table overleaf which gives the Bank's investment record. The Table shows that from the start of operations in 1951 the Bank has made 888 loans amounting to a gross total of Eth.$9,226,914 (U.S.$3,690,765). The total amount of investments outstanding at December 31, 1955, net of repayments, was Eth.$7,536,094 (U.S.$3,014,437). Of this amount Eth.$7,236,094 was in the form of loans, the balance of Eth.$300,000 representing the entire issued common stock of the Ceres Company, a trading enterprise. The Bank also had loans outstanding to the Ceres Company amounting to Eth.$688,729 at the end of 1955.

The industrial loans were mainly to enterprises engaged in the processing of agricultural products, such as cotton mills, oil seed mills, soap factories and meat refrigeration. They include the equity of, and loans to the Ceres Company.

The agricultural loans were made for tools, work animals and farm improvements. They include those taken over from the Agricultural Bank, all of which were up to Eth.$2,000, repayable in three years, rate 3 to 6%. Those which have since been made by the DBE range in amount from Eth.$1,500 to $30,000, for 3-5 years at 5 to 6%. They include loans for coffee production which are part of an experiment in the cultivation of coffee under forest conditions.

The following table shows how the Bank has managed to make a profit on the basis of a relatively small volume of business.

Table II

Net Profit

	Eth. $
7 1/2 months to April 30, 1951	- 120,000
12 months to April 30,	
1952	- 130,000
1953	57,000
1954	250,000
1955	226,000

THE INDUSTRIAL CREDIT AND INVESTMENT CORPORATION OF INDIA

I. Background and Purpose

The Corporation, which is a unique example of financial cooperation between private investors in three continents, an international organization and two governments, was established in January 1955 for the purpose of stimulating private industrial enterprise in India. It is incorporated under company law and its common stock has been subscribed exclusively by private investors though as a consequence of the nationalization of insurance companies, 16% of the Corporation's total issued capital has passed into government ownership for the time being.

The Corporation may be regarded as an addition to the armory of new financial institutions which have been established in India since the end of the war for the purpose of financing industry. There are now three central financial institutions, and also a number of state institutions established by the provincial governments for the purpose of financing small enterprise. The first of the central institutions, the Industrial Finance Corporation, was established in July 1948 for the purpose of making medium- and long-term investments in industry in circumstances where recourse to the capital market was considered inadvisable. Although empowered to provide finance in a variety of forms, it has confined its business to the making of mortgage loans (the total of which outstanding as at the end of March 1955 amounted to Rs. 252 million, which is equivalent to U.S.$52,774,869). Of the Corporation's issued capital of Rs. 50 million (U.S.$10,471,204), Rs. 20.3 million (U.S.$4,251,308) has been subscribed by the government and the central bank, and the balance by private financial institutions. The second institution is the National Industrial Development Corporation, owned and financed by the government, and possessing very wide powers to finance, promote and manage private and public industrial enterprises. It was established in October 1954, and has not so far done a great deal of business; it is perhaps too early to assess precisely the role it will play in the Indian capital market.

The third institution, the ICICI, is expected to supplement the work of the others in two different ways; first by providing finance for industry by way of loans and subscriptions to capital stock (its assistance is however, intended to be mainly in the latter form); and secondly by cooperating with the private capital market as a whole in carrying out the underwriting of public issued. By the end of its first year of operation, the Corporation has shown promise of fulfilling both these purposes satisfactorily; and it is perhaps particularly worthy of note that the Corporation is assisting in the establishment of a more efficient underwriting machinery than the Indian capital market had previously known.

The Corporation's purposes as laid down in its Articles of Association are as follows:

(1) To carry on the business of assisting industrial enterprises within the private sector of industry in India, in general by:

(i) assisting in their creation, expansion and modernization;

(ii) encouraging and promoting the participation of private capital, both internal and external, in such enterprises;

(iii) Encouraging and promoting private ownership of industrial investments and the expansion of investment markets;

and in particular by:

(i) providing finance in the form of long- or medium-term loans or equity participations;

(ii) sponsoring and underwriting new issues of shares and securities;

(iii) guaranteeing loans from other private investment sources;

(iv) making funds available for re-investment by revolving investments as rapidly as prudent;

(v) furnishing managerial, technical and administrative advice and assisting in obtaining managerial, technical and administrative services to Indian industry.

II. Capitalization

	Rupees	Equivalent in U.S.$
Issued common stock	50,000,000	10,471,204
Government advance	75,000,000	15,706,806
IBRD loan (in U.S. dollars or other currencies)	47,750,000	10,000,000
Total initial resource	172,750,000	36,178,010

The authorized capital stock is Rs. 250 million, of which Rs. 50 million has been issued to shareholders in India, the U.K. and the U.S., as shown in the table below, on the basis that no single individual or class of stockholders shall have effective control of the Corporation.

The Corporation's borrowing powers are limited in relation to its equity capital. Total indebtedness may not exceed three times the total of the unimpaired capital plus reserves, plus the amount of the government advance outstanding.

A most important contribution to the Corporation's earning power, and its ability to take risks, is the government's advance (representing the counterpart of an American gift of steel). This is interest free and repayable by 15 equal annual instalments beginning in the 16th year. The government has the right to appoint a director, and to veto any increase in the Corporation's share capital. If the capital of the Corporation, including the government advance is impaired by 20%, the government, the Corporation and IBRD are to examine the situation and discuss remedial action; if by 30%, the government, acting in consultation with IBRD and the Corporation may apply for a court order to wind up the Corporation. Twenty five per cent of profits must be put to reserve until reserves are equivalent to the amount of the government advance.

The IBRD loan has a maturity of 14 years.

The total issued capital stock of ICICI is Rs. 50 million (U.S. $10.47 million) distributed as follows:

Distribution of Stockholdings

		Rs. Million	%
British and American interest in U.K. and U.S.		15	30
British and Commonwealth life assurance companies in India	1.3		
Indian life assurance companies	6.7		
Total life assurance in India		8	16
Indian investing public		15	30
Indian banks, directors of ICICI, etc.,		12	24
		50	100

The British subscription is divided between 8 Eastern Exchange Banks, 30 leading insurance companies, the Commonwealth Development Finance Company Ltd., and 5 industrial corporations. The American investors are the Bank of America, the Rockefeller Bros., the Olin Mathieson Chemical Corp., and Westinghouse International Corporation.

III. Management

Board of Directors. The Board consists of not less than five and not more than ten members not including the government director and debenture director (if any). The President of India has the right to appoint a government director as long as the government advance remains unpaid. Provision is made for the appointment of a debenture director to represent debenture holders should the Corporation issue any debentures. The first Board of directors was nominated to serve until the first general ordinary meeting of the Corporation (though remaining eligible for re-election by the shareholders).

Subsequent Boards are elected by the shareholders, and one-third of their members retire from office every year, while remaining eligible for re-election. The chairman of the Board is elected by the directors.

Powers of Directors. Power to manage the business of the Corporation is vested in the Directors, including the power to appoint the manager and staff.

IV. The Corporation's Record

The Corporation completed its first year of operations on December 31, 1955. Most of the Corporation's resources are still held in the form of quoted securities which will be liquidated as and when funds are required for its own customers. During the year the Corporation had agreed to give financial assistance of one kind or another in 11 cases, of which 5 related to the underwriting of public issues of common or preferred stock, 4 to direct subscriptions to such stock, and 2 to loans, (the total amount actually advanced being Rs. 7,664,550 (U.S.$1,605,141) of which Rs. 6,639,550 (U.S.$1,390,481) is in the form of preferred and ordinary stock). The rate on loans has been 6 to 7%, and the charge for underwriting 2%, plus 1% brokerage.

In its underwriting activities, the Corporation has made very thorough investigations of the enterprises concerned before agreeing to support their offer of securities to investors. It has also made it a condition of underwriting the issues that the offer should be made to the public, rather than, as is often the case, to an inner circle of the directors of the enterprise and friends of the promoters. The Corporation is also organizing teams of underwriters, and it is likely that in future years there will be joint underwriting of issues by ICICI, insurance companies, brokers, and special development institutions.

Industries which the Corporation had agreed to assist were the manufacture of paper, electric equipment, fuel injection equipment, textile machinery; sugar refining, the processing of metallic ores, and cotton spinning.

No investments have been made out of the proceeds of the IBRD loan for two reasons: firstly, no arrangement has been made as to who will carry the exchange risk, and secondly, foreign exchange has been available to industry from the Reserve Bank of India, with no liability to exchange risk. A demand for the use of the IBRD loan is likely to arise should there be a decline in the Reserve Bank's holdings of foreign exchange.

THE DEVELOPMENT FINANCE CORPORATION OF CEYLON

I. Background and Purpose

The Development Finance Corporation of Ceylon was set up by an Act of Parliament of October 4, 1955, to meet a deficiency in the supply of long-term capital for industry, and to provide technical and managerial advice to enterprises in the private sector. There is no lack of bank credit in Ceylon but both the Central Bank and the private banks confine themselves to short-term business, principally the finance of trade.

The Corporation is a smaller and less ambitious organization than the ICIC of India, which, however, it resembles in its general conception. Its purposes are formulated in similar terms, as follows:

> The purposes of the Corporation are to assist in the establishment, expansion and modernization of private industrial and agricultural enterprises in Ceylon, and to encourage and promote the participation of private capital, both internal and external, in such enterprises. To carry them out it is empowered to make medium or long-term loans with or without security, take participations, underwrite new issues, guarantee loans and furnish technical and managerial assistance.

The DFCC started operations only on May 15, 1956, and therefore has no record to speak of. Its capitalization is given in Table I, the distribution of shareholdings is given in Table II, after which follows an outline of the Corporation's management.

II. Capitalization

	Rupees	Equivalent in U.S.$
Issued common stock	6,000,000	1,250,000
Borrowing power from the Government of Ceylon	16,000,000	3,333,333
Borrowing power from IBRD	24,000,000	5,000,000
	46,000,000	9,583,333

The Corporation was set up with an authorized capital stock of Rs. 8 million, of which Rs. 6 million had to be subscribed before it could start business. This was done by May 15, 1956; the distribution of applications for shares in April 1956 is shown in Table II below. The amount of stock issued is now over Rs. 7,000,000.

Provision is made for the borrowing from the Government of Ceylon of Rs. 16 million, free of interest, to be repayable by 15 instalments, the first of which would fall in the 16th year of the loan. This counts as capital rather than debt until repayments fall due.

While this advance is outstanding, (a) the Corporation shall set aside 20% of its net profits to a special redemption reserve, until the amount of this reserve equals the amount of the loan then outstanding; (b) the Corporation shall not distribute a dividend of more than 12%; (c) if the capital of the Corporation is impaired by 30%, the government shall have the right to request the shareholders to replenish the capital and if this is not done, to require the liquidation of the Corporation. In the event of liquidation the government loan ranks after the share capital.

The government will guarantee a loan to the Corporation from IBRD of not more than the equivalent of Rs. 24,000,000. No such borrowing had been made at the time of writing.

The following table shows the distribution of applications for shares in the Corporation as of March 23, 1956, but not the final allotment of shares:

Distribution of Applications for Shares as of March 23, 1956

	No. of Stockholders	Amount of Shareholdings, Rs.
Bank of Ceylon	1	2,800,000
Eastern Exchange Banks (London)	6	2,000,000
Individuals	162	290,500
Indian and Pakistan Banks	3	200,000
British Corporations	2	7,500
Ceylon insurance companies	1	50,000
Directors	6	41,000
Ceylonese Corporations	4	33,500
Ceylonese estate companies	1	5,000
Life insurance companies		
Foreign	1	100,000
National	1	2,000
	188	5,541,600

Note: Between the date of this table and the time of writing the total of subscriptions had increased to over Rs. 7,000,000, the additional subscriptions coming principally from Ceylonese investors.

III. Management

Board of Directors. Apart from three special appointments, the number of regular directors (or shareholder directors, as they are called) is not less than four or more than six. The initial Board is appointed by the Minister of Finance, and at the end of each financial year, one of the initial shareholder directors retires, and his successor is elected by the shareholders. The majority of shareholder directors must be citizens of Ceylon. A chairman is elected by the Board from amongst the shareholder directors. In addition, as long as there is any loan outstanding from the government to the Corporation the Minister of Finance has the power to appoint a government director; and there are also two ex-officio directors without voting rights; (1) the director of the Ceylon Institute of Scientific and Industrial Research; (2) the general manager of the Corporation.

Powers of the Board. The general supervision and control of the business of the Corporation is vested in the Board. Amongst other things the Board has the duty to ensure that every application is considered strictly on its financial and economic merits irrespective of all other considerations.

The Management. The Board appoints a general manager who is the chief executive officer of the Corporation subject to the direction of the Board of Directors.