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COMMERCIAL BANK FINANCING OF SMALL-SCALE INDUSTRIES: POLICIES AND MEASURES

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TABLE OF CONTENTS

I. INTRODUCTION

In order to be able to appreciate the role which commercial banks play in the sphere of economic development, it is necessary to follow the evolution which has taken place in the concept of banking in the developing world during the course of the 20th century, at least since the end of the First World War. Very broadly speaking, this era can be divided in three periods·

The first which ended in 1944, when most existing nations sent representatives to Bretton Woods to consider the financial structure of the post war era. The second period ended in the very early sixties, with the wholesale withdrawal of the colonial powers from their former colonies, and the third period is the one which we are now living.

The first period was characterized by the development of a private banking system, generally closely linked with that of the industrialized nations and geared mainly to support export oriented activities, usually extractive, mainly controlled by foreign interests. There was little interest in mobilizing local savings for local application, mainly because there was but very little to mobilize, the local population being largely kept from having an active part in resources generating activities. In this fashion, commercial banks were not so much interested in creating conditions capable of producing local wealth than in procuring profits for their main offices abroad.

While this description applies mainly to colonies and territories, it also applies to Latin America, as an important part of the wealth generated by local interests left the region, mainly for Europe.

During the second period, local nationalism became quite active, with the result that local financial institutions began to play an important role, helping to create wealth which remained in the countries to create new wealth. It is during this period that commercial banks really began to provide credit for local production, generating new resources in the form of deposits from the incipient middle class. Foreign banks continued to finance export oriented activities, often limited in their activities by newly restrictive banking regulations.

During the present period, local nationalism has brought a further change in the situation. Foreign banks have to integrate themselves in the local structures, with the result that they now compete with local institutions or, where such competition has not yet developed, as is the case in many African countries, between themselves as national institutions. In some instances, the process has gone even one step further, the banks being nationalized.

This process of integration of the foreign banks into the national economy has taken many forms, the most interesting one being the internationalization of ownership which means that financing which used to go formerly almost only to nationals of the metropolitan country of the bank's origin, now go to any creditworthy client, irrespective of his origin, except in the few countries where local citizenship is a prerequisite for obtaining credit. This evolution from foreign orientation to local orientation has been accompanied by similar changes in the concept of the role which commercial banks have to play. Whereas in the past they were mainly interested in strictly commercial operations, they are now frequently participating in the process of economic development through the granting of credits on longer terms for production purposes. Official statistics are not a precise guide to gauge the extent of this evolution, as many credits to industry appear as commercial operations. Nevertheless, just as one example, it can be indicated that in the countries of the West African Monetary Union, the percentage of medium and long term credits increased from 14.6% of total credits on September 30, 1964, to 19% two years later. It may be assumed that commercial bank credits had their proportionate share of this increase, at least in the industrial sector where the increase was most significant.[1)]

Finally, it is necessary to take note of one further trend now taking place in the concept of banking, namely that smaller credits are not only interesting but also necessary, in support of the larger ones. In the field of industrial credit in particular, it is evident that credits to large scale, often infrastructural, industries must be complemented with credits to the many smaller enterprises which process the primary and semi-elaborated products of these industries.

A case in point is the Paz del Rio steel plant in Colombia which did not really start operating with a certain degree of efficiency until a vigorous programme of development of the processing industries, largely through credit, was launched.

In this fashion, the consciousness of the importance of the smaller industry is slowly gaining in strength, as an intermediate between the capital goods producing industry and the consumer, as a sub-contractor in the more intricate manufacturing processes, and as an economic entity in smaller markets to process local raw materials. The importance of this smaller enterprise as an important source of employment often at relatively low cost per unit of employment is becoming more and more appreciated and therefore the need to give it all possible means of support.

1)Banque Centrale des Etats de l'Afrique de l'Ouest-BCEAO Annual Report for 1966

II. Commercial financial structures in developing countries

Commercial banking services available in developing countries are by no means uniform. In many countries, there is a strong legacy from the colonial era which, at times, has been adapted not only to new political structures but also to new political concepts. It is thus possible to consider three broad groups of financial institutions capable of providing credit to small-scale industries on a commercial basis, namely:

1. strictly private banks
2. public banks
3. mixed banks

1. Private banks

Private banks can in their turn be divided into three sub-categories, following the degree of independence which they enjoy in determining their own policies in the country.

First, we find strictly local banks, with either only local participation in their capital structure, or with minority participations from foreign interests but with control in local hands. While it is at times difficult to establish with precision the ownership of certain banks at any given time, as it does frequently fluctuate, we find that autonomous private commercial banks exist in the following countries which have been selected for the purpose of this study (Appendix I):

In Africa: Ethiopia, Nigeria, Sudan, Tunisia, Morocco, Zambia

In Asia: Afghanistan, India, Iran, Israel, Lebanon, Malaysia, Pakistan, Philippines, Saudi Arabia, Singapore, Taiwan, Thailand

In Europe: Greece and Turkey

In Latin America. Argentina, Brazil, Chile, Colombia, Mexico, Peru

The main characteristic of these autonomous banks is that they can be closely attuned to the necessities of the country, particularly to the needs of strictly local industries which, with very rare exceptions, include all of the small scale enterprises. Autonomous banks are often capable of adapting their policies to changing local conditions as special programmes are evolved for economic development. However, their influence varies greatly from country to country, or even from region to region. In Latin America, they generally form the very core of the banking structure, and have ample resources, being able to mobilize a large part of the savings available. In Asia, the same situation exists in a limited number of countries such as India, Israel, Lebanon, the Philippines, Taiwan and Thailand. In Africa, on the other hand, most autonomous banks are quite new and have not yet succeeded in acquiring a preponderant role in the financial community.

Next, we find <u>semi-autonomous</u> financial institutions, registered under local law, but with final control in foreign hands, be it entirely, or in a majority in participation with local interests. It is in Africa that semi-autonomous banks have found their greatest development, the result of the internationalization of the banking system following the era of independence in the late fifties and early sixties. A study prepared by the Central Bank for the States of West Africa in 1963 [1] clearly sets forth the complexity of the current ownership of the African commercial banks. A revised edition of this study is under preparation for publication in late 1968 or early 1969; it is

1) Petite Revue des Banques Commerciales Africaines, Etudes No.100 Banque Centrale des Etats de l'Afrique de l'Ouest

not expected that it will show drastic changes from the situation which existed in 1963 and which indicated that most of the semi-autonomous banks were owned by foreign bank consortia with generally little more than token local participation. However, the very fact that majority foreign ownership is diversified provides the possibility of greater attention to local interests which the former system of fully-owned subsidiaries prevented, as it tended to favorize either foreign trade with the mother country or enterprises owned and/or operated by nationals of the country of the owner bank. It is interesting to note that by and large, with the exception of the big British banks, foreign banks participate in the ownership of semi-autonomous banks in Africa, rather than operating there through their own agencies.

There is no information exactly comparable with that on the banking system in Africa available for the other regions of the world. In general, however, it may be said that the semi-autonomous banks play a less preponderant role than in Africa, even though the tendency for foreign banks, particularly those from non-colonial countries, to seek participations in existing banks is quite developed.

Finally, we find in the private banking system, simple agencies of foreign banks, with little or no autonomy in the setting-up of their policies. In many developing countries, however, they play a very important role as, having been established already for many years, they have tapped local resources, in the form of savings and deposits and have therefore sizeable funds available for their activities. Unfortunately, their tendency is to take a minimum of risks in their operations which often precludes their entering the field of credit to small producers. Furthermore, since they lack a proper capital structure and since the tendency in most metropolitan countries now is to prevent the export of capital resources, these agencies tend to put a lesser percentage of their deposits back in circulation in the form of credits than autonomous and semi-autonomous commercial banks. From the point of view of the development of small-scale industry credits, this category appears to be the least prepared to make a worthwhile contribution.

2. Public banks

Public banks can be divided in two categories. First the banks which carry out commercial operations in competition with private banks and second, banks operating in an entirely nationalized context.

As regards the first category, the most typical example is reconstituted by the commercial departments of former National Banks, split in two to permit the establishment on the one hand of a proper Central Bank, and on the other hand of a publicly owned commercial bank. To mention two examples of this type: the Commercial Bank of Ethiopia Ltd. came into being when the State Bank of Ethiopia limited itself to being the country's Central Bank; the Bank of Brazil lost its central banking functions when the Central Bank of the Republic of Brazil was established in 1965. Because of their background, these public commercial banks often play a preponderant role in the financing of industry, as they tend to reflect directly government policies regarding assistance to one or another sector of the economy. It is probably such banks which, in market economies, provide the greatest support to small-scale industries. Not only are they able to accept risks which private commercial banks would generally discard, but they can also support greater costs in lending, as there is less of a profit motive in their operations. Furthermore, having large resources at their disposal, they are able to take the lead in establishing new patterns of lending; these are often followed by private banks in order to be able to maintain their position in the community and continue to attract deposits.

The second category of public commercial banks is represented by the institutions in socialist countries which have either centralized all credit operations in one or two state-owned institutions (such as in Poland or in Yugoslavia) or have retained the private banking structure which existed when the private banks were nationalized, (as is the case in the United Arab Republic). Even though both forms apply government policies with respect to credit, there is perhaps greater flexibility in the interpretation of these policies in the nationalized system than in the monolithic institution; this makes for a certain degree of competition between various nationalized banks concerning both the mobilization of savings and their utilization for productive purposes.

3. Mixed banks

Mixed banks are of two types. First there are the banks in which a government holds the majority control with minority shareholders, either national, or foreign, or both. Such banks are frequently found in Africa, for instance in Cameroon, Dahomey and Sudan. Second, there are the banks in which the state owns a minority participation, either directly or through a government controlled institution as in the case of Tunisia, Senegal, Ivory Coast and Gabon.

In both cases, the banks are generally operated as private banks, without government interference in the day to day business of the institution. It is evident however that, as far as broad policies are concerned, government has an important voice in defining them.

III. General credit policies of commercial banks with respect to small scale industries

Several studies have already been prepared on the financing of small scale industry, such as the one by Robert Davenport or that by Sabas Francia Garcia which relates more closely to Latin America. Other studies have been written on commercial bank financing of industry in developing countries in general terms. We have been unable to find studies dealing specifically with small industry financing by commercial banks in developing countries. To overcome this deficiency, a questionnaire was mailed to 81 autonomous or semi-autonomous banks in 33 developing nations and to 5 of the large foreign banks doing branch office or affiliate bank business in the developing world. For the purpose of this questionnaire, we had to set some norm as to what could be classified as a small-scale industry, there being no universally-accepted definition. We used the definition arrived at in the course of our study of small-scale industry in selected countries of Latin America[1] namely, an enterprise employing generally less than fifty (50) workers, without the usual break between artisanal and small-scale enterprises. We would have liked to utilize the much better definition of Joseph Stepanek[2] which bases itself on the essence of small-scale industry, but banks seldom keep track of purely human characteristics.

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1) Benjamin P. Spiro Encuesta relativa a la situación económica de la pequeña indústria y la artesanía en varios países de América Latina - International Labor Office, Geneva, 1964, Colombia, page 3: "Sin embargo, desde el punto de vista de esta encuesta, la pequeña indústria se define como la indústria de iniciativa local que no tiene atracción para el capital extranjero. Desde el punto de vista estadístico, esta indústria corresponde, en términos generales, a la que emplea menos de 50 trabajadores. Or Credit with Technical Assistance to Small and Medium Scale Industry in Colombia, Benjamin Spiro Associates, Inc., October 1964: small scale as opposed to large scale industry can be defined qualitatively: as that of local initiative which does not hold attraction for foreign capital, and quantitatively: as that employing generally less

The answers which we received constitute background information for this and the following chapters of this paper. They are of value just as much by what they say, as by what they fail to say. Two conclusions can be drawn from the relatively low percentage of answers received (25%) from the autonomous and semi-autonomous group of banks querried. The first one is that in many countries there are no firm requirements that commercial banks dedicate a portion of their resources to small industry financing and that, therefore, many institutions do not keep adequate records permitting them to identify this type of financing as a category separate from their other activities. The second conclusion is that there is still a gross lack of consciousness in most developing countries of the importance of small-scale industry in the economy and of the means required to promote its development.

As regards the large foreign banks doing branch office business in the developing countries, all but one answered our questionnaire. Those from former colonial powers answered in great detail, indicating thereby that their branch offices, most often established long before independence, have a definite consciousness of the

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1)cont)
than 50 workers with, as far as Colombia is concerned, a capital of generally less than 1 million pesos.

2)Stepanek, Joseph E., Managers for small industry, Stanford Research Institute, Menlo Park. The Free Press, Glencoe Illinois, 1960, p.39."Small industrial enterprises need managers - one individual per enterprise - qualified to handle all management problems."

needs of the various economic sectors of the countries where they are located, balancing the small returns, if any, from small industry financing against the profits from larger scale operations. The other large scale banks are generally relative newcomers in the developing world and are mainly interested in the profit making potential offered by a limited number of larger credits. Unless compelled to do so by local regulations, they have little motivation to seek the smaller entrepreneur and assist him in developing his industry.

In spite of the relatively small percentage of returns from the very broad sample we were seeking, we find that the answers are sufficiently representative to give a valid impression of commercial bank policies and practices with respect to small-scale industries.

1. Purposes for which loans are made to small-scale industries

Credits are extended for working capital purposes by all but one bank, to purchase raw materials and against inventories of finished goods. Half of the banks factor receivables, while three quarters finance the purchase of machinery and equipment. One third of the banks indicate that they also finance other purposes such as new project manufacture of prototypes. The following table summarizes the answers received [1]

Purposes of loans	No.of autonomous banks	No.of foreign banks
Purchase of raw materials	10	3
Inventories of finished goods	11	2
Purchase of machinery and equipment	9	3
Factoring of receivables	5	2
Other	4	2

[1] Not all banks answered all questions in the questionnaire

2. Terms for which loans are generally made

The banks, autonomous and foreign, lend generally for periods of up to one year. Two banks specialize in shorter term lending up to 180 days. One bank specializes in longer term lending of from one to more than five years with the bulk of the loans extending from 3 to 5 years. These answers must however be qualified since, while bank facilities are primarily short term, (that is six months to one year), lendings are, in theory, repayable on demand. It can be appreciated then that, in the absence of fixed repayment terms, overdrafts may continue for a number of years on a fluctuating basis. This fluctuating overdraft technique for longer term financing, which is quite different from the loan system, is a leftover from the colonial era and is used particularly in Africa and in the Caribbean region.

Besides the one bank specializing in longer term financing, seven autonomous and one foreign banks make term loans for periods exceeding one year, up to five years, when the purchase of fixed assets is involved, including the purchase of machinery and equipment.

The terms mentioned above are those which the banks offer when lending their own resources. It is evident that when there exist special resources made available by government institutions for use by commercial banks acting as agents to small-scale industries, the terms are those established by the government institution which in the final analysis, assumes the ultimate risk. Such programmes are known to exist in Mexico - Fondo de garantiá y fomento a la Industria Mediana y Pequeña; Chile - Linea de Credito de Promoción para le Pequeña y Mediana Empresa.; Brazil - Programa de Financiamento a la Pequeña y Mediana Empresa, and Fundo de Democratização de Capital de Emprêsas; India - Industrial Development Bank of India; and Morocco - Banque Nationale pour le Développement Economique. Such terms must however be analyzed rather under the respective government programs for financing small-scale industry than under the present heading.

The following table illustrates the answers received:

Terms of loans	Sample distribution of portfolios					
60 to 90 days	–	40	40%	–	20	–
90 to 180 days	–	25%	50	–	–	50%
181 days to 1 year	90%	25%	8%	–	70%	–
over 1 year to 2 years	–	4%	2%	8%	10%	50%
over 2 years to 3 years	–	3%	–	–	–	–
over 3 years to 5 years	10%	3%	–	84%	–	–
over 5 years	–	–	–	8%	–	–

3. Guarantees which are generally required

Guarantees required vary greatly from bank to bank and from country to country. In Latin America for instance, receivables are used as collaterals for loans of up to two years, real estate mortgages being required for longer term loans. On the other hand, short term loans are made without collaterals, except for personal guarantees. In Asia, short term loans will be guaranteed by receivables and/or personal guarantees of the partners or directors, or yet by third party co-signature. Longer term loans will include chattel mortgages and loans on materials purchased. Real estate mortgages may also be required. In India, guarantees from the credit guarantee organization sponsored by the Government of India is generally obtained, in addition to personal guarantees of partner/s, director/s and managing agent/s. In Africa, personal guarantees and guarantees of directors are taken whenever possible, regardless of the term of borrowing, although this is not invariably a pre-requisite. Guarantees are normally taken on the bank's form and are of a continuing nature, unless a guarantor stipulates a fixed period. It appears that there is a general tendency to require adequate security without mortgaging unduly the borrower's working assets. The main emphasis seems to be on self-liquidating guarantees on the one hand, and on co-signatures on the other. The influence of a Government-guaranteed scheme (as does exist in India) will be considered in chapter VI.

4. Cost of the loans to the borrowers

As could be expected, it is in this category that the greatest divergencies appear in the answers received from the banks surveyed. There are not only great differences between countries, but also between banks in the same country. There is also a very interesting difference in the concept of the cost of money between Asian and Latin American banks. In the former, it is customary for short term rates to be lower than for medium and long terms. In Latin America, the reverse is true, namely short term rates are generally higher than longer term ones. It is difficult to think of a logical explanation, particularly in countries with very high rates of inflation, except perhaps that resources employed for longer term lendings are not the bank's own but have been provided by Government agencies such as those mentioned under item 2 of this chapter, in Mexico, Chile and Brazil. Another characteristic feature of Latin American lending is that interests are frequently covered in advance from the loan itself which means that the rates indicated, which are already among the highest in the world, must be further increased by the discounted value of the interests to determine the real cost to the borrowers.

In the questionnaire, we requested that interest charges and commissions be shown separately. Unfortunately, all but one of the banks, failed to do so, even though three indicated that they did not charge any commissions. It is therefore not possible to relate interest charges to local Central Bank's discount rates, but we can assume that these rates are the normal basis for computing interest rates, the difference between rates so calculated and the rates indicated in the replies received in effect representing the bank's commissions. The variation in the rates charged by the same institution to various borrowers are due to their differences in standing as well as to the quality of the security offered.

In Africa, where the bulk of lendings is done on an overdraft basis, simple interestsare applied on the daily balances outstanding at commercial rates. The following table reflects the average charges reported in typical countries:

Country	Rates of interest charged for short term	medium term	long term
Ethiopia	8 to 9 %, irrespective of term		
India	8 to 9½%, irrespective of term. 1% may be added when the loan is guaranteed by a mortgage		
Israel	6 %	9	10 %
Pakistan	7 to 7½ %	8 %	8½ %
Philippines	12 to 14 % irrespective of term		
Taiwan	10 to 12 irrespective of term		
Thailand	14 %	12 %	
Colombia	14 %	12 %	12 %
Central America	9 %	10 %	
South America	up to 18 % in cases where reserve and other requirements are extraordinary		

Since all the banks which replied can be classified as private commercial banks, we are unable to present the differences which might exist between such banks and public and mixed types of commercial banks, if any, regarding the credit policies which have been outlined in this chapter.

IV. Current practice in lending to small-scale industries

1. Small-scale industry credit as part of the overall industrial credit portfolio:

In order to gauge the impact of the general credit policies followed by commercial banks in developing nations, we attempted to obtain data concerning the percentage of industrial loans to small scale industries from the overall industrial credit portfolio. To ascertain that such data was available, we inquired from the banks as to whether they differentiated in their loan portfolio between various categories of industries, such as by size or by type. The conclusion we reach from the answers received is that the majority of banks do not keep such records and when they do, it is at the request of their Central Bank. For instance in Africa, the Banque Centrale des Etats de l'Afrique Equatoriale et du Cameroun requires all the banks to register with the "Centrale des Risques" their loans classified by terms and by size of industries. In this manner, this central bank was able to provide us with up-to-date statistics on credit to small and medium-scale industries in the five countries [1] for which it is responsible, differentiated between short, and medium and long-term.

The scope of our enquiry did not include an approach to Central Banks to ascertain their requirements in representative countries. We feel, however, that in most countries which have Government-sponsored credit assistance programmes for small-scale industry for which commercial banks act as agents, the type of data we sought to obtain may be available. This is borne out by the answers which we received from

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[1] Cameroun, Central African Republic, Congo, Gabon, Tchad

Indian banks, for instance, which included comprehensive data. Within these limitations the data we have collected give rise to several conclusions.

First, small-scale industry loans represent but a small percentage of total industry lending. In India it ranges from a high of 30% to a low of 7 %. It must be noted in this case that the definition [1] of small-scale industry is rather broad and undoubtedly includes a fair number of industries which elsewhere would be classified as medium-scale. In the Philippines the percentage is 6 %. In the Cameroun where short term credit to industry represented 6.4 % - as compared with 40.3% for commerce - of total banking credit, credit to small and medium scale industry may be extrapolated as having represented more than half. However in the case of medium and long term credits, the share of small and medium scale industry falls to little more than about 20 %. By and large it may be assumed that small industry credit seldom reaches 10 % of total industrial credit in any given country.

Second, there are certain types of small-scale industries which appear more frequently as borrowers from commercial banks than others. Food processing is universally present. Next in line are: metal working, textile processing, leather processing, electrical repairs, services, mechanical repairs, wood processing and at the very bottom of our list, graphics. There are other categories which generally add up to a sizeable percentage of the small industry loans.

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[1] The official definition of a small scale industry - opposed to a large scale one - is: an industry which is engaged in the manufacture/preservation/processing of goods and whose investment at original cost in plant and machinery does not exceed Rs.7 ½ lacs. (US $ 100,000)

Third, the average size of credits going to small scale industries in any of the nine industrial branches included in our questionnaire is several times larger than the average for the "others" category, which seems to confirm that these nine branches are effectively the principal fields of activities of small entrepreneurs. Within these nine branches, there are considerable differences between banks and between countries. In the case of India, there exists an obvious bias caused by the preference given to defence-oriented and export-oriented industries.

The above conclusions give us a certain context within which to consider the policies outlined in the preceding chapter, except for the fact that in themselves, they do not answer the fundamental question as to why small scale industries come out so poorly in the distribution of the resources made available by the commercial banks to the industrial sector, while by the value of their production, they represent a much more important share. In Colombia for instance small scale industry, defined even more stringently than for the purposes of this paper as it also sets a limit to the capital which these enterprises may have [1], produces about 30 of the country's gross industrial product. However in that country commercial banks, though they are compelled by law to reserve funds for developmental loans, are not lending them and in fact discourage industrialists to apply for such loans, as the rate of interest is lower than for regular commercial operations and the cost of complying with requirements much higher. Whenever a loan is made, however, commercial banks insist that all the liquid resources of the borrower be placed in a current account with them. [2] It is only fair to mention,

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[1] Encuesta relativa a la situación económica y social de la pequeña indústria y la artesanía en various países de América Latina. Parte IV - Colombia. International Labor Office, Geneva, 1964

[2] Id.

on the other hand, that small industrial borrowers often lack the sophistication to even apply for loans, or to be able to submit adequate information to the bank to enable it to form an opinion as to the credit risk involved. We shall come back to this subject in chapter V, but felt it necessary to mention it already here to indicate that the best stated policies may be ineffective if certain factors, often unstated, are not taken into account.

2. Recovery experience

Recovery experience of the banks varies greatly and, as the floating overdraft system is frequently utilized, it is natural that data on lateness of repayment cannot be presented with accuracy. There is another aspect which affects the information received. It is our experience that few banks do keep very accurate track of their loan portfolio inasmuch as renewals are often almost automatically granted, placing many loans in a category very similar to that of floating overdrafts. Further, statistics are not kept very adequately, relatively few banks having to answer to inquisitive banking commissions or to share-holders not directly involved in the bank's management. This is no doubt why several banks limited themselves to answering that their experience was generally satisfactory.

From the banks which did provide us specific statistics, the following table can be prepared:

Normal recovery	% of number of loans	% of amount of portfolio
Ethiopia	55.66	32
India	80	90
Pakistan	80	85
Philippines	10	10
Taiwan	87	92
Thailand	44.5	n.a.

Refinanced or renewed		
Ethiopia	33.33	60
India	20	10
Pakistan	15	12
Philippines	80	80
Taiwan	n.a.	n.a.
Thailand	30	n.a.
In arrears up to three months		
Ethiopia	3	1
India	-	-
Pakistan	2	3
Philippines	5	5
Taiwan	n.a.	n.a.
Thailand	15	n.a.
In arrears over three months		
Ethiopia	1	2
India	-	-
Pakistan	2	1
Philippines	4	4
Taiwan	13	8
Thailand	10	n.a.
In default, written off		
Ethiopia	7	5
India	-	-
Pakistan	1	1
Philippines	1	1
Taiwan	n.a.	n.a.
Thailand	0.5	n.a.

It is not possible to draw general conclusions except perhaps that refinancing and renewals are relatively high, but not necessarily much higher than for the industrial sector as a whole. Published balance sheets of banks do not provide sufficient ventilation to permit an adequate comparison.

As regards defaults, one possible mean of gauging the relative importance of the above figures would be to compare them with the category "doubtful and in litigation" which the Banque Centrale des Etats de l'Afrique de l'Ouest shows in its Annual Report, regarding the application of resources by commercial banks in the seven countries in which it operates[1]. During the period September 1964 - September 1966, the percentage of total loan portfolio of the commercial banks in the seven countries which was doubtful and in litigation varied from a low of .3 % to a high of .45 %.

This would seem to indicate that defaults, as a rule, are higher for small scale industry loans than for the loan portfolio as a whole. It should be noted that the percentage of total loan portfolio of the development banks in the same seven countries which was doubtful and in litigation during the same period varied from a low of 3.6 % to a high of 6.4 % or over tenfold the amount reported for the commercial banks. This comparison stresses the fundamental conservatism of the commercial banks, to which the probably better portfolio management and less rigid reporting requirments might be added, this going a long way towards explaining the low level of small scale industry lending by the commercial banks.

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[1] Ivory Coast, Dahomey, Upper Volta, Mauritania, Niger, Sénégal, Togo

3. Liquidity of guarantees

To analyze the fundamental reluctance of the commercial banks to lend to small scale industry, it may be well to go back to the comment made in item 3 of chapter III, namely that the emphasis of the commercial banks seems to be on requiring self-liquidating guarantees.

In view of the fact that by and large the overwhelming bulk of small scale industry credits are made for terms not exceeding one year, self-liquidating guarantees are relatively easy to obtain. However, when the credit ceases to be for working capital in a fairly narrow sense, and is instead utilized for the purchase of machinery and equipment necessitating longer terms, self-liquidating guarantees are no longer so easy to obtain and recourse must be had to equipment and machinery collaterals or to mortgages. The question which arises in such cases is what is the real value of the guarantee should it become necessary to realize it. Once brought into a developing country, a piece of machinery loses its international value and becomes subject to the local law of supply and demand. It is evident that the supply side is there, when the lender, (the commercial bank) may wish to realize a guarantee. The problem is: is there a demand? When the machinery given as collateral is of a very common nature and used by a fairly large number of small industries in the same sector of production, then it may be assumed that there exists a certain demand potential. All too often, however, the number of firms utilizing the same type of machinery is limited and therefore the bank may find, when wanting to realize the collateral, that it has in fact little or no value. It is therefore very important for the commercial bank to consider the marketability of the machinery, the purchase of which it is requested to finance, to be able to assess its real value as a guarantee. This may mean ascertaining the existence in the country of similar equipment, as well as of servicing facilities. This is all the more important because of the tendency in so many countries where the degree of technical sophistication is still limited, for machinery to be ordered from catalogues, the decision being based on the attractiveness of the illustrations and on payment considerations. On far too many occasions, we found in small scale enterprises equipment which could not be effectively used, which represented nothing but a burden to the firm. From the point of view of the commercial bank which had financed the purchase, the value of the guarantee represented by the machinery was nil.

There is another aspect of this question which must be considered and which might offer a solution to the problem of longer-term financing by the commercial banks. The fundamental guarantee for a loan is the ability of the entrepreneur to direct his enterprise efficiently, and on the capacity of the enterprise, well managed, to produce not only enough to permit the servicing of the loan but to leave an adequate return to the owner as well as to cover reasonable risks to the lender and the owner. Looked at in this way, the notion of guarantee shifts from that of an individual piece of equipment or even of unrelated pledges of real property or individuals to the concept of the unit of production under which the entire unit serves as a dynamic guarantee. The real problem is no longer one of realizing often unrealizable collaterals, but to maintain the unit of production producing, avoiding losses of production and the cost of idle investments in machinery. To what extent is it possible for the commercial bank to evaluate first the technical as well as moral capacity of the small-scale entrepreneur and therefore his ability to have an effective unit of production, and second, the risk which the very nature of the small scale enterprise represents, namely that the entrepreneur make the enterprise, without any delegation of authority or capacity permitting the continuation of production should anything happen to the owner?

Development banks have attempted to reduce the burden which the requirement of real guarantees represents as far as longer term lending to

V. Government policies in selected countries, regarding commercial credit to small scale industries

1. Chile

In spite of the fact that, legislatively speaking, small scale industry has not yet been recognized as a special sector of Chile's economy, and that internal revenue legislation goes so far as to penalize small enterprises [1], the Government of Chile has been conscious for some years already of the need to not only promote small scale industries, but to give them a type of assistance markedly different from that offered to the large scale industrial sector. To this effect, a service of technical co-operation has been organized as a subsidiary of the Development Corporation, to assist small enterprises to become creditworthy subjects for the Development Corporation. This however, has proved to be insufficient, government institutions being by their very nature ill-equipped to offer easily the variety of credit facilities which manufacturing enterprises require for their day to day operations. Largely for this reason, the Central Bank of Chile approved on October 13, 1966 the opening of a "promotional line of credit", in favor of the commercial banks, to enable them to finance the working capital of small and medium scale enterprises. Medium and small scale enterprises were defined in function of their working capital needs over a one year period, which should not exceed seventy times the annual minimum wage in force in Santiago. In the descriptive bulletin [2], (printed

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[1] Encuesta relativa a la situación económica y social de la pequeña indústria etc. Parte I. Chile

[2] Manual para la linea de crédito de promoción para la pequeña y mediana empresa

small scale industry is concerned. If the experience in West Africa can be considered as being representative, the risk is not one that commercial banks can assume themselves. We must therefore think in terms of other alternative solutions which will be explored in subsequent chapters.

in November 1967 but the commercial banks were informed a year earlier of the establishment of the promotional line of credit), the purpose of this line is defined as a way to permit enterprises to work out agreements with one to three commercial banks which will guarantee the enterprises their financial requirements instead of having to depend on the re-discounting of letters or on other types of loans, always expensive and often very difficult to secure. The utilization of the promotional line of credit presupposes the preparation by the enterprises, of a financial program based on the estimates of revenues and expenses during the period of the agreement. The system is so new that at the time of writing, it has not been possible to obtain published data on the extent of its application. However, on the face of it, it should bring the commercial banks into much closer contact with small-scale enterprises, giving them the opportunity of developing contacts which should eventually result in a broader bank-client relationship, which in turn should produce a greater volume of credits of the conventional type.

2. Colombia

In theory, the financial needs of small-scale industry are met by a variety of programs, the main one being the "fund for Private Investments" created in 1963 by the Bank of the Republic. This Fund should discount the credits made to industry by the commercial banks. But in practice, small and medium scale industry has benefited very little from this program as it has generally been unable to submit the very detailed information required by the Central Bank. Furthermore, the commercial banks have not been very anxious to avail themselves of the Fund's resources, preferring to concentrate their attention on their principal clients, thus generating a more important volume of deposits. [1]

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[1] Encuesta relativa a la situación económica y social de la pequeña indústria y la artesanía en varios países de América Latina, Parte IV - Colombia

In addition, the commercial banks are compelled by law to reserve part of their resources for development loans. However, the banks are not lending these funds; in fact they even discourage industrialists from applying for such loans as the rate of interest is lower than for regular commercial operations, while the cost of complying with requirements is much higher. Whenever a loan is made, however, the commercial banks insist that all the resources of the borrower be placed in a current account with them [1]. In this way, governmental policies so far have failed to bring the commercial banks to the point where they would represent an important factor in small-scale industry financing.

3. Brazil

The situation in Brazil is, to say the least, very confused. First of all, the biggest commercial bank - the Bank of Brazil - is publicly owned and, because of this characteristic, it has access to much more important resources than the privately-owned commercial banks. Furthermore, as a state-owned institution, it acts both as a primary and as a secondary lender, that is, under given circumstances it serves as an intermediate credit institution when it comes to repassing resources made available by the government for small and medium-scale industry credits. Thirdly, the profit motive being only marginal to other considerations of a publicly-owned institution, the Bank of Brazil has been able to undertake various programs to improve and increase its small-scale industry lending, such as training courses for industrial advisers who, as a result, are better able to assist the smaller industrial borrowers prepare their loan requests and reap the maximum benefit from the credits obtained [2].

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1) Credit with technical assistance to small and medium-scale industry in Colombia

2) Lecture given on July 15, 1965, to the 1st training course for industrial advisers of the Bank of Brazil.

Because of the ponderousness of the principal financial institutions which, besides the Bank of Brazil, include the Central Banks and the National Bank for Economic Development, the Government has found it convenient (when, in the mid-sixties, it decided to introduce new concepts within the philosophy of development credit), to create special "Funds", largely independent of these institutions . The principal ones are: The Fund for the Democratization of Capital (FUNDECE), the Fund for the financing of machinery and equipment (FINAME) and the Fund for the financing of small and medium enterprises (FIPEME). [1] These Funds are financed from a variety of sources, largely foreign, and are all largely dependent on agents to bring their resources to the ultimate borrower. These agents are often publicly held banks, but also private commercial banks which have found it quite advantageous to avail themselves of these relatively inexpensive resources.

These Funds had the great advantage that during a period of rapid inflation, they made medium and longer term resources available to smaller enterprises which otherwise would have been unable to find any financing. But, to be absolutely objective, the number of firms which have benefited is quite limited, and the measures taken by the Government have so far had but little influence in prompting a greater volume of lending by the commercial banks from their own resources to small and medium scale enterprises.

4. Uruguay

In the early sixties, the Government of Uruguay, conscious of the importance of the small scale industry sector to provide for diversification in the export sector, particularly within the context of the Latin American

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1) Intermediate Credit Institutions in Brazil - Credit to small scale industrial enterprises, Banjamin Spiro Associates, Inc., 1965

Free Trade Area, decided to obtain the financial support of various external sources such as the Export-Import Bank, the Inter-American Development Bank and the U.S. Government. By the end of 1964, US $ 13 million had been mobilized for lending by the Bank of the Republic, which is Uruguay's largest commercial bank. In addition, the Bank of the Republic had to provide the equivalent of US $ 3 million from its own resources for this program of credit to small and medium scale industries. However, contrary to the experience in other countries, the Bank of the Republic decided to be its own distributing agent for these resources, ignoring the facilities which the commercial banks might have offered to reach the smaller enterprises. It is true that at about the time the foreign loans were secured, Uruguay went through a serious banking crisis, with the Bank of the Republic forced to take over various private banks. This was not designed to create a very favorable climate to promote the activities of the private financial sector. Be this as it may, the Bank of the Republic failed entirely in its task to assist small scale industry and, at the end of the decade, the foreign loans are still practically unutilized and, in at least one case, being withdrawn. It can be asked whether by a positive policy regarding commercial credit to small and medium scale industries (which represent 98.3 % of all industrial enterprises in Uruguay according to the 1960 industrial census), the crisis in which the country finds itself now could have been averted or at least somewhat alleviated. The fact that the Bank of the Republic failed to accept the concept that it is the quality of entrepreneurship which counts above anything else in the ability of small and medium scale enterprises to be promoted reflects the lack of confidence in ability versus traditional guarantees; this is undoubtedly a major factor in Uruguay's present economic deterioration. [1)]

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1) Development Credit in Uruguay, Benjamin Spiro Associates Inc., July 1966

5. West Africa

The principles which guide the activities of the Banque Centrale des Etats de l'Afrique de l'Ouest in its relationship with the commercial banks of the seven countries in which it operates include relating its activities to the real requirements of the economy by ascertaining that the terms of credits correspond to the needs, in order to avoid that investments or long-term applications be financed with short-term facilities, and guaranteeing rediscounting facilities to any and all activities which, based on a sound financial situation, contribute to the general development of the economy. While these principles do not imply a dynamic action on the part of the Central Bank, they at least guarantee a positive response to actions which the commercial banks may take within the context of development. Unfortunately, published data are not sufficient to permit a detailed analysis of the effects of the application of these principles on the volume of commercial banks credit to small scale industries. It is nevertheless interesting, though perhaps not relevant, to note that while during the period September 1964 - September 1966 the percentage of total credit represented by medium and long-term credit granted by development banks decreased from 49.5 % to 48.4 %, the corresponding percentage of commercial banks portfolio increased from 5.5 % to 6.2 %. This might indicate a greater willingness on the part of the commercial banks to avail themselves of the resources of the Central Bank with its policy to reserve all the monetary resources of the region to the financing of its needs, and thus avoid the outflow of resources.[1] As the needs are established by the national monetary committees on which the ministries of economy and of planning are represented, it can be

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1) Principes et modalites du concours de la Banque Centrale au Financement de l'Economie Ouest-Africaine, BCEAO, November 1966

assumed that the Central Bank, within the scope of its responsibilities, carries out a definite programme of assisting commercial banks' small scale industry credit programmes. However, as all the commercial banks in the region are either public or mixed banks, the latter semi-autonomous or branch offices, it is difficult to properly weigh the importance of all the factors which can intervene in the response of these banks to the facilities offered.

6. India

The Industrial Development Bank of India, a wholly owned subsidiary of the Reserve Bank of India is authorized to rediscount medium and long term loans made to small scale industries by commercial banks, provided the loans are covered under the Guarantee Scheme for Small Scale Industries of the Government. Mr. David Fritz, in his paper on measures to increase commercial bank financing of industry in developing countries [1] analyzes the overall effects of the IDBI's action in refinancing industrial loans by commercial banks. His conclusion is that it would be very difficult to determine how successful the IDBI programme has been in terms of increasing the amount of funds going into industrial term loans above the level that banks would normally make available from their usual resources. It may be that some of the financing under the IDBI programme may represent a shift from loans that would normally have been made. While this may generally be true, answers to our questionnaire seem to indicate that advances to small scale industries have increased as a result of the Government credit guarantee scheme, even if it is not possible to quantify this increase.

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[1] UNIDO, ID/CONF.1/B.9, 8 April 1967, Background paper for the International Symposium on Industrial Development, Athens, 29 Nov-20 Dec. 67

7. Mexico

The operations of the Fondo de Garantía y Fomento a la Indústria Mediana y Pequeña established by the Government of Mexico in December 1953 have already been described so often, that we mention this Fund here only for the sake of completeness. [1] Of all government schemes established to promote commercial credit to small scale industries, it is undoubtedly the one which has had the most success.

[1] Sabas Francia Garcia: Financiamiento a la Indústria Pequeña en los países en Desarrollo. UNIDO, Mexico, D.F., Febrero de 1968.

VI. Techniques which could increase the volume of small scale industrial credit from commercial banks

1. Collateral guarantees by public institutions

With the general proviso that the proposal be acceptable in itself by the commercial bank, slightly more than half of the institutions answering our questionnaire are prepared to accept the guarantee of a public or semi-public development bank or corporation instead of the usual guarantees required from small scale industrial borrowers. The other banks answer that they would be prepared to accept such public or semi-public institutional guarantee in addition to the borrower's signature. One foreign bank would not be prepared to accept the guarantee of a public institution. In several cases, the banks answering positively already benefit in their countries, from institutional guarantee schemes. One bank is quite specific in stating that in view of the Government's interest in promoting the small scale industrial sector, they are endeavouring to increase their financial flow to small scale industries.

On the other hand, the foreign bank's reaction towards public institutional guarantees is surprising, as none of the developing countries in which this bank has most of its branches seems as yet to have government schemes offering collateral guarantees. This would appear to indicate that there is a certain prejudice on the part of the bank, otherwise known for its liberal credit policies, towards existing public financial institutions and their capacity to effectively develop and manage schemes to guarantee small scale industrial credits.

From the answers received, it would appear that widespread use of the collateral guarantee by a public or semi-public institution would probably result in a material increase of lendings to small scale industries, as it would decrease the burden of work which the gathering of specific collaterals represents. It is evident however, that this easing up would not affect the need for the commercial bank to assure itself that the manager of the small scale enterprise not only requires the financing, but also that he is able to utilize it productively and make it fructify. It would also be necessary to ensure that the assets which would normally have been used to guarantee the loan, are not used to guarantee other borrowings from other sources. In fact, the effective use of a credit guarantee scheme does imply the existence of a strong bank-client relationship, the scheme itself merely reducing the credit risk assumed by the commercial bank.

2. Credit insurance, inter-institutional or by a public agency

There has been much talk, on various occasions, about the advisability of establishing credit insurance schemes, particularly for small scale industry credits. From a statistical and actuarial point of view, it should be possibe to determine the real margin of risk which is involved in small scale industry lending, including both the risk represented by arrears which mean a slow down in the rate of turn over the bank's resources, and that represented by defaults either to be written off or in litigation. The data which we show on pages 21 - 22 provid an idea of the order of magnitude of this risk. It must be remembered, however, that the sample is not only small, but that small scale industry credit represents but a small volume, in numbers and amounts, in most commercial banks' portfolios. Therefore, in order to arrive at a representative estimate, it would be necessary to carry out the computation on an inter-institutional basis, something which can only be conceived within the context of a Central Bank's sphere of action. The result would be the establishment of a uniform insurance rate of premium to be covered from the borrowers. The resources collected would accrue to a central fund from which losses would be paid to participating banks. In view of the fact that most banks carry reserves against bad debts, one is led to wonder if the increase in the cost of loans to borrowers (which the insurance premium would represent) would be warranted. The fact that so far such schemes have remained, to our knowledge, at the discussion level seems to indicate that other alternatives have been found more desirable as means of increasing the volume of small scale industry credit from commercial banks. Yet, answering our question "Would you participate in or accept a programme of credit insurance? What would be the effects of such a programme on both volume of credit and cost to the borrowers?" most banks stated that they would consider favorably such a programme, and that it would undoubtedly increase the volume of loans while increasing the cost to the borrowers.

3. Programmes of credit supervision

The concept of credit supervision, particularly of smaller credits, is well established in the field of rural credit. Supervision generally takes two forms, first to see that the credit is applied at the opportune time within the production cycle and second that the end product of the credit, the crop, is marketed in such a way as to permit the reimbursement of the loan. Generally, the end user of the credit is a small farmer much in need of advice concerning the effective development of his unit of production. To a very large extent, a parallel can be drawn between this small farmer and a small scale industrial producer. However, few institutions, except perhaps public institutions, have drawn this parallel. In fact, it is just as important for a close contact to be maintained between the commercial bank and its small scale industrial client, as it is between the rural credit institution and the small farmer. However, while it is an accepted fact that government extension services can work in close relationship with the rural lending institutions, few similar services have yet been established for industry, and the concept of an industrial extension service at the national level really remains to be implemented.

This does not mean that there is not consciousness of the need for such services.[1] Each one of the banks answering our questionnaire stated that is would participate in a scheme of supervised credit. Two banks, however, qualify their answer, making it dependant on the merit of the scheme. Credit supervision, to be effective, must be carried out in a broader sense than merely supervise the correct execution of the project, that the investments have been made according to plan, that the raw materials are being transformed and the fi ished products sold. Quite often, the very existence of the project creates new problems which the entrepreneur may need to discuss, to find appropriate solutions. A close relationship between the borrower and the bank's supervisor makes not only team work possible between them, but also permits to anticipate problems and to be prepared for new circumstances when they arise. To be effective, this credit supervision must be backed by technical ability to permit to suggest to the borrower the remedial action required in time to assure the survival of the production unit which represents the real guarantee for the lender.

Credit supervision is thus not merely an accounting technique. It is much more and to be effective requires specially trained supervisors. Credit supervision must in fact start with the evaluation of the credit request. The supervisor, therefore, must possess the necessary qualifications to appraise all the aspects of the proposal, managerial, technical and financial. Because of the nature of the small enterpreneur as the man responsible for all the aspects of his enterprise, the supervisor must be able to place himself in a position in which he can communicate with him,

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[1] The role of industrial extension services in small scale industry development programmes - UNIDO ID CONF. 2/3 - 19 April 1967

at his level. Experience in various Latin American countries has shown that such supervisors need, and can receive a very special training, which then becomes the best insurance which the lending institution has against faulty loans. While we do not believe that the peculiar bank-client relationship which exists in industrial lending could readily subject itself to the direct intervention of an industrial extension service, we feel that the training of industrial credit supervisors could well be organized on a national, even on a regional basis. While industrial extension agents have been trained in various countries under ILO managed projects, or in India under Ford Foundation sponsorship, the personnel formed has generally been attached to government services rather than to financial institutions, public or private. Other projects, particularly in Colombia, Brazil and Uruguay were aimed at giving specialized training in credit evaluation, supervision and technical assistance to small scale industries, to personnel either already on the staff or specially hired by public credit institutions to expand their credit activities in the small scale industry field. The programmes in Colombia and Brazil were successful while the one in Uruguay failed for reasons not related to the programme itself.

In all three cases, the training programme was aimed at forming generalists in the four principal fields of interest to small enterprises - management, controls, technology and marketing, rather than specialists in any one of them. This corresponds largely to the lack of specialization which is the main characteristic of a small entrepreneur.

In Colombia, it was decided to seek as trainees, economists, industrial engineers, graduates in business administration as well as high level staff of the institution itself with experience equivalent to a professional formation, to give them as thorough a background as possible in all the facets of small industry. The training included courses in accounting and controls, management, productivity, marketing and technology, as well as in the technique of credit appraisal. We believe that the course material developed for these training projects could well be used as the basis for a course to which qualified staff from several commercial banks would be invited to participate for a two or three months period. We are convinced that the better appreciation of what is a small scale industry and the capacity to deal with it with techniques developed specifically for the purpose could result in a substantial increase in small scale industry credits at reduced cost and risk.

4. Credit with technical assistance

The commercial banks answered generally in the affirmative to the question as to whether they did or would participate in a scheme of credit with technical assistance being provided either by the public or semi-public development bank or corporation in their country, by the industrial extension service or by consultants sponsored by such institutions. The answers in several cases were not sufficiently clear to see whether the banks already participated in such a scheme, or merely that they would participate. One bank answered with an unqualified no, while two other banks qualified their answers, by making them dependent on the merit of the scheme and on the circumstances prevalent at the time it might be established.

In the training programmes mentioned in the preceeding section the aim was to prepare staff capable of providing technical assistance up to a certain level, related to the credit sought. In fact, in the three countries the programmes were developed as a means of establishing industrial extension services which did not yet exist, thus having the public financial institutions perform, at their own expense, a function which might normally be carried out by the state, and not be necessarily related to credit. This extension service, however, was strictly limited to the clients, actual or potential, of the public financial institution involved. From the answers, it appears now that there is scope for close co-operation between a publicly run industrial extension service providing technical assistance and the commercial banks providing credit to technically assisted small scale industries. However, while the commercial banks are generally ready for this type of co-operation, it is the extension service which does generally not yet exist.

Therefore, we feel that the training of credit supervisors along the lines already mentioned would permit a certain level of technical assistance, to be supplemented by more advanced services either by a publicly established organization, or by private groups or consultants. Such groups include for instance the Colombian Institute for Administration (INCOLDA), the Institute for Technological Investigation (IIT), the Institute for the Development of the Direction of Enterprises (IDDE), and the various Productivity Centers in Latin America. There are also quite a number of private industrial consulting firms which have established themselves in various developing countries which should be able to provide services when called upon.

5. Internal loan management

So far the emphasis has been on increasing the volume of small scale industry credit mainly with techniques which have their origins outside of the commercial bank itself. This has left out measures which can be taken internally to facilitate the handling of small scale industry credits, to reduce unit cost and increase profits from this category of operations. Far too often, commercial banks in developing countries lack the appreciation of the benefits which might accrue from improved internal loan management techniques, such as have been developed by most commercial banks in industrialized nations. The very fact that the risk is spread far wider compared to large scale enterprises should make it possible to cut down on the collaterals required and on the volume of paper involved in each operation. Greater decentralization in the decision making process with, at the same time, stricter internal controls would also help reduce materially the time required to handle each application. It could be very profitable to seek ways and means of transferring the banking know-how evolved in the industrialized nations to the autonomous banks and at times even to the branches of foreign banks operating in the developing countries. It might represent a step forward from the money lender's technique which is still all too prevalent, to real commercial banking with all its modern and even social implications.

As a last consideration, we should like to stress the importance of the timeliness of the credit to small scale industries. So far development banks and other public credit institutions have been largely unable to speed up their process of appraisal and of decision making to meet the needs of small scale enterprises. Thus, while they aim at providing low cost credit, the benefit is lost because of the long delays which the borrower has to face; this in fact often means a substantial increase in the real cost of the money by the time it becomes available to him. Commercial banks, by being more agile in their treatment of small scale industry loan requests may be able to charge higher nominal rates which in the end may still in effect be lower than those of the public banks, all the while reducing their unit cost of lending. Commercial banks should therefore not be afraid to charge the right amount for the money lent, if it is lent at the opportune moment for the right purpose. A recognition of this simple principle would go a long way towards making small scale industry lending more attractive.

VII. Possible means of increasing resources available within the commercial bank system for small scale industry lending

Mr. David Fritz in his paper "Measures to increase commercial bank financing of industry in developing countries" analyzes the various techniques which might be utilized in general terms. In our questionnaire, we tried to pinpoint the effects of such measures with particular regard to small scale industry. Since the techniques have already been well defined, we shall limit ourselves to stating the questions and analyze the answers received.

1. Could and should commercial banks be used to channel public funds allocated for small industry development? The answers are nearly unanimous to the effect that commercial banks, because of their knowledge of the credit worthiness of borrowers are very well suited for the job

2. Would you increase the volume of your loans to small and medium scale industries were the Central Bank to liberalize its margin requirements with respect to such loans? The answers vary from country to country but are nearly all affirmative, the exceptions coming mainly from banks in countries where Central Banks are not making use of margin requirements as a tool to influence credit policies. Most banks however make it quite clear that the mere easing of margin requirements would not automatically cause them to step up their lending. They would continue to make finance available on merit to individual customers. The sense of the answers is that it is not so much a matter of resources than of suitable projects being available for financing.

3. Would you increase your volume of loans to small and medium scale industries were the Central Bank to refinance them at a lower rate of interest? The answers are all affirmative, with the usual proviso that suitable projects are available. The answers as to what would be the

bank's operational margin in such cases vary from a high of 10 % to a low of 1 %, with the great majority between 2 and 3 %.

4. Under what circumstances would you accept public financing for loans to small and medium scale industries? The answers are very mixed. Several banks would not accept such financing under any circumstances. Others make it depend on the operational margin which would be granted them. Others yet would reserve their acceptance depending on the terms and on the prospects of each project considered. Two specific possibilities mentioned are: that the commercial banks be appointed disbursing agent of the Government, and that the lending be done at the risk of the Government, or that the losses be subsidized. There seems to be a considerable fear of interference from the public sector in the operations of the private banks as well as of unreasonable red tape.

5. Would government subsidies be desirable to increase your volume of small and medium scale industry financing? What type of subsidy would you consider? Opinions are quite divided on this question. One third of the banks are opposed to any form of subsidies. The Indian banks feel that the existing method of credit guarantee already serves the purpose. A large group of banks consider the question relevant only to the extent that the applicant's business is thereby made viable. Finally, some banks specify that subsidies of the following types could result in a material increase in small scale industry lendings:

- Refinancing of the laons granted to small scale industries by the Central Bank,
- equal share of risk with the Government, with a reasonable handling commission,
- indirect subsidies such as tax rebates or exemptions.

In general, the commercial banks do not appear to suffer from a lack of resources to lend to small scale industry. If lending remains at a very low level, it can be ascribed to the following reasons (which do not pretend to be all inclusive):

- Time and again, the banks have insisted on the importance of suitable projects; this can be interpreted in two ways: small scale industry is treated in the same way as large scale and therefore unsuitable appraisal criteria are applied and second many banks, particularly those of foreign origin, often still consider the native small scale entrepreneur as a poor risk.

- Most developing countries suffer from an inadequate system of land tenure which prevents the establishment of valid mortgages to be used as security for longer term loans. This problem, as well as the previous one arises from the fact that commercial banking is often still based either on traditional money lending methods of the pre-colonial and colonia era, or on lending methods evolved in the industrialized countries before the recent revolution in lending techniques. In other words, commercial banks have failed to develop methods suitable for operations within their own environment.

- Small scale industry suffers from a lack of know-how (technical, administrative and managerial) and therefore is unable on the one hand to raise the necessary risk capital and on the other to operate sufficiently efficiently to become a suitable credit risk. There is little question that small scale industry generally lacks know-how, but on the other hand, there is generally a lack of understanding on the part of the commercial banks of what small scale industries are and of their role within the economy.

The conclusion is that commercial banks must be made to think in socio-economic terms and to appreciate the importance of the relationship between large and small scale industry in the process of economic development. They must be taught to devise ad hoc methods to deal with this relatively new client, which is the small scale entrepreneur, as a producer and no longer only as a trader. It is worth noting that India where the greatest amount of attention has been given to the problems of small scale industry, is the one country where non classical methods have been devised to overcome traditional barriers against small scale industry lendings by commercial banks.

We feel that while the various methods which have been proposed at some time or other to make more resources available within the commercial bank system for small scale industrial lending have all some merit, they are mere palliatives which do not reach the root of the difficulty, namely education of both the lender and the borrower. We feel that the most effective measure to achieve this aim is the establishment of training courses for credit supervisors, or industrial extension agents. It would also be very useful to analyze the modern lending techniques which have been evolved in the industrialized countries in order to adjust them to the needs of commercial banks in developing countries.

VIII. Summary and conclusions

The exact degree of commercial bank financing of small scale industry in developing countries is not easy to determine as most commercial banks do not differentiate in their loan portfolio between industries by their size. There are exceptions, such as in India where special provisions for guarantees for loans to small scale industries - defined very broadly in terms of a maximum value for the original cost of the investment in plant and machinery - leads the commercial banks to keep separate records between small scale and large scale enterprises.

One of the main reasons for this lack of differentiation is the fact that no generally accepted definition of what is a small scale industry exists as yet.

From the data gathered from a broad sample of commercial banks operating in developing countries which answered a questionnaire on their policies with respect to the financing of small scale industry, it appears that small scale industry loans represent but a small percentage of total industry lending, rarely reaching 10 %, with the exception of India where it reaches 30 %, in one of the reporting commercial banks.

From the answers received, it is evident that so far very few commercial banks only have defined policies regarding credit, be it short or long term, to small scale industry. Generally, commercial banks apply the same policies to this sector as they do to their other industrial credit. One exception is India because of the special credit guarantee scheme for small scale industries administered by the Reserve Bank of India. Other programmes, such as the one in Chile, tend to define small scale industry in terms of the amount to be lent, but this does not affect the policies applied by the commercial banks.

The survey indicates that it is not so much the lack of resources which limits the volume of small scale industry lendings by commercial banks as the lack of special techniques to appraise and manage a small scale industry credit portfolio in such a way as to make it attractive from the point of view of return to the lending institution.

The problem of collaterals required from small scale industrial borrowers has not yet been resolved, largely because the nature of small scale industry itself has not yet been clearly understood by the commercial banks. The commercial banks do not have specialized staff capable of dealing with the special problems which small scale industry presents from the credit risk point of view.

The conservative attitude of the commercial banks is reflected in the low percentage of credit granted to small scale industry, out of proportion with its real importance in the economy, and with the important percentage of the gross industrial product it represents in any given country.

To remedy this situation, a number of measures could be taken, such as:

1. The establishment of regional, sub-regional or country centers for the training of commercial banks selected staff in the techniques of small scale industry lending. Such techniques would aim at reducing unit costs of lending as well as increase the volume of lending which should make it possible to generate sufficient income for the lending institution to enable it to set aside adequate reserves for potential defaults.
2. In order to facilitate the work of appraisal of the newly trained small scale industry credit staff, Governments should make readily available to the commercial banks detailed information regarding industries and their products. Up-to-date information regarding price trends of the principal commodities should also be made available. This type of information would enable the commercial banks to take correct decisions regarding limits and margins on their securities.[1]

[1] These measures have been suggested by answering banks. They are, included here as being relevant to this paper.

3. Wherever possible, credit information centers should be established where adequate credit files pertaining to as large a number of the industrial units in the country as possible should be kept. The government, the commercial banks and the industrial associations should co-operate fully in keeping this credit file up-to-date. Such a system would facilitate the granting of adequate credits at the proper time. [1)]

4. Since small scale industries are generally more vulnerable to financial and other crisis, than larger units, regional study teams should be organized to analyze the problems of credit at the micro as well as at the macro levels. They should undertake credit planning and make recommendations at the country level which should be passed on to the commercial banks for their guidance.[1)]

5. Measures such as programmes of credit insurance, special central bank refinancing or easing of margin requirements when applicable, as well as government subsidies should be explored further, geared to the special needs of any given area.

It is however already clear that first and foremost, it is in the field of banking techniques and training that the principal answer must be found to the problem of increasing the volume of commercial bank financing of small scale industry.

In view of the findings of the survey, it is difficult to properly gauge the respective advantages and limitations of public versus private financing of small scale industry. Experience indicates that in the short term field, where quick decisions are of the essence, commercial banks are better suited than specialized public institutions. If appropriate measures can be taken to develop adequate lending techniques for longer term financing, commercial banks may also be better able to attend

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[1)] These measures have been suggested by answering banks. They are, included here, as being relevant to this paper.

to the need of the existing small scale industry, particularly through the use of the technique of 'fluctuating overdrafts'', leaving generally the financing of industrial development to the specialized institutions.

Finally, it may be well to remember that in spite of all the statements to the effect that private enterprise is the future of developing countries, experience indicates that, particularly in the financial sector, there is a strong trend towards resolving problems through controls and even nationalizations. We strongly believe that if the private commercial banks as defined in chapter II are able to justify their usefullness to economic development by broadening the sphere of their activities, particularly by paying greater attention to the important sector which small scale industry represents, the risk of nationalization might well recede, and a better understanding be worked out between public and private functions to the greater benefit of socio-economic progress.

Appendix I

Countries selected for the purpose of carrying out a survey of commercial banks practices regarding credit to small scale industries

Africa	Asia	Europe	Latin America
Algeria	Afghanistan	Greece	Argentina
Cameroon	Hongkong	Poland	Brazil
Rep. of Congo	India	Turkey	Chile
Ethiopia	Indonesia	Yugoslavia	Colombia
Ghana	Iran		Mexico
Ivory Coast	Israel		Peru
Kenya	Lebanon		
Morrocco	Malaysia		
Nigeria	Pakistan		
Senegal	Philippines		
Sudan	Saudi Arabia		
Tunisia	Singapore		
U.A.R.	Taiwan		
Uganda	Thailand		
Zambia			

Appendix II

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