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Private Capital for Developing Countries

by a former Adviser of the Commonwealth Development Finance Company, Ltd, London

A number of national and multinational institutions have been established in recent years to invest capital raised in industrially-advanced countries in specific private enterprise projects in developing countries. The purpose of this article is to examine the experience of one of the oldest institutions of this type—the Commonwealth Development Finance Company Limited of London¹.

Forerunner of Similar Institutions

When CDFC was formed in 1953, the idea of creating a specialised institution to invest in developing countries was new and challenging. The International Finance Corporation was not formed until 1956. Similar national financial institutions in other European countries were not formed until the 1960s—the Deutsche Gesellschaft für Wirtschaftliche Zusammenarbeit (Entwicklungsgesellschaft) mbH (the DEG) in 1962, the Nederlandse Investeringsbank voor Ontwikkelingslanden in 1965 and the Industrialisation Fund for Developing Countries in Denmark in 1968. Indeed, CDFC is probably best classified as a forerunner of the new type of multinational corporation formed by a wide range of financial institutions and companies in Europe, the United States, Canada and Japan—the ADELA Investment Company (formed in 1964) to invest in Latin America and PICA, the Private Investment Company for Asia, (formed in 1968).

CDFC is best compared with ADELA and PICA because it uses only private capital for its investments, because it concentrates on supporting commercially viable private enterprise projects, and because the Company was formed by a similar group of sponsors. CDFC is controlled by a Board of eleven Directors. The majority of these represent the 160 leading companies broadly representative of British Industry and the City of London who own 55 p.c. of the Company's

equity capital. The remaining 45 p.c. of the ordinary shares are held by the Bank of England and Central Banks of certain other Commonwealth countries².

The present pattern of ownership reflects the purpose for which the Company was originally formed. When the Commonwealth Finance Ministers met in September 1952, they discussed the possibility of finding new ways for London to expand its role of supplying the major part of the foreign capital required by Commonwealth countries. The intended formation of CDFC to act as an intermediary between would-be borrowers in Commonwealth countries and the London capital market was announced at this meeting. CDFC was discussed again by the Commonwealth Finance Ministers in 1958, but the pattern of ownership remained virtually the same³.

CDFC's Experience with Investments

When the CDFC was formed in 1953, some observers doubted whether the aspirations of helping the developing countries as much as possible could be successfully combined with the goal of commercially profitable operations. But over the years the conditions for foreign investment steadily improved and CDFC's experience suggests that the risks of investing in developing countries may frequently be over-estimated. In the 16 years to March 31, 1969, the Company committed nearly £40 mn for investment in 105 projects in 27 different Commonwealth countries. Of these 105 investments, 9 had been repaid or sold by March 31, 1969. Of the 96 remaining, 5 were located in Australia, 3 in New Zealand, 7 in Canada and 3 in South Africa. In Africa, 23 investments had been made in 10 developing countries. A total of 42 investments had been made in six developing countries in Asia; this

¹ The Company is widely known as CDFC. These initials should not be confused with CDC — the Commonwealth Development Corporation (formerly the Colonial Development Corporation) which was formed by the British Government in 1948. CDFC is a finance house using private capital; CDC is an institution similar to the Kreditanstalt für Wiederaufbau, which invests in a much wider range of development projects using mainly Government funds and taking management responsibility for most of the projects in which it invests.

² CDFC's authorised equity capital is £30 mn. At present, £26.33 mn has been issued and £7.33 mn called up in the form of cash resources. The issued equity capital consists of £14.59 mn 1 'A' ordinary shares held by private enterprise companies and institutions which are only 10 p.c. paid up, and £11.74 mn 1 'B' ordinary shares held by the Bank of England and other Central Banks which are 50 p.c. paid up. Under CDFC's present Memorandum of Association, the call on the 'A' shares cannot be raised above 10 p.c. until the 'B' shares have become fully paid.

³ In 1959, The Central Banks of certain Commonwealth countries subscribed for 0.85 mn 'B' shares.

included 23 investments in industrial projects in India alone. There were 9 investments in developing countries in the Caribbean. Of the £27.8 mn invested in these 96 projects, £17.2 mn was invested in industrial projects; public utilities claimed £4.4 mn; agriculture, forestry and food processing projects £2.8 mn; hotels and property £1.3 mn; miscellaneous projects £1.3 mn and investment in local development finance companies £0.8 mn.

CDFC's investments have not suffered seriously so far from what are called "political risks"; the Rhodesian element in the Company's investment portfolio is affected by the present Rhodesian prohibition on remittances, but no losses have been incurred so far due to expropriation of assets or war damage. Commercial risks have been successfully minimised by careful pre-investment examination of each project and selection of those projects which were assured of sound management on a continuing basis.

If these conditions are satisfied, there is every reason to expect that an investment in a developing country will face less commercial risks and be more profitable than similar investments made in the much more competitive atmosphere of an industrially advanced country. CDFC's experience seems to have borne this out as far as the commercial risks are concerned; the only losses incurred have been small ones in certain Australian enterprises rather than from the Company's much more numerous investments in developing countries. Some projects have faced hard times, but with CDFC and other shareholders' help, the situation has been corrected in time⁴.

CDFC's Profit Record

For various reasons, the Company's profit record neither proves or disproves the postulate that investment in developing countries should be more profitable. After a slow start, pre-tax profits reached £203,000 in 1958-59 and £546,000 in 1964-65. However, because of the high cost of borrowing in London over the last five years, they have only risen above the 1964-65 figure once so far—in 1967-68 when profits included substantial capital gains from one investment. Profits are best measured as a return on the equity capital of £7.3 mn. For the five-year period ending March 31, 1963, the ratio of pre-tax profits to the equity capital averaged 5 p.c.; for the six years to March 31, 1969, it averaged 7 p.c. No dividend was paid by the Company for the first ten years but

a dividend of 3 p.c. has been paid in each of the last years.

Some of the reasons for the slow growth in CDFC's profit earning capacity have been analysed in detail elsewhere⁵. The main reason was the Company's heavy concentration on loan financing. Loans still account for nearly 80 p.c. of the disbursed portfolio; over one third of the present portfolio was committed in the 1950s, when the Company's directors appear to have felt that they should charge the lowest possible rate of interest commercial prudence would permit to help the project itself and the country in which it was located. As the outstanding part of these loans is repaid, the Company's financial position will steadily improve. Higher rates of interest have been charged on loans made in the 1960s and the average yield of the loan portfolio has been rising steadily; it is now almost up to 7.5 p.c.

Sources of Finance

CDFC's profit earning capacity has been affected by the Company's financial structure and its sources of financing. Throughout the 1950s, the investment portfolio was financed by equity capital (increased from £1.5 mn at the start to £7.3 mn in 1959) and short-term borrowing from British commercial banks. At March 31, 1969, disbursed investments of £27.8 mn and certain current assets were financed by an equity capital of £7.3 mn, reserves of £2.3 mn, debenture stocks issued on the London market of £12.5 mn, and short-term advances of £6.8 mn from British commercial banks.

Although CDFC's main form of investment was long-term loans made at interest rates which reflected the current cost of borrowing in London at the time, it was not until 1963 that the Company decided to approach the London capital market by issuing £7.5 mn of 5.5 p.c. debenture stock maturing in 1983/86; a further £5 mn of 7.25 p.c. debenture stock maturing in 1984/88 was successfully raised in 1966. The long-term nature of this borrowing means that the Company will eventually have substantial funds at its disposal which are relatively cheap compared with the cost of raising the same volume of funds today. In the meantime, the Company will have to await the repayment of long-term loans committed in the 1950s at rates of interest which did not fully reflect the cost of money subsequently borrowed to finance them.

There have been three distinct phases in the evolution of the Company's investment policy.

⁴ The value of certain investments in Australia was written down by £54,000 in March 1968. A note to the March 31, 1969, Balance Sheet indicates that 'in view of the long term nature of the Company's interests, your Directors are of the opinion that no provision need at present be made in respect of the fluctuations in the current values of quoted or unquoted investments'.

⁵ See two articles on "The Commonwealth Development Finance Company Limited" in the *Banker's Magazine*, January and February, 1969.

Both the first phase — from 1953 until the late 1950s—and the second—from 1960 until 1968—were guided by the Company's first Chairman, Lord Godber, who came to CDFC after a distinguished career with Shell. The third and perhaps the most challenging phase has recently been launched by the new Chairman Sir George Bolton, a name which most readers will associate with the Bank of London and South America and the development of the Euro-dollar market.

Throughout the 1950s, CDFC was prepared to invest substantial sums in a wide range of expensive development projects, a majority of them outside the field of industry. South Africa and on occasions Canada and New Zealand were seen as suitable areas for investment as well as the developing countries of the Commonwealth. Contributions of £3 mn each were made to the financing of a newsprint mill in New Zealand and the giant Kariba dam in Central Africa. Other major projects financed included electricity supply projects in Jamaica, Malaysia and South Africa, a gas pipeline in Pakistan and uranium mining in Canada. Investments were also made in commercial projects to grow timber in Swaziland, sugar in Rhodesia, rubber in Nigeria and tea in Uganda. Nearly £10 mn had been committed to seven projects by March 1955; over the next four years a further £5.6 mn was committed to ten new projects. In all these investments, CDFC's decision was probably influenced as much by the developmental value of the projects as by its goal of achieving a good record of profitable investments. Most of the investments were in the form of long-term loans rather than equity capital.

By the end of the 1950s, finance for most types of development projects had become more readily available from such sources as the World Bank and bilateral aid. From 1960 onwards, therefore, CDFC steadily increased its portfolio of investments in industrial projects and by March 1968 this type of investment accounted for 60 p.c. of the total portfolio. The sums involved were not so large; between March 1963 and March 1968, £14.2 mn was committed to 54 projects, indicating an average investment of about £300,000. In the early 1960s, most of the investments were in the form of loans, but over the years the initially cautious policy of investing in the equity of new industrial projects was gradually relaxed, and equity investments accounted for 20 p.c. of the total portfolio by March 31, 1968. From 1965 onwards the Company was prepared to supply venture capital, in some cases mostly in the form of equity, to new enterprises in Canada (where it has a close association with the Canadian Enterprise Development Corpora-

tion) and in Australia (where it established a subsidiary company under its own management).

The New Investment Approach

The aim of the Company's new investment policy announced in May 1969 is to raise the amount of profits and dividends to a higher level so that it will be easier for the Company to raise additional equity capital in the future. In place of the past emphasis on loan financing, the aim is to increase profits by a greater concentration on equity investment and the rendering of financial services.

In the past, CDFC frequently supplied no more than 10 or 20 p.c. of the finance provided to a project in the form of equity finance and the remainder as long-term loans without conversion rights or share options attached. Loan or debenture finance will still be provided in the future if it is necessary to complete the financing arrangements in a way which maximises the return to the equity shareholders in a project. But CDFC's main interest is now in equity financing and the company will only finance those enterprises in which it can acquire a stake in the equity share capital, either directly at the outset or eventually through conversion rights or share options. However, as a financial partner, CDFC will never take more than a minority stake.

CDFC has pursued this policy in recent years for its investments of venture capital in young business enterprises in Australia and Canada with sound and progressive, but unproved, management teams. Now the Company is going to apply the same criteria to new industrial enterprises established in developing countries as well. The willingness to back such enterprises is not new; the 1966 Annual Report revealed that of the 48 industrial enterprises supported by the Company at that time, 13 were sponsored by local entrepreneurs and 25 were joint-ventures. What is new in the Company's policy is the decision that the Company neither needs to nor should it supply the majority part of its financing in the form of straightforward long-term loans.

The same criteria will be applied to investments in which CDFC is invited to be a financial partner of a British or other foreign firm investing in a developing country. The big internationally-minded firms do not require CDFC's assistance to share the risks involved in such investments, but small and medium size enterprises often do. CDFC has the experience of local conditions and on-the-spot contacts to help many such firms (whether British or not) to overcome their natural hesitancy to invest in a developing country for the

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GERMAN PRISM

The Economic Position of the Federal Republic in 1970

The growth margin of the gross domestic product in real terms will be smaller than in 1968 and 1969. Moreover, the decline of the growth rate should be less pronounced in the first half of 1970. For the whole of the year, however, a growth rate of the gross domestic product in real terms of a good 5 p.c. is still to be expected.

In 1970 demand is more influenced by consumption than in 1968 and 1969. In comparison, although investments should increase distinctly once more they will not show the dynamics of the preceding year. Finally, vis-à-vis 1969 a reduction of the external contribution (+ DM 13 bn) will have to be anticipated due to the DM revaluation and restrictive measures abroad. In the aggregate this development of demand will lead to an increase of the GNP at current prices by 9.4 p.c. At the same time a price increase of the GNP by 4 p.c. must be expected.

While gross wage and salary increases will be able to maintain their previous year's growth rate (+ 12.5 p.c.), gross incomes of entrepreneurs and from property, it is true, will still register a rising trend (+ 4 p.c.), but they will not reach the preceding years' growth rate.

Private Investment Abroad Increased

Private investment abroad of German industry generally, and particularly in developing countries, has grown again during the first nine months of 1969. On September 30, 1969, the total volume of private capital investment abroad had reached about DM 16.4 bn and thus had grown by DM 2 bn as compared with the beginning of the year. During this period the developing countries' share in these capital investments increased from 28.8 p.c. to 29.5 p.c.

German industry believes in the urgency of a continuous intensification of investment activities abroad, and mainly in less developed countries, for world-economic, national economic and operational reasons. On the one hand, it thus contributes to an equalisation of the balance of payments, and, on the other, it widens its production base by the establishment of new production

plants. This way the economic development of less developed countries is promoted and the Federal Republic's dependence on exports reduced. Simultaneously disturbing influences of any fluctuations of exchange rates are softened through a worldwide dispersion of production.

New Rolling Mill in India Put in Operation

In the presence of the Chief Minister of the Indian Federal State of Mysore the medium-sized mill train, and with that part of the new rolling mill of Mysore Iron & Steel Ltd. has been put in operation at Bhadravati.

The new rolling mills supplied and installed by DEMAG AG, Duisburg, constitute such a large part of the final equipment of the high-quality steel project of Bhadravati that it will soon reach its planned capacity of 72,000 tons of high-grade steel.

The basis of this project was a steel works that had also been supplied by DEMAG. The extension of the old plant to the present high-quality steel works, called Alloy and Special Steel Plant, that had been started at the end of 1964, brought DEMAG orders to the value of about DM 45 mn. Part of the total cost of the project was financed with a DM 60 mn credit given by the Reconstruction Loan Corporation. Together with the high-quality steel works at Durgapur the plant at Bhadravati will now become India's main supplier of special and high-grade steels. Hitherto production of these steel qualities lagged far behind demand in India.

Series of "omni"-Ships of Hamburg- Amerika-Linie

With its motor ship "Ludwigshafen" Hamburg-Amerika-Linie puts the first of four new constructions of its new class of ships in operation. The MS "Ludwigshafen" belongs to the series of "omni"-ships and this or the next year will have three sister ships. Although individual technical innovations installed in the "omni"-ships are not unprecedented, the sum total of innovations in one unit represents an optimum rarely to be found again.

"omni", this name stemming from the Latin word "omnis" means that the new units can be used

for "all" purposes. They are so expedient that they can serve the shipping companies' interests all over the world. Main aspect of these new ships is their usefulness for carrying cargo. The sum total of experiences undergone by HAPAG with its world wide liner services was at the beginning of the whole concept. The efficient and up-to-date transshipment of goods was the main target set for the shipbuilders. Therefore "omni"-ships are not only constructed for mixed cargo but also for the transport of unified loads, containers and liquid as well as solid bulk goods. Particularly bulky goods can also be transported by these vessels.

**10,000
Exhibitors
Expected at
Leipzig Fair**

Approx. 10,000 exhibitors from 65 countries announced their attendance at the Leipzig Spring Fair between March 1 and 10. The Federal Republic of Germany including West Berlin requires with 28,000 squaremeters the largest exhibition area, second only to the German Democratic Republic. A total of 1,020 exhibitors from the Federal Republic promised their attendance. The Soviet Union as most important trade partner of the GDR occupies an area of 13,000 squaremeters of the available space. The total exhibition area amounts to 350,000 squaremeters. The attendance of 2,000 exhibitors from East-bloc countries and 1,780 from Western states is expected.

**Industrial
Production
in Dec. 1969
Weaker than Usual**

After the vigorous business expansion in November, industrial production in December developed less strongly than usual at the season. As compared with November it declined by about 10 p.c. and thus decreased more than on a several-years-average of this season. The production decline of the capital goods industry, where a slight increase would have been seasonally usual, showed this trend with a particular clearness.

As compared with the previous year's corresponding period the growth rate of total industrial production declined from 11 p.c. to 7 p.c. in December. The growth rate was 11 p.c. (Nov. + 17 p.c.) in the capital goods industry, 9 p.c. (Nov. + 11 p.c.) in the basic industry and 6 p.c. (Nov. + 9 p.c.) in the consumer goods industry. The building industry was particularly affected by

inclement weather conditions and its performance remained 23 p.c. below the previous year's corresponding period.

**Siemens:
Many Incoming Orders
Expected**

Siemens anticipates for the current business year 1969/1970 an increase of new orders booked by 5 p.c. to approx. DM 14.5 bn and a growth rate of international turnover of probably DM 1.6 bn to DM 12 bn. Investment will reach about DM 1 bn, DM 200 mn of this sum total will be invested abroad. A further increase of the returns in absolute terms is expected. The development of proceeds depends above all on whether wage and salary increases will not remain as eruptive as they were during the last months and whether and to what extent it will be possible to enforce necessary price increases.

The business year 1968/69 brought a growth rate of incoming orders of 30 p.c. to DM 13.8 bn and a turnover increase by 19 p.c. to DM 10.4 bn. The share of foreign countries in these figures declined slightly to 40 (42) p.c. due to the particularly favourable business conditions in the domestic market. DM 912 (472) mn were invested including investments abroad that rose by 36 p.c. to DM 162 mn. Production capacities abroad expanded more than hitherto, due also to the lack of manpower in the Federal Republic.

The Annual Register 1969
of the Monthly Review
of International Trade and Development
INTERECONOMICS
is enclosed in this issue

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first time. It is very often the case that the experience and technology of this size of firm is best suited to the limited market available in the developing country concerned.

Financial Services

CDFC has played an active role in the establishment of many of the local industrial development banks established in developing countries in the Commonwealth over the last 15 years. The Company's investment in those new privately-controlled financial institutions has usually been a small one, but in three countries—India, Pakistan and Ceylon—CDFC organised substantial subscriptions to the initial equity capital from a range of British companies and financial institutions. The working relationship is much closer. In many cases, CDFC has invested in projects supported by the local industrial development finance company. And as CDFC does not maintain offices abroad, most of these institutions act as a correspondent through which local investors can learn about CDFC and make their preliminary contact with the London office.

CDFC's assistance is not confined to the investing of money. As a City of London institution, CDFC is prepared to act as financial adviser as well as financier, particularly for those firms whose management has little experience in this sphere. A fee will be charged for any services rendered. The full range of financial services and advice will be based on CDFC's own wide experience and that which it can call upon from any of its numerous shareholders. As there are 160 of those, there cannot be many branches in industry in which CDFC does not have potential access to at least some broad general advice on the choice of appropriate technology etc.

CDFC's operations should therefore become increasingly profitable in the years ahead as the low earning power of the loans in its existing portfolio is replaced by more profitable investments. The new policy of providing financial backing for sound but unproved management at an early stage in a business enterprise's development will give the portfolio something of the flavour of a "go-go" or "performance" mutual fund. These risks will be greater, but the rewards in terms of capital gains could be much greater than those achieved with equity investments so far. But given the present state of the capital market in most developing countries, these gains may take much longer to realise than they would for similar investment made in the West.

CDFC's directors consider the new emphasis on equity financing to be appropriate for the situa-

tion which the Company faces today in most of the countries in which it has invested in the past. Over the last 10-15 years, most of the developing countries in the Commonwealth have established their own institutions specialising in supplying long-term finance for privately-owned industrial enterprises. But whilst these local industrial development banks can usually supply most of the loan finance required, few of them are prepared to provide sizeable investments in the form of equity financing for enterprises whose management is not already proved and established. As a result, many business enterprises are operating in developing countries with an inadequate volume of equity financing in their over-all capital structure, and many promising smaller enterprises never obtain access to the equity funds which they need in order to grow. CDFC therefore intends to do more to help fill this gap.

The recognition that such a gap exists and that filling it is likely to be a profitable area for investment is a further encouraging sign of the maturity of the developing countries, the approach they are adopting towards their industrialisation programmes, and the men and management they are producing to run their business enterprises.

It is also surely a welcome show of support for the private enterprise system itself. Now that profits are harder to earn in Europe, North America and Japan, many internationally-minded companies recognise that they can earn a higher return on their total capital employed by investing more heavily in industrial enterprises in the developing countries. The more widely this trend is recognised, the more likely the developing countries are to attract the much larger volume of foreign private capital which most of them will need as their programmes for industrialisation accelerate in the 1970s.

In this process, CDFC has an expanding role to play. Although it is still at present an essentially British institution, the Company has always been prepared to invest in projects established in Commonwealth developing countries by European and other non-British firms. The Company recently widened its area of investment activity to include countries outside the Commonwealth. In his recent annual review of the Company's operations, the Chairman noted that CDFC would need to finance some of its future investment by raising finance outside the United Kingdom. It would not be surprising, therefore, if at some stage in the future, CDFC was to be transformed into a still more widely-owned international investment company specialising in investments in developing countries.