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THE INTERNATIONAL FINANCE CORPORATION: UNIQUE EXPERIMENT IN MOBILIZING SAVINGS

Address of

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Washington, D. C.

at the

62nd Annual Convention
The Savings Banks' Association of Connecticut

Whiteface Inn, Lake Placid, New York

Monday A. M.

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Before I begin my formal remarks today, I believe that a word of explanation is appropriate. The title of my remarks was scheduled to be "Observations on Savings Banking in Connecticut." That title and the subject matter have been changed to "The International Finance Corporation: Unique Experiment in Mobilizing Savings."

To be perfectly candid, I produced an original draft that dealt in the main with "sound principles." Now no one appreciates "sound principles" more than I, after six bank failures this year, but it seemed silly and almost presumptuous to lecture you gentlemen on "sound principles" when you have been practicing this philosophy with spectacular success for more than 150 years in the State of "steady habits." So I wrote another draft on a subject which is very close to my heart, which I believe to be appropriate, and which I hope will prove interesting. That subject is the International Finance Corporation.

The question naturally arises "What business does the Chairman of the FDIC have with the International Finance Corporation?" My answer is that two years in the Congress and three years in the Treasury have convinced me that the problems that face the financial community of the United States cannot be divided into neat little categories labeled "Commercial Banks," "Mutual Savings Banks," "Savings and Loan Associations," "State Problems," "National Problems," and "International Finance." On the contrary, experience has indicated to me that nothing is as volatile as money and the issues associated with it: taxes, monetary policy (both domestic and international), fiscal policy and bank regulation, to name a few. It is for this reason that I have thought it appropriate to speak out on such subjects as debt management, taxes and the balance of payments, as well as my more parochial responsibilities as Chairman of the FDIC.

This subject of the International Finance Corporation is an area where you, as mutual savings bankers, can bring to bear experience and informed intelligence. I intend to present the issue to you as I see it, partly at least in the hopes of convincing you, but even more in the hopes that you will see fit to pursue the study further on your own.

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The International Finance Corporation was formed in 1956 in order to give to the World Bank an affiliate which could make investments without the need for a government guarantee in each transaction, as is required under the World Bank's charter. Since IFC was designed to deal solely with private enterprise, it was later empowered to make equity-type investments as well as loans. The idea was for IFC to promote joint ventures between private investors in the less developed countries and private investors in Europe and the United States, with IFC acting as an investment banker first, and, on a small scale, as an investor for its own account. With these objectives in view, it is not surprising that the capital structure of IFC looks very much like the capital structure of a private American corporation. The governments which agreed to participate in the founding of the new enterprise subscribed just under $100 million to get it started.

IFC almost didn't get started at all. Investors here and abroad greeted the new organization with open skepticism. There was originally opposition to the concept of an international organization of governments making equity investments, and, accordingly, the articles of agreement establishing the IFC precluded direct equity investments. As a substitute, IFC experimented with a whole orchestra of complicated investment instruments from convertible debentures to contingent interest clauses. These instruments may be well understood on Wall Street, but they baffled the cement manufacturer in Chile and the shoe manufacturer in India. As a result, IFC made only nine investments in its first three years of existence -- two of which subsequently had to be liquidated at a loss.

In 1961 the prohibition against direct equity investments was removed from the IFC charter and since then IFC's record has grown with a series of investments which, when you dig behind the figures, read like chapters in a very exciting book on business adventures abroad. IFC has now made 87 investments in a wide variety of projects -- in steel mills and metals manufacturing plants, in chemical and wood processing plants, in copper mines and textile mills. It has helped in the capitalization of 13 different development finance companies and has arranged underwritings in two countries. IFC is in business in 29 countries; its gross commitments now exceed its original capital by some $11 million. This has been possible largely because the IFC has been able to sell -- without recourse -- $22 million out of its investment portfolio at a profit.

But the figures on IFC's balance sheet don't begin to tell the story. Last year IFC committed $21 million in various countries, but in these same investments other investors committed nearly seven times as much in loans or equity. In most cases IFC assumed the role of investment banker, agreeing to take up a commitment, and then interesting banks and businesses in Europe and the United States in participating in its commitment. In many cases, particularly in development finance companies, IFC makes an investment in equity while the World Bank makes a loan at the same time. More and more, IFC is becoming an equity investor; today 30 percent of its portfolio is in equities; a year ago only 17 percent.

The justification for IFC's existence is simply to stimulate local private enterprise with the help of foreign participation. You know as well as I that nothing distinguishes an underdeveloped and poor country quite so much as the absence of a business class ready, willing, and able to invest scarce local savings in productive industrial enterprises. Often neither the institutions for mobilizing savings to finance productive investments nor the habit of making such investments has taken root. Savings are scarce, very scarce in most developing countries. What savings do exist are most usually channeled into trade or real estate, both for reasons of profit and to hedge against inflation. Direct foreign investment, private and public, of course does help to overcome these shortages. But what nation ever established a measure of economic strength without first developing a home-grown class of businessmen, in charge of their own interprises? And what country ever developed a class of businessmen without the help of a local capital market, managed by appropriate financial institutions? These are the vital problems on which IFC is working. These are the vital problems which gave birth to many American financial institutions -- including, I dare say, some of your own.

Let me tell one story to illustrate how this remarkable organization works. In 1962 the leading steel company in Mexico was badly in need of $5 million in new capital. A syndicate of Mexican banks, interested in helping the company, calculated that all that could be raised in the Mexican capital market was $1 million. There appeared to be no other prospect, save perhaps inviting a foreign steel manufacturer to buy into the Mexican company. But the Mexicans knew how to make steel; what they needed was capital to expand and modernize their operation. They were, understandably, not interested in inviting foreign participation in ownership or management.

Here IFC stepped in. IFC agreed to buy $1 million worth of stock from the company. At the same time IFC agreed to arrange an underwriting for the additional $4 million in partnership with the Mexican banks. Nothing like this had ever happened in Mexico before. The Mexicans insisted that $1 million was all that the local market could be expected to absorb, but here was an underwriter, IFC, agreeing to take 75 percent of a $4 million commitment and fully expecting to get stuck with most of it. But this is the sort of risk IFC was set up to take.

Before the books on the offering were opened, IFC persuaded two banking houses in New York and one in Switzerland to participate in its commitment up to $1 million. When the books were opened, IFC was able to sell in Mexico 60 percent of the $2 million commitment it had left. Within the first few days the whole of the offering was taken up by foreign and local investors in Mexico except for $800,000 left with IFC. After a few months IFC was able to sell off even this sum, the Mexican market in the end absorbing the whole offering.

This was the first chapter in the story. The second chapter opened at the beginning of this year when the Mexican steel company launched a $50 million expansion program, with the help of a $28 million loan from our own Export-Import Bank. The company put up $10 million out of its own earnings, but it had to raise another $12 million in the local market before the promised Export-Import Bank loan would become effective. In this way the Export-Import Bank, like IFC, lent its influence to the problem of expanding the local capital market. Again IFC stepped in and agreed to arrange an underwriting. The $12 million was by far the largest public offering ever made to private stockholders in Mexico.

This time the syndicate of Mexican banks agreed to take 40 percent of the offering, leaving IFC with $7.5 million or 60 percent -- which was incidentally, IFC's largest single commitment. But before the books were opened, the Mexican syndicate upped its commitment to 50 percent and the same three banking houses which participated in IFC's 1962 underwriting agreed to take another 44 percent. This left IFC with a commitment for only $720,000. And when the books were opened, the whole offering was taken up by investors in Mexico within 10 days.

The Mexican capital market, which local bankers calculated in 1962 could only yield $1 million for the country's leading steel manufacturer, did in fact yield $12 million in 1964.

Incidentally, you will remember that I said that IFC in 1962 agreed to buy $1 million worth of this company's stock. Well, the stock was bought in 1962 for 110 and is currently selling for 160, giving IFC a very nice profit to show for its work.

As I say, the figures on IFC's balance sheet don't begin to tell the story of this remarkable organization. IFC is currently negotiating and underwriting in Nigeria and hopes to extend this kind of operation to many other countries where only the rudiments of a local capital market exist, but where there is a prospect for building up that market if the initial risk can be cushioned and spread by IFC. Meanwhile the bulk of IFC's commitments go directly to private industrial enterprises where the need is for equity capital and where there are not yet enough local investors to meet that need.

Each IFC investment is different, for the corporation has almost as much flexibility as a private international banking house. IFC-supported projects must be important in terms of the development of the country concerned; IFC must satisfy itself that no other source of private investment is available; and, of course, IFC will not support a project unless it finds good management, good engineering, and a good prospect for profit. But in general its policies are quite the same as you would find in a private banking house...a <u>banque d'affaires</u>, as the French say. And, as would be the case in any private banking house, some IFC investments can be sold promptly for a profit; some take a long time to mature, perhaps involving a second IFC commitment to cover a small overrun or a miscalculation in costs; and some--only two to date---don't work out and have to be liquidated at a loss. While IFC does not take an active part in management or vote its share capital, it is an equity investor, and it does keep a lively interest in the financial health of companies it invests in. Recently, an IFC representative has been appointed to the Boards of some development finance companies in which IFC has an interest.

About a sixth of IFC's capital has been invested in various kinds of development finance companies--which, in turn, deal with scores of very small private enterprises. Through this means, IFC and the World Bank have found a way to help the small entrepreneur, at least indirectly. IFC normally provides equity capital to these companies while the World Bank and private banks in Europe and the United States supply debt capital. These investments are not, typically, highly profitable. Returns are low and for the most part IFC is "locked in"---unable to sell out of its portfolio. This is not surprising, since these development finance companies deal with dozens of very small private enterprises. It would be quite impractical for the IFC, or the World Bank for that matter, to make loans to a great many small private enterprises--loans denominated often in the hundreds rather than the thousands of dollars equivalent. Yet providing financing for the very small private businessman is, in some respects, the most important development 'need' in many countries in Africa, Latin America, and Asia.

With its current commitments already exceeding its authorized capital, IFC itself is going to need additional resources before too many months are out if it is to continue and expand its current record. At the beginning of this year, Mr. George Woods, who doubles as the President of IFC and of the World Bank, began to consider ways and means of replenishing IFC's capital. He rejected the course of asking member governments to increase their subscriptions. As an alternative, he suggested that the charters of the World Bank and IFC be amended to permit the Bank to lend money to IFC. At the recent Annual Meetings in Tokyo, the Boards of Governors of the Bank and IFC approved this suggestion. Next year the United States Congress will be asked to approve these amendments. I hope some of you will interest yourselves in this matter, for I think it is only natural that your Congressmen and Senators will be turning to you for advice and counsel.

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If the IFC seems remote from your business--or from mine--let me again assure you that it is not. You are concerned with mobilizing savings and channeling them into productive investment, and so am I. We know that the cycle of investment, often painted so drably by economists and financial analysts, not only can be as fascinating a phenomenon as the cycle of life itself, but is the phenomenon that determines whether life is supported by material progress or hobbled in poverty and want.

Today in most of Latin America, Africa, and Asia the cycle of productive investment is just starting--as it was in Connecticut 150 years ago and more. That the United States Government should be deeply concerned to see that a productive investment cycle does get started in these parts of the world-- and in a way consistent with our own security and prosperity--is hardly remarkable.

Our Government is concerned; its concern is expressed in part through our indispensable foreign aid program, and in part through support for a number of regional and international financial institutions, of which I have chosen to look at only one. But the interest of the Government is not enough; in fact, in the long run, it cannot be any more than the interest of those like yourselves, whose deep knowledge of and experience in our own investment cycle has made this country the envy of all mankind.

We must never forget that it is the result of the impact of our heritage on the world--not the result of any communist conspiracy--that millions today will not acquiesce in a life of poverty or in the strife which poverty breeds. We showed the world that there is an alternative to a life of poverty. Our task is to help maintain the balance of hope. A small but highly useful tool is the International Finance Corporation.

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