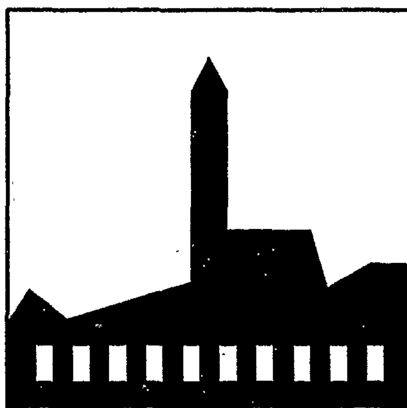
INDUSTRY AND DEVELOPMENT BANKING IN JAMAICA



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FLEXIBLE SPECIALISATION AND DEVELOPMENT BANKING IN JAMAICA

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Summary

1. Flexible specialisation (FS) refers to a production strategy which marks a sharp break from the traditional mass production approach. Instead of long runs of standardised products, using purposes made machinery and semi skilled labour, FS stresses adjustable runs of customised outputs, using flexible machines and multiskilled labour. Instead of looking to increase labour productivity through large fixed investments, FS seeks to improve working capital productivity through cutting stocks, defects rates, and work in progress times. Its focus of competition is less on price than on quality, design and product innovation, and in order to achieve these things it has developed new ways of decentralising control to the immediate producers, and of establishing, long term co-operative relationships between suppliers, customers and competitors.

2. The successful areas of FS production in Europe are also distinguished by particular structures of finance for small and medium sized enterprises. On the basis of the European experience this report suggests that we can talk of an FS approach to industrial finance which entails the following:

- finance should be seen as part of a broader customised package, including training, technology and consultancy, if new projects are to be successful, and there need to be institutional means of securing such integration;

- stress should be put first on working capital savings (and the continuous improvement of production methods) before shifting to the question of raising new capital to finance growth.

- banks should play an active rather than a passive role with respect to projects and sectors, and develop specialist expertise accordingly

- banks should seek to establish long term relations of trust between themselves and their clients

- there should be formal and informal means for industrialists to co-operate among themselves to improve projects and reduce risk.

The distinct feature of such an FS approach is that it concentrates less on the quantity of finance and its price, but on the qualitative relations between banks and their clients, and between the finance, preparation and implementation of projects.

3. The Jamaican financial system is relatively sophisticated, and reflects a British and North American model of banking rather than a German/Japanese one. It is dominated by 11 commercial banks who account for nearly two thirds of the sector's financial assets, who are primarily short term in outlook, and geared to established borrowers and those with strong collateral. In spite of the recent rapid growth of merchant banks there is little active banking, nor until the launch in November 1990 of the Jamaica Venture Fund, has there been any institution specialising in risk equity finance. There are still too few facilities offering medium and long term funding to manufacturers, particularly small and medium sized firms. There is no industrial sector specialism nor programme of sectoral lending, and there is an absence of integrated technical support and advice alongside the flows of finance.

4. More seriously, there is a danger that the Jamaican financial system will replicate another feature of the US and UK systems, namely the tendency for finance to become dissociated from the long term interests of industry rather than serving to support them. Over the past twenty years the financial sector in Jamaica has grown at nearly ten times the rate of the economy as a whole, and at more than twenty times the rate of manufacturing. Increased lending in the 1980s, both by banks and near banks, went primarily into construction, land and tourism. The larger and well established manufacturing exporters have been able to gain access to funds, but other industrialists face greater difficulty in obtaining adequate, reasonably priced finance, where they cannot offer the necessary

security. There is no one body - whether a bank or quasi public financial institution - which is looking at the long term prospects of particular industries and ensuring that there are adequate funds to secure their competitiveness. Tourism, urban property and 807 exports have all offered good returns in the short run, but are vulnerable in the medium to long term. An industry with long run competitive potential takes time to build up. The danger of a deregulated and disconnected financial sector is that it will tend to neglect the need for long term commitment in favour of areas of more immediate returns.

5. Jamaican industry has been able to supply some of its own cash needs through re-invested profits. These profits have risen sharply during the 1980s not as the result of an improvement in labour productivity (which has in fact fallen by a quarter since 1979) but because of a cut in wages (real wages in manufacturing fell by nearly 50 per cent during the eighties). It is unlikely that these rates of profits can be maintained during the 1990s without major improvements in productivity, and this again will highlight the problems of industrial finance that currently exist.

6. There are three bodies which have sought to meet these needs - the National Development Bank (NDB), the Exim Bank, and the Trafalgar Development Bank, but each face limitations. The NDB is a wholesaling facility operating through approved financial institutions, mainly commercial banks, and this means that potential borrowers who do not meet the normal criteria of commercial banks are screened out. The Exim Bank has retreated from medium term industrial financing after it faced client difficulties. The Trafalgar Development Bank has been able to grow on the strength of a substantial spread on its concessionary funds supplied by international donors, but will be increasingly drawn towards customary commercial criteria if continued supply from this source of funds cannot be maintained.

7. Neither the structure of the present development finance institutions, nor the quantity of their funds allow them to adequately fill the gaps in the system of industrial finance. One possibility is to revive public retail development banking, but there is considerable opposition to this as a result of the losses incurred in the late 1970s by a previous retail facility, the Jamaica Development Bank, (JDB).

8. The experience of the JDB was not an uncommon one for development banks at this period throughout the developing world. Many had been required to take on tasks which conflicted with the robustness of their balance sheets, and the international downturns of the mid and late 1970s, and the continuing recessions of the 1980s, exposed the weak parts of their portfolios. Over the past decade the World Bank, which had done much to promote the original model of development banking, encouraged a retreat of these banks from front line lending towards wholesaling concessionary finance through existing private intermediaries. Jamaica's NDB was only one of many so called apex wholesaling institutions set up at this time. Those development banks which retained their retail facility were nevertheless forced to impose increasingly tight commercial criteria, and to diversify into other areas of private banking and business services, because of a reduction in the supply of public funds to them. The overall result has been that the developmental role of these banks has been sharply reduced.

9. The need for developmental finance, however, remains as acute as ever. The report recommends that the original model of development banking and its shortcomings be re-examined to find a better way of resolving the tension between developmental needs and commercial requirements than was done previously. In a brief review of the JDB experience it suggests that the bank's main problem was a 'confusion of economic languages' and the lack of a clear distinction between its developmental and its commercial tasks. It outlines a new model of development banking consistent both with an active developmental function, and with commercial viability, building on

previous models from the developing world, and the experience of local and regional banking in continental Europe.

10. The report recommends an 'objectives-based' strategy for industrial finance, in which policy is focussed on (i) long term industrial competitivity; (ii) means of economising of the need for finance by increasing the productivity of fixed and working capital; (iii) the provision of medium and long term funds at stable rates of interest reflecting the long term social rate of return, (iv) the need to link finance with a package of 'real services' for the small and medium sized enterprises which lack the specialisms to provide them internally.

11. It proposes a 10 point plan covering the following issues:

- the development of an agreed perspective on industrial finance between bankers, industrialists, the Government and quasi public bodies.
- the gathering of more detailed evidence on the financial needs and difficulties of Jamaican manufacturers through industrial sector studies, and through an extension of work on Jamaica's financial institutions by case interviews with the users of funds.
- the establishment of a pilot sector strategy working group on a single sector, bringing together professionals from industry, the banks, the trade unions, quasi publics and Government Ministries, with the financial requirements of the industry as a particular part of the brief.
- the exploration by industrialists of the feasibility of setting up (a) a manufacturers' merchant bank, (b) a financial guarantee consortium.

- a study by the financial and monetary group at the University of the West Indies on the German and Italian local and regional banking systems, and their relevance to Jamaica.

- discussions with the commercial banks as to how they could develop more active industrial lending policies.

- the strengthening of complementary 'real services', notably in connection with loans financed by the NDB.

- the carrying out of a feasibility study into the establishment of a Jamaica Enterprise Board.

- a project to consider the extension of the system of national statistics to accommodate a policy of flexible specialisation, with particular reference to finance.

- the consideration of current training provisions for bankers, and the feasibility of setting up a two year part time course to cover current changes in industrial management, and comparative institutions for the financing of small and medium sized industry.

12. At the moment the Jamaican system of industrial finance has been least adapted to the development needs of small and medium sized enterprises, the enterprises which are being particularly hard hit by the process of economic liberalisation. A policy of flexible specialisation, while not confined to firms of this size, does give significant place to them and it is important that forms of finance and technical support are made available to them so that they can strengthen their economic presence within the Jamaican economy as a whole.

INTRODUCTION

Background to Study and Terms of Reference

1. In November 1989 a two person team visited Jamaica at the invitation of the Ministry of Development, Planning and Production to explore the relevance and feasibility of a flexible specialisation strategy for industry in Jamaica. This was a strategy which had developed on the basis of the experience of a number of the most successful regions in Europe and Asia, and placed its emphasis on encouraging flexible production and organisation systems capable of adapting rapidly to changing external requirements. Rather than the focus on standardisation, volume, special purpose equipment, cost cutting and semi skilled work processes characteristic of mass production systems, flexible specialisation shifted attention to quality, design, innovation, customisation, stock reduction, multiskilling of labour, and a more co-operative two way relationship between firms. For readers unacquainted with this strategy, a summary is provided in Appendix 1.

2. The report of the initial visit suggested that there was considerable scope for flexible specialisation in Jamaican industry.1 As a small island economy, with a limited internal market and vulnerable to fluctuations in the international economy, flexibility was particularly important, as was a strategy which reduced the economy's dependence on providing low cost labour for mass production industries geared primarily to the North American market. The team visited a number of firms which had strong design capacity, an export orientation, but substantial production problems for which the flexible specialisation approach could be seen as immediately

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1. R. Murray and K. Hoffman, Flexible Specialisation: the Potential for Jamaica. Report Presented to the Ministry of Development, Planning and Production, November 1989.

relevant. The report proposed a number of ways of taking the policy forward, through pilot projects, sector studies, study visits and seminars, and the establishment of specialists in Jamaica - in both the public and the private sector - who could take responsibility for developing and implementing the strategy. These proposals drew on the experience of flexible specialisation in another small island economy, that of Cyprus, where it was found to be paramount to have a core of institutions and individuals who understood the strategic approach and could implement it in their own way in their respective fields.

3. In the summer of 1990 Dr Kaplinsky of the Institute of Development Studies at the University of Sussex, visited Jamaica with UNIDO support, to continue the discussions on the new strategy with industrialists, trade unions and government departments and agencies. He addressed more than a dozen meetings, and went on an extensive programme of factory visits, notably in the garment sector2, in order to help identify firms ready to act as pilot enterprises. He also prepared a terms of reference for the Jamaican Productivity Council, and for studies on Financial Incentives and on Development Banking. It is with Development Banking that the present report is concerned.

4. The report is concerned with four things:

i) the relevance of flexible speicialisation concepts to the analysis of industrial finance.

ii) the nature and history of the banking system in Jamaica.

iii) the institutions of development finance in Jamaica, their history, and policies, in the light of comparative experience of other developing countries.

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2. R. Kaplinsky, Flexible Specialisation: Productivity Policies and Institutional Aspects, Report of UNIDO mission, July-August 1990, Supplementary report on the garment industry.

iv) the main options for policy in the field of industrial finance in Jamaica, and the changes required to fill the gaps in the present structure in the light of the needs of industrial flexible specialisation.

Chapter 1

FLEXIBLE SPECIALISATION AND THE BANKING SYSTEM

1. Traditional approaches to industrialisation, like development in general, have given a central place to the supply of money capital. As Edward Nevin put it in his text on the subject thirty years ago "Capital alone will not solve the problem of underdevelopment, but it provides access to the multiplicity of other ingredients whose intelligent combination can eventually bring the impoverished peoples of the world to a tolerable standard of living"[3]. For industry this meant funds to purchase fixed capital, machinery, disembodied technology, and the requisite buildings. The key questions were how to ensure an adequate supply of funds, a parallel incentive to invest, and the establishment of properly functioning markets both for the purchase of inputs and the sale of what was produced. It was a mechanical model. Capital was the key scarce factor of production - the means to obtain 'the multiplicity of other ingredients', and was recognised as such in a whole range of growth theories.

2. In many ways this is still the case. Government incentive systems privilege investment in fixed capital. Regimes of protection include lower duties on imports of capital equipment, and there is the long standing concern with the development of a capital goods industry. Aid is still primarily focussed on the supply of capital for investment, not least because it is easy to quantify and straightforward to supply. Money capital allows governments, no less than businesses and economists, to short circuit problems in the 'other ingredients' of production, since they can be translated into financial needs.

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3. E. Nevin, Capital Funds in Underdeveloped Countries, Macmillan 1961, p. xi.

3. No one, of course, would query the significance of fixed investment, nor the supply of funds for industrial development. But what we can now see is that these priorities in part reflected mass production strategies. Products were standardised. Economies of scale came through production in volume from bespoke machinery. When operating labour was relatively unskilled and plentiful, the key to the establishment of such industries was access to the substantial finance needed to purchase the machines, dies, models, patents, and if necessary key technical and managerial labour from abroad. How many industrialists - and public policy makers - do not still see the main path to their competitivity and expansion in terms of purchasing the latest machinery from an international machinery fair, with recipes and blueprints attached?

4. Flexible specialisation provides a useful corrective to this view. It puts particular emphasis on improving the productivity of working capital: by cutting inventories and work in progress through just in time production; by improving quality and pursuing 'zero defect' goals; by establishing close links with customers which, when married with flexible production systems, allows a growth in making to order and a reduction of the stock of finished goods. The improvement in stock turnover ratios further allows a reduction in fixed capital requirements, as space for the stocks of inputs and finished goods is cut down. The restructuring of volume producers on flexible specialisation lines typically frees up at least a quarter of factory space. Furthermore the principles of 'kaizan' or continuous improvement, mean that machine productivity is achieved more through constant modifications and adjustments than through the purchase of new off the peg equipment. When Toyota cut automobile die changes down to four minutes while Western car makers were still taking several hours, they did it not through investment in machinery, but re-organisation of the work process and the modification of existing machines. Toyota exemplifies a more general truth - that the productivity lead of so much of Japanese industry is

achieved first and foremost through the organisation of work rather than simply investment in new machinery[4].

5. A central strategic variable for flexible specialisation is therefore the restructuring of production and distribution without necessarily a significant increase in capital. Investment may be needed, particularly in software like design, or training, or the introduction of management information systems. But the capital costs may be more than outweighed by the increases in capital productivity arising from the new methods of production. For governments or academic economists these processes necessarily remain a black box. They demand detailed knowledge of particular processes and industries. They cannot be aggregated in plans, nor specified from afar. The levers for these changes are in the hands of those directly involved in production - production managers and the workforce. They require a greater decentralisation of policy therefore than those strategies centred on finance or interventions in markets. Neither a change in interest rate nor a lowering of tariffs ensures the introduction of a kan ban system or total quality control. These depend on the application of particular strategies in production[5].

6. The first thing to say therefore about flexible specialisation and banking is that the flow of funds is a subsidiary rather than a

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4. On Japan, see: K. Suzaki, The New Manufacturing Challenge, Free Press 1987; M. Best, The New Competition, Polity Press 1990, Chapter 5; R. Shonberger, World Class Manufacturing, Free Press 1986; Canon, Production Systems, compiled by the Japanese Management Association, Productivity Press, Cambridge, Mass.; and K. Hoffman and R. Kaplinsky, Driving Force, Westview Press, 1980, Chapter 4.

5. On flexible specialisation more generally see M. Piore and C. Sabel, The Second Industrial Divide, Basic Books, 1984, M. Best, op. cit., and for its application to developing countries: The Cyprus Industrial Strategy, 8 volumes, UNIDO, Vienna, 1987, and H. Schmitz, "Small Firms and Flexible Specialisation in Developing Countries" Labour and Society, Vol.15, No.3, 1990.

primary issue. In so many factories in developing countries what appears as a problem of passive banks and high interest rates turns out on closer inspection to be a question of production organisation, or the need for the restructuring of supply lines or final distribution[6]. Such re-organisation will lower the overall capital requirements of a firm, and at the same time release capital for further investment. A recent IDS case study of restructuring a clothing enterprise in Cyprus showed that the speed up in stock turns gave a once and for all cut in working capital which more than covered the costs of re-organisation, and saved annual interest charges of £6,000 pa.[7] In cases like these - and they apply to much industry in developing countries - capital is no substitute for production strategy. Indeed without such a strategy, low cost funds can delay rather than hasten industrial restructuring.

7. Another way of putting this is that capital needs to be part of a strategic package. In a large firm packages are made up by top management, drawing on the skills of their functional departments - marketing, production, R&D, finance and so on. Small and medium sized firms can rarely afford the specialisms found in the head office of a large firm. What is striking about the successful industrial districts in Europe is that the small and medium enterprises have found ways of collectively providing such specialist services normally associated with corporate headquarters.

8. In some instances the collective institutions are consortia of firms themselves. In Germany and Italy, groups of firms finance common overseas marketing operations. There are joint purchasing

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6. A survey of 103 small enterprises in Colombia found that apparent financial needs were a cover for other problems - planning, marketing, design and quality. Only 20 per cent of the firms were judged to be in actual need of finance. See: IBRD and SIDA, Financing the Development of Small Scale Industry, World Bank Staff Working Papers, No. 191, November 1982.

7. R. Kaplinsky, Flexible Specialisation in Cyprus: a case study of a clothing firm, IDS, January 1991.

consortia. In Italy the National Confederation of Artisans (the CNA) handles the accounts of small firms through an extensive network of branch offices. They deal with tax, provide financial and technical advice and represent the interests of small firms politically. In many cases local and regional government partially funds and organises the common services: specialist training colleges for example, or the transfer of know how from universities and research institutes to the enterprises. In Italy the sectoral Centres for Real Services are controlled and part funded by the enterprises and supported by the municipal and regional governments. They provide market information, advice on new technology, they translate overseas tender documents, and operate data banks of designs, or details of overseas standards. They may even provide access to specialist machinery such as CAD equipment. They are called Centres for Real Services to distinguish them from financial services. They are the non financial elements of the package upon which the Italians have learnt to set such store.[8]

9. The relevance of the above to banking is that in some cases the banks themselves have been the providers or coordinators of important parts of the non financial package. In Germany the industrial banks have sector specialists to advise on strategy, to provide a network of contacts and technical advice. In the Basque region of Spain the Mondragon group of 168 co-operatives with 20,000 workers, has grown round the Group's co-operative bank, the Caja Laboral Popular, which has acted as a collective brain as well as a source of finance. It was founded by four co-operatives in 1959 to meet three needs: financing, social security and technical and managerial assistance. It had divisions corresponding to each of these needs: a banking division which now offers full banking facilities both to the Group's members and to independent customers; a social security division which has been spun off as a separate co-operative; and an enterprise

8. On the centres for real services see S. Brusco, "Local Government, Industrial Policy and Social Consensus in Modena" Economy and Society, 18.4, November 1989, and on the National Confederation of Artisans and the Third Italy experience more generally see chapters 7 and 8 of M. Best, The New Competition, Polity Press 1990.

division which promotes new co-operatives and provides technical assistance in support of the banking function[9].

10. It is the connection between the functions which is important. Workers wishing to start a co-op first approach the enterprise division. Sometimes they have their own product ideas, more usually, from the mid 70's, the bank saw itself as the main source of ideas. The group are asked to find a manager, and after the group of workers and the manager are fully instructed the in requirements of co-operative working, the manager is brought into the enterprise division and works alongside its staff. A member of staff is made 'the godfather' responsible for seeing the project through, and a team including the manager then prepares a set of detailed feasibility studies. The costs of the manager during this phase, and of visits to leading manufacturers in Europe in connection with the project are carried by the Bank, to be repaid later if the project goes ahead. The co-operators participate at each point of decision making and can withdraw at any time before the final decision to go ahead.

11. After the final decision, the enterprise division specialists arrange for factory space and the purchase of machinery, the enterprise opens and the godfather stays closely in touch with the project for at least a year. Thereafter the co-op submits monthly control figures to the bank, and if there are difficulties the co-op will call on the division for technical help. The banking division remains quite separate during these early phases, but given the system of project preparation and management, it advances initial and subsequent capital in response to the recommendations of its sister division and its own assessments. These structures mean that the bank is acting in effect as a head office, but unlike many head offices it rarely puts firms into bankruptcy. By the late 70's only

9. For Mondragon see: R. Oakeshott, The Case for Workers Co-ops,, RKP, 1978, Chapter 10; H. Thomas and C. Logan Mondragon: an Economic Analysis, Allen and Unwin 1982; and "Mondragon" in: Basque Enterprise, November 1987, available from SPRI, Gran Via 35,3°, 48009 Bilbao, Spain.

one project had failed, and the Mondragon group have been able to weather the recessions of the 1970's and 80's more effectively than most Spanish industry.

12. The Mondragon case is a particularly well developed example of something which can be found in a number of development banks, the link between managerial and technical advisory services and the narrower banking function. What it highlights is the close two way inter-relations between organisationally independent units around the successful development of an enterprise. It is a feature of flexible specialisation that firms build up long term commitments between them, based on trust and their capacity to respond to each other's requirements. Whereas in a classical mass production firm, suppliers will be chosen on the basis of their tendering for contracts where designs are specified by the assembler or retailer (in furniture for example), in flexible specialisation suppliers are chosen because of their capacity for quality and innovation, rather than simply their current tender price. Suppliers are seen as potential contributors to product development - it is no longer a question of blueprints handed down by the buyer. If the supplier falls out of line in costs or performance with competitors, a buyer would expect to work with the supplier to put difficulties right.

13. The basis for this change in interfirm relations is the need for continuous innovation and the costs of dealing on a purely arms length basis. There are costs of information in arms length contracting concerning supplier and product quality. There are risks of non performance. There is the waste of the suppliers specialist knowledge when blueprints are specified by the non producing party. There is the possibility that the short term abandonment of particular suppliers may lead to their bankruptcy and the long term loss of local supplier capacity and advice. We can speak of co-operative rather than anonymous markets, in which markets are embedded in direct productive relationships between the contracting parties.

14. In the case of the Mondragon Bank there are two such relationships of importance. The first is that between the enterprise division and the producer co-operative. At first it is a parental relationship, with the division helping to launch the new project, and thereafter acting as a monitor of progress and a source of technical and economic advice. Much of the substance of this relationship centres on information - about products, markets, technology, sources of machinery supply and so on. The bank helps to provide information and establishes systems of management information which allow it to monitor the performance of the industrial co-operatives. Among the key advantages of large firms relative to small is the former's access to specialist information, and its capacity to process it. The Casa Laboral Popular is a means of counteracting this advantage of large firms by itself being a provider of specialist information.

15. The second relationship is that between the Casa's banking and enterprise divisions. This is also one of trust and adherence to a common assessment system. The banking division is confident that the enterprise division will help the co-operative to supply feasibility studies in the detail required by the banking division. It is confident that the projects coming before it for funding have been thoroughly looked at by technicians and economists. If the firm is in financial difficulties the banking division can ask the enterprise division to assess the project for the bankers. It too will come to trust the enterprise division's assessments on the basis of its continuous relationship with that division.

16. The concept of trust has come to be recognised as one of central importance in the effective operation of markets and economic organisations. Trust cuts down the cost of transactions - the need for lengthy contracts, safeguards and guarantees. It permits greater decentralisation within organisations, reducing the costs of overseeing and the need for approval of decisions. The basis for

trust is in part technical: in the case of the Mondragon bank, knowing that the firm has access to a wide range of product and market information, that it has in place systems for 'reading' its own performance, and certain standard data processing and reporting procedures. But trust as a concept goes further than this. It involves the trusting of someone's judgement and their ability in the conduct of affairs. It also involves the idea of moral conduct - trustworthiness, that a party to any transactions will keep his or her word and will not try to deceive others. Such trustworthiness depends nor merely on shared moral values, but on social institutions which both affirm and punish according to an individual's conduct. It does not depend on people knowing each other, but tends to be stronger when they do.

17. The point about emphasising these points in relation to banking is that banking above all depends critically on trust. The very word credit after all is derived from the Latin verb credere to believe or to trust. A banker will interpret an absence of trust as an increase in risk, and seek both a higher return and stronger guarantees. Risk in this sense is clearly a subjective rather than an objective cost. The more atomised a society the greater the risk for any member of it engaging in an economic transaction. The long term trend to higher interest rates can be seen in part as a result of the breakdown of cohesive societies following the globalisation of finance. Risk is a cost of fragmentation.

18. For international banks risks will be less when lending to large companies. For these companies can be thought of as playing the role of an informational and disciplinary intermediary between a local branch plant and the international bank. Lending to a branch plant through the central finance department of a large industrial company will reduce the risk to a bank, not least because the company as a whole is concerned about its reputation with banks in general, and acts in effect as a guarantor of any loan channelled through it. In this sense the major international companies and the transnational banks do form a society, with its detailed sources of information

about each other, and means of discipline. This is not true of smaller firms. For international banks they are more risky because less is known about them, and mutual obligation is weaker. As a consequence interest rates are higher, and conditions for security more stringent.

19. By way of contrast the high growth regions of Europe centred round small and medium sized enterprises have been characterised by a local and often co-operative banking system. This is true of West Jutland in Denmark for example, where local industrial firms recently helped an important local bank resist takeover by a large national one. In Germany the link is equally clear. The majority of lending to all domestic firms is undertaken by regionally based 'Landerbankens', a network of 592 local savings banks, and a strong set of co-operative banks, set up originally as self help institutions for farmers and artisans. The twelve major Landerbanken - all of them linked into regional government, accounted for one sixth of all private sector lending in the decade up to the mid 80's. In 1979 the savings and giro banks accounted for two fifths and the co-operative banks for one fifth of all such lending, and for nearly 70 per cent of all lending to the so called Mittelstand - the celebrated small and medium sized firms which have played such an important role in German growth.[10]

20. The local savings banks operate within special savings bank laws which specify their main tasks as providing credit for low earners, the middle classes, and local industrial and commercial needs. They work together and engage in co-financing with the landerbanks. Between 1958 and 1978 their share of total bank business actually rose from 36 per cent to 38 per cent. Over the same period the co-operative banks' share also went up from 8 per

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10. There are sections on the German regional banking system in: The Greater London Council, The London Financial Strategy, 1986, and C. Sabel, G. Herrigel, R. Deeg and R. Kazis, "Regional Prosperities Compared: Massachusetts and Baden Wurttemberg in the 1980's", Economy and Society 18.4, November 1989.

cent to 14 per cent. The strength of both types of bank appears to owe much to local knowledge and reciprocal obligation. For example, the boards of directors include owners or directors of leading firms in the district. Through the bank they become, as it were, indebted to each other, each knows about the other's accounts, and each may be called on to assess another's loan applications and financial robustness. They form in short an effective community.

21. The losers have been the large commercial and overseas banks. They have not only seen their market share falling over three decades, but have failed in their efforts to get into these local and regional markets, in spite of decentralising loan giving authority and presenting themselves as regional banks. Citibank has recently given up its attempts to enter local markets, saying that the market was too complicated and the competition too steep. This suggests a certain duality in industrial financing: the large banks serving the large corporate borrowers, and local communal and co-operative banks serving the medium and small ones.

22. The industrial districts of Italy also have strong local and regional banks. But they possess a distinct institution, namely loan guarantee consortia between local artisans and industrialists. To take the example of the town of Modena, an industrial centre of 600,000 people in the region of Emilia Romagna. There is one typical consortium of this type which comprises 3,500 artisans (that is enterprises with less than twenty workers) which guarantees working capital loans of up to £8,500. Its failure rate is 0.7 per cent compared to 8 per cent for these kind of loans in the Italian banking sector as a whole. There are a number of other such artisan loan consortia in Modena, mostly organised along party lines, and this political identity helps in part to explain the sense of mutual obligation which has been a factor in their success. There is also a consortium for five hundred medium sized firms, which has advanced

working capital loans of a total value of more than £7 million during the 1980's, and has had a failure rate of 0.15 per cent.[11]

23. These consortia share a number of features. To begin with the loan applications are assessed by people who know both the applicant and the industry. In the case of the medium sized firm consortia, there is a loan committee elected by the membership with sectoral representation, which looks into the application and suggests amendments where they think the project has potential. They then pass it on to banks who have joined the consortium scheme (originally local banks) who make their own assessment but in the knowledge that the proposal has been approved by people with more knowledge of the borrower and the local industry than a general bank manager would be likely to have.

24. One of the benefits of this scheme is that it requires little capital from the guarantors. There is a minimal fee for joining. Their obligation is to underwrite 50 per cent of the loan should it not be repaid, but because of the minimal failure rate (well within the size of the consortium's reserves) there has been no call of this kind. Moreover, because of the low failure rate banks have been eager to join the scheme, and the consortium has then been able to bid down the interest rate, acting as a kind of union of borrowers. Currently the cost of funds is 4 per cent under the normal lending rates. For the artisan consortium the comparable discount was 1.5 per cent in the mid 1980s.

25. These rates are a measure of the benefits of a particular structure of loan processing on the one hand, and a means of collectivising the obligation to repay on the other. What is striking is that this collective guarantee is so rarely called on

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11. Material in English on the loan consortia can be found in the article by Sebastiano Brusco cited in footnote 8, and in: R.Murray, M.Best and M.Pezzini, "Consortia and the Third Italy", IDS, University of Sussex, June 1989.

since its very existence puts an obligation on the individual borrower to repay. As one person remarked: "the person who receives a loan from the co-operative will stay up at night thinking up ways of repaying his loan. Whereas the person who receives a bank loan will stay awake at night thinking of ways of not repaying it". What the head office of a large firm secures through authority, the financial consortia achieves as a result of mutual obligation.

26. To sum up then, a flexible specialisation approach to the question of industrial finance suggests the following:

- the re-organisation of production provides a way for reducing the demand for finance by an improvement in the productivity of both fixed and working capital.

- the supply of capital must be part of a strategic package; institutions to supply individual parts of such a package and the coherence between them are as important as the supply of funds.

- instead of passive banks, employing standardised assessment and loan procedures, and requiring collateral as primary security, banks need specialist knowledge (of industrial sectors and/or localities) both to contribute to the customisation of the package, and to improve the quality of information about project and borrower.

- small, specialised banks - particularly local banks - have particular advantages in providing such customisation and sustaining long term relations with borrowers. What they need are forms of joint provision of those services and opportunities open to large banks (for example with respect to the supply of funds).

- an important emphasis is put on the long term relationship between banker and borrower, based more on a sustained partnership than arms length client relations.

- mechanisms for grouping borrowers and lenders directly - through financial guarantee consortia, credit co-operatives or local savings banks, increase the sense of mutual obligation, reduce the risk of default and may provide a means for project advice.

- risk, high interest rates and collateral requirements are seen as a reflection of the inadequacy of the institutions for giving and receiving loans, rather than as necessary features of the projects themselves.

Chapter 2

THE BANKING SYSTEM IN JAMAICA

1. Over the past twenty years the financial sector has been by far the fastest growing sector of the Jamaican economy. While GDP rose by 19 per cent over this period, a rate of less than 1 per cent per year, finance and insurance grew by 182 per cent (see Table 1). From providing 3.9 per cent of the Jamaican domestic product in 1969, its share rose to 9.1 per cent in 1989, (Table 2). The assets of the financial system rose at a similar rate, nearly doubling in the nine years between 1979-88 (Table 3). During the 1980's indeed the growth rate of the financial sector was at least four times that of other expanding sectors (with the exception of transport), and contributed half of all GDP growth in the decade. These are remarkable figures - not simply in what they reflect about the composition of Jamaican development over this period, but because the financial sector itself plays so significant a role in determining the direction of that development, through its provision of funds and its forms of discipline. What the European and Japanese experience suggests is that the nature of the banking system has a significant influence on the structural development of an economy, not least on the size and nature of the manufacturing sector.

2. We can distinguish two broad models of financial structure - the British and North American on the one hand, the German and Japanese on the other. The first is characterised by arms length relations between finance and industry, short termism, a strong stock market and an influential accounting profession. In the second there is a closer relationship between banks and industry, both the stock market and financial accountants play a less dominant role in 'allocative discipline', and greater emphasis is put on non financial

Table 1

SECTORAL GDP 1969-89

Jamaican dollars millions

Constant 1974 prices

	1969	1979	1989	% change 1969/89	% change 1979/89
Finance and Insurance	68.1	102.3	192.1	182	88
Government services	150.7	360.8	323.2	114	-10
Transport, Storage & Communications	98.1	129.7	173.3	77	34
Real estate & business services	173.2	214.1	260.4	50	22
Miscellaneous services	94.2	98.7	122.8	30	24
Mining & quarrying	108.2	148.0	140.1	29	-5
Agriculture	132.4	159.5	152.7	15	-4
Manufacturing	327.9	316.3	355.2	8	12
Distribution	395.9	293.9	327.3	-13	11
Construction	216.3	137.4	167.4	-23	22
Gross Domestic Product	1,762.3	1,940.0	2,104.4	19	8

Source: Statin

Table 2

SECTORAL COMPOSITION OF JAMAICAN PRODUCTION 1969-89

	%			% change
	1969	1979	1989	1969/89
Finance & Insurance	3.9	5.3	9.1	133
Government services	8.6	18.6	15.4	79
Transport, Storage and Communications	5.6	6.7	8.2	46
Real estate & business services	9.8	15.1	15.6	26
Mining	6.1	7.6	6.7	11
Miscellaneous services	5.3	5.1	5.8	9
Agriculture	7.5	8.2	7.3	-3
Manufacturing	18.6	16.3	16.9	-9
Distribution	22.5	15.1	15.6	-31
Construction	12.3	7.1	8.0	-35
Gross Domestic Product	100	100	100	-

Source: Statin

Table 3

ASSETS OF THE FINANCIAL SYSTEM IN JAMAICA 1979-88

Jamaican dollars millions

Constant 1974 prices

	1979	1984	1988	% change 1979/88
Central Bank	655	1715	1522	132
Commercial Banks	744	1116	1375	85
Non Bank Financial Institutions of which:	490	590	773	58
Merchants Banks	56	139	209	275
Trust Companies	59	112	93	58
Finance Houses	24	29	19	-20
Credit Unions	52	64	53	2
Building Societies	115	139	200	74
Life Insurance Companies	170	179	170	-
Commercial and Non Bank Financial Institutions	1234	1707	2148	74
All Finance & Insurance	1889	3422	3670	94

Source: Bailey, J., "The Role of Non Bank Financial Institutions in the Jamaican Economy 1979-88", Kingston, 1989.

strategic planning[12]. There is now a considerable literature on the shortcomings of the first model for industrial competitivity in the current period[13].

3.. Seen from this perspective, the Jamaican financial system has been pre-dominantly influenced by British and North American practise. It has a wide range of institutions, 11 commerical banks, 6 building societies, a large number of insurance companies and co-operative banks, 85 credit unions, 27 merchant banks, 7 trust companies, 8 finance houses, 5 development finance institutions, a mortgage bank, a recently announced venture capital fund and a stock market. This is a relatively developed financial structure, competitive, innovative, and increasingly integrated.

Commercial Banks

5. The commercial banks are the heart of the Jamaican financial system, accounting for nearly two thirds of financial assets and over

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12. In Germany impersonal financial markets are less important than direct relations between banks and industry. Whereas in the UK one quarter of the liabilities of personal and non financial companies were to banks, in Germany the figure is two thirds, while securities which accounted for one third of the British figure, amount to only one tenth in Germany. The stock market is broken up into eight regional exchanges in Germany, with only public limited companies (2,140 of them in the mid 1980s) allowed to own raise funds on the stock market with the backing of their banks. The banks 9 per cent of company shares but have much greater influence through the use of voting powers entrusted to them. The bond market is more important than the share market, and it too is dominated by the banks, bank bonds accounting for 75 per cent of bonds outstanding. The banks use the bond market to raise long term funds which they in turn invest in industry, and monitor through the ties already mentioned. In this way the financial system has not become separated from industry, as has tended to be the case in the UK. On German banking see: "Business Finance in the UK and Germany" Bank of England Quarterly Bulletin, September 1984; Marcello Clarich, The German Banking System, European University Institute Working Paper, No.269, 1987.

13. For the divergence of finance and industry in Britain, see Geoffrey Ingham, Capitalism Divided? The City and Industry in British Social Development, Macmillan 1984.

half the sector's value added during the 1980's. Historically they were primarily concerned with trade and working capital finance and they are still geared to short term lending, with strong collateral and - for longer term lending - a preference for property investment, and well established customers. In the early 1980's about 10 per cent of the commerical banks' portfolios were in mortgage loans, secured either by residential properties valued at least 20 per cent above the loan amount or by tanglible business assets valued at 50 per cent or more above the loan. Construction, land and tourism now account for 31 per cent of all commercial bank lending, (as of December 1989) and for 75 per cent of the increase of that lending in real terms during the 1980's. Manufacturing by way of contrast comprised 15 per cent of the increase, and a substantial proportion of this was to the larger firms. A recent study suggests that the growing proportion of overdrafts in the commercial banks' business sector loan portfolio (47 per cent in 1988) "reflects the high volume of financing provided by the banks to their traditional and well established borrowers."[14] Even to large and estabilished firms however, most banks operate a ceiling above which they will not lend irrespective of collateral or activity to be financed. Their basic criteria have been described as "liquidity, security and safety."

6. The Jamaican commercial banks are largely locally owned, but many retain strong ties with present or past parent institutions in Britain, Canada and the USA. This in part accounts for their particular banking culture. But legislation has also played a part, both in putting a ceiling on consumer credit which some of the banks had used in the 1960's as a means of extending business finance (using cars as security for example), in limiting the holdings of commercial banks in equity, or in the trusts which had sprung up as instruments of trust and mortgage lending. Some commercial banks did follow less conservative lending policies, but found themselves

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14. E.Shaw and J.Robinson, "Commercial Bank Credit and Sectoral Performance: Some Emerging Patterns in Jamaica 1981-1988" paper presented to 21st Annual Conference of the Regional Programme of Monetary Studies, Bridgetown, Barbados, December 1989, pp.9-10. The authors report that overdrafts have been used for working capital and fixed capital expansion.

exposed in the downturns of the later 70's and 80's. There were many cases of clients disappearing abroad. Banks complained of a decline in business morality. One leading commercial bank which had prided itself on following more adventurous policies - lending against stocks, accepting debentures without asset backing, taking the risks on foreign exchange loans - was forced to switch to a more conservative approach in 1985/6, when many accounts got out of hand, and loans had to be called in. For this bank at least commercial banking was short term in outlook and safety conscious because of the risks resulting from Jamaica's macro economic fluctuations. It was the market rather than commercial banking as such which was to blame.

Insurance Companies and Building Societies

7. The insurance companies were the second biggest mobilisers of savings in the 1980s after the commercial banks, accounting for 30 per cent of the sector's value added in 1988. They, too, are now largely locally owned, and like the commercial banks, have traditionally had a passive conservative investment approach. During the 1970s the bulk of their funds went into Government paper, stocks, deposits and real estate. In the eighties they have been major investors in construction (insurance companies took a leading role in the New Kingston commercial office boom) in tourism and in the larger exporters. Some insurance funds have, therefore, found thier way into industry but on a more restricted scale than the commercial banks. The building societies, with lower value added than insurance companies in 1988, but higher assets than life insurance companies taken alone, directed 90 per cent of their funds into residential property, and less than 2 per cent into commercial ventures.

Near Banks

8. Alongside the commercial banks the insurance companies, and the building societies, a number of other financial institutions have grown up - in part to fill the gaps left by the commercial banks. Particularly striking has been the expansion of near banks -

including trust companies, finance houses, and merchant banks. Between 1970 and 1988 their value added grew four and a half fold, so that by the end of the 1980's it reached more than a quarter of the figure of the commercial banks (see Table 4). Most significant have been the merchant banks. There had been an expansion of merchants banks - many of them foreign owned - in the 1960's, but they were run down by the early 1970's, only to have a resurgence in the early 1980's. By 1989, there were 27 merchants banks, with assets which had quadrupled during the decade.

9. This second wave of merchant banks were different to the first. As a number of bankers put it to me, the second wave had little to do with merchant banking as conventionally understood. It grew in the context of the structural adjustment programmes and deregulation, which both reduced public sector borrowing (from 20 per cent to 7 per cent of GDP) and expanded the demand for credit in particular branches of the economy. Given these opportunities for intermediation, the merchant banks had a particular advantage since they could be started with a capital of only J$250,000, and had reserve requirements of only 5 per cent as against 20 per cent for the commercial banks. Many of the new merchant banks were therefore simply offshoots of commercial banks. Funds were mobilised through the merchant banks and on lent through the commercial banks (rather than - as the government hoped - the other way round).

10. Of the other merchant banks, some were conversions of trust companies. Others were affiliates of insurance companies. Only a few are independent - and they have significantly earned the reputation of being the more adventurous and innovative in the field. The Eagle Merchant Bank for example has developed around it a financial network which includes a unit trust, an insurance brokerage, a life insurance company, a mortgage guarantee insurance company, a stock brokerage, a financial consultancy and a commercial bank. Such financial supermarketing has become a common feature of the Jamaican financial system. What is distinct about Eagle is that it is centred round a merchant bank. Eagle has made its mark by its

Table 4

VALUE ADDED GROWTH OF THE FINANCIAL SECTOR IN JAMAICA 1970-88

Jamaican dollars millions

constant 1974 prices

	1970	1975	1980	1985	1988	% change 1970/88
Commercial banks	40	43	55	55	76	90
Near banks	4	7	10	16	20	447
Building Societies	2	3	4	2	5	106
Industrial Development Banks	0.3	2.0	0.2	0.4	0.9	184
Other financial services	2	2	2	1	2	1
Life Insurance	14	18	25	31	31	125
General Insurance	10	13	13	14	15	44
Total finance and insurance	72	87	108	119	150	108
Gross Domestic Product	1973	2153	1829	1836	1980	19

Source: Statin

rapid response time to loan requests, and its development of new financial instruments.[15] But even with an active merchant bank like Eagle, their loans by and large remain small, many are personal loans, and their terms are still mainly short to medium, 3 months to 4 years. They lack the industrial specialism and resources for 'hands on' industrial banking of the kind we have earlier discussed, and although we did find merchant banks which sought active involvement in the management and restructuring of enterprises, they remained limited and were project not sector based.

11. It would not be accurate to describe the Jamaican financial system as a whole as passive. But there is a sense in which 'liquidity, security and safety' do remain its predominant features. The commercial banks have always favoured self liquidating loans, that is to say loans for purposes which will soon realise cash. But the non banks have also exhibited such preferences, and a recent study of their uses of funds has shown that they have held on average 24 per cent of their funds in liquid balances in the nine years between 1980 and 1988.[16] Safety and security are also characteristic of the near banks, reflected in the extent of collateral demanded, in the preference for lending to established customers, and to activities with a strong realisable asset base (such as construction, tourism or factory building).

Development Banks

12. The problem has been providing finance for the high risk and longer term projects, and for those which lack the level of asset backing generally required. This includes new enterprises but is not confined to them. To meet these needs the Jamaican Development Bank

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15. See a paper to the Barbados conference on Financing Development in the Caribbean by the executive chairman of Eagle merchant bank, Paul Chen-Young, "The Jamaican Financial Sector".

16. J.A.Bailey, "The Rôle of Non Bank Financial Institutions in the Jamaican Economy, 1979-88" paper presented to Barbados conference, op.cit, December 1989.

was established in 1969, but ceased active operation in 1981 after substantial losses. It has been succeeded by two wholesaling development banks (the Agricultural Credit Bank, and the National Development Bank) an Export-Import bank, and by a private AID supported initiative, the Trafalgar Development Bank. It was clear from our discussions with industrialists that these institutions were only able to make a modest contribution to the needs of longer term industrial development.

13. Table 5 provides available figures on manufacturing investment and finance. There are no investment figures for manufacturing in Jamaica, but some measure is provided by overall investment in industrial machinery and equipment. In 1988 estimated loans through the development banking network amounted to 8 per cent of this figure, and this of course leaves out the funding requirements for land and buildings and working capital. Their loans were 15 per cent of the increase in volume provided by the commercial banks to manufacturing in that year, and 3 per cent of manufacturing operating surplus.

14. I will consider the history and potential of Jamaican development banking experience more fully in the next chapter. At this point we should note that the National Development Bank of Jamaica has by and large been cast as a source of cheap finance to the commercial banking network. Projects seeking NDB funds have to go through 'Approved Financial Intermediaries' (AFI's) - primarily commercial banks - and are subject to the AFIs' normal assessment procedures and criteria. The AFIs' are restricted to a 3 per cent spread on the borrowed funds and are required to bear the risk, often contributing funds of their own to the project. The availability of NDB funds has undoubtedly lowered the financing costs of projects - their loans currently carry a charge of 16-17 per cent compared to a commercial bank lending rate of 32-34 per cent, but the cost of funds by itself is not enough to meet the gaps in the market for industrial finance. Furthermore, the NDB has increasingly focussed on tourist investment at the expense of manufacturing, with 85 per cent of

Table 5

MANUFACTURING INVESTMENT AND FINANCE

Jamaican dollars millions

current prices

	1988	1989
Manufacturing value added	3,750	4,498
Operating surplus	1,238	1,513
Investment in industrial machinery & equipment	433	722
Level of manufacturing stocks	548	1,047
Consumption of fixed capital by manufacturing	176	263
Change in advances to manufacturing by the commercial banks	238	256
Gross output of industrial development banks	61	
Loan commitments to industrial sector by National Development Bank	18	
Trafalgar Development Bank loans to manufacturing	18	20*

* This is an estimated figure on the basis of growth of TDB's loan portfolio growth in 1988/9

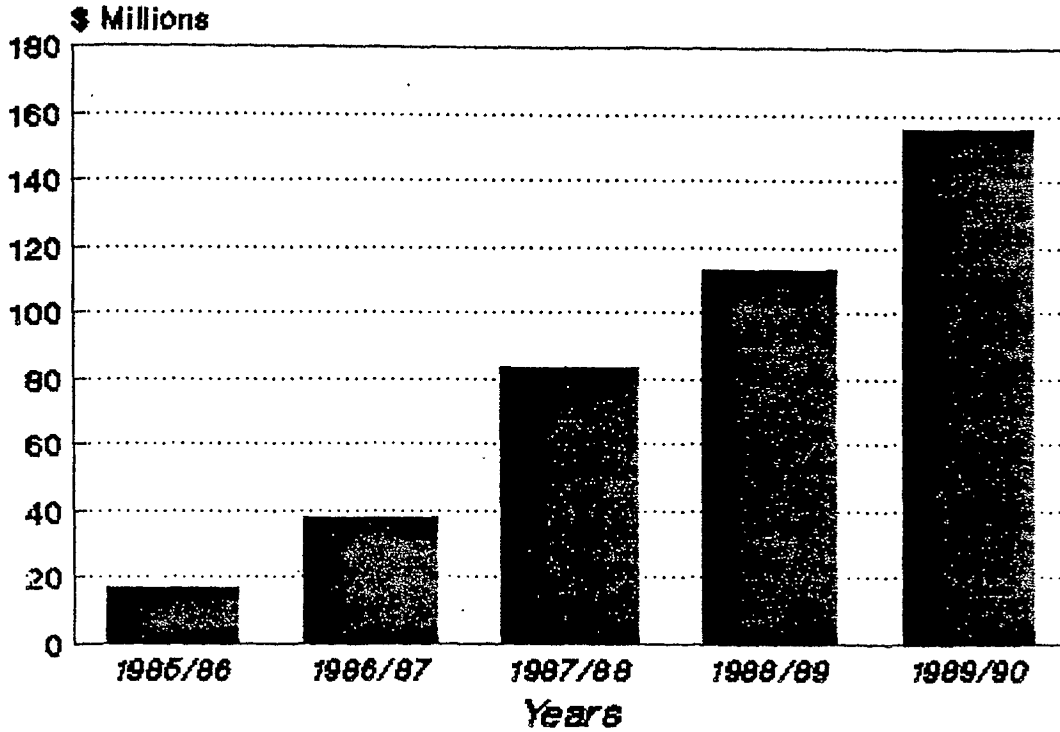
Source: Statin
Bank of Jamaica
Company data

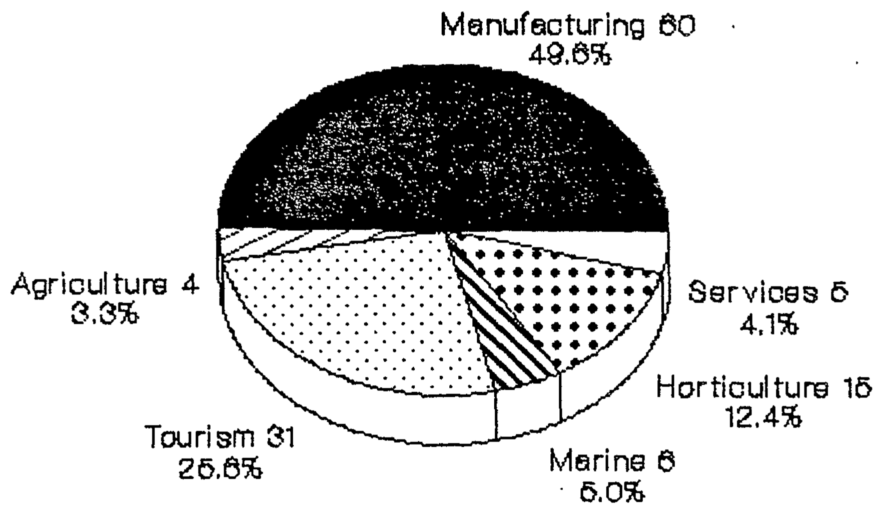
commitments in 1987/8 being directed to tourism, and only 14 per cent to the industrial sector. As of March 31st 1988, 49 per cent of the NDB's outstanding loans were to the tourist sector, as against 47 per cent to manufacturing.

Alongside the NDB public financial support has been given to the industrial sector through the National Export-Import Bank of Jamaica (the Exim Bank). This was established in 1986, taking over from JECIC, an agency of the Bank of Jamaica, which provided export credit insurance and pre and post shipment financing. By 1988 the Exim Bank was providing 11 per cent of all credit in the economy, lending the productive sector J$882 million during the year, 91 per cent of it through the Export Credit Facility which provides working capital support to exporters through discounting receivables. It also provided medium term finance, playing for a short time a quasi development bank role to manufacturing exporters. Loans were granted for the import of capital equipment for four companies, but with one exception they were not successful, and the machines were repossessed. Although in 1988 the Bank had medium term receivables of J$35.5 million, on credit of 2-4 years, it has drawn back from this form of lending over the past three years.

15. In addition to the NDB and Exim Bank, Jamaica has a private body specialising in medium to long term loans, the Trafalgar Development Bank. It has been operating for five years, and has a capital of J$42 million. It specialises in long term loans (4-10 years) geared particularly to the foreign currency needs of potential foreign exchange earners. With subsidised aid funds, it offers a loan rate of 20-24 per cent, with a 1:1 collateral requirement (as against the 3.1 common in the commercial banks). It has a staff of twenty five professionals, ten of whom are project officers, and sees itself as an active bank, providing technical services in project preparation, sending in financial managers in cases of delinquency to advise on financial systems, and in one case taking effective charge of the management until a turnaround was effected. Like the NDF, they are organised with a technical assistance bureau distinct from the banking side, and where they cannot provide assistance directly

Diagram 1





they see themselves as intermediaries, maintaining a list of approved consultants for clients to draw upon.

16. Their outstanding loan portfolio now exceeds J$150 million (140 loans) of which some J$80 million is to seventy medium to large manufacturing firms. These loans are entirely on a project basis - they do not yet have any sectoral expertise, but rather buy it in when needed. Thus although the TDB has a necessary short term concern with profitability because of its quotation on the stock exchange, and although a number of people commented on its relative conservatism in lending, it nevertheless has provided an active, hands-on support service to projects of a kind less common with NDB loans channelled through commercial banks. At the moment it can provide these services because of its access to subsidised loan funds. These allow it both to charge rates below the market rate of interest while preserving its own spread and profitability (it realised a 36 per cent return on capital in 1989/90). If subsidised funds fail to grow with the bank itself, it will be under pressure to follow the investment patterns and even the security and rate of return criteria of other medium to long term commercial lending.

Small firm credit institutions

17. The NDB provides most of its funds for small enterprises through a specialist institution, the National Development Foundation, and through the Jamaica Credit Union League. In 1987/8 loans through these channels amounted to J$2,594,000 (1 per cent of commercial bank advances to manufacturing) and comprised 41 loans to small manufacturers. Both the NDF and the Credit Unions work in ways which have many parallels with the financial institutions in the European industrial districts discussed in Chapter 1.

18. The NDF is a private, not for profit organisation, which by 1989 had a loan portfolio of J$34 million, J$7.5 million of which (22 per cent) was in manufacturing. Like, Mondragon it has a banking

section, and a section dealing with technical services and training. It operates out of four branch offices, lending to very small firms, and providing technical assistance and training both in the feasibility stage and during operations. As security for its loans it accepts - in addition to normal assets - a guarantor, and lends for up to three years for working capital, and up to ten years for fixed assets. It sees itself as much as an educator as a banker (the Executive Director is significantly an ex-teacher and educational psychologist) and sees its banking work as helping to write projects rather than simply lending money. In spite of the frailty of its customer base, it has achieved remarkable success, with the banking division recording a surplus in 1989 of more than J$0.5 million, in spite of its loan arrears currently averaging around 10 per cent because of the difficult trading conditions affecting small enterprises.

19. The Jamaica Co-operative Credit Union League is an association of 85 active credit unions with 344,000 members, and outstanding loans of J$549 million. Its members tend to be low income employees, with few assets, who would find it difficult to borrow from a bank. The loans are primarily personal, mainly instalment credit and housing finance, though a growing proportion has been business related (up from 13 per cent in 1982 to 21 per cent in 1987). What is interesting about this movement is that in spite of its relatively weakly developed administrative practices, a high delinquency rate (currently about 11 per cent), a disadvantage in attracting deposits because of a legal ceiling of 6 per cent on what they can offer, they have nevertheless survived a difficult decade. Their membership and assets have once more been increasing, with assets above the 1979 figure by 1988 and still rising.

20. What appears to lie behind this ability to hold their own despite their disadvantages, is that their resolute refusal to see themselves as banks has some countervailing advantages. Their small size, particularly in the parishes, means that their members are to an extent known to each other. Loan committees take into account the

reputation of members, and of the guarantors, and publish the names of defaulters as a means of putting peer group pressure on those concerned. Their form of administration, and the co-operative nature of the association means that the spread charged by many credit unions is less than commercial banks. In spite of their growth they have also managed to maintain amongst members a feeling of a collective venture:

> "We are not bankers. A credit union is a co-operative association of men and women, associated together with the common impulse to manage their own financial affairs, honestly and efficiently, for common good".

This and similar quotations can be found in the pages of the annual reports produced by the movement. Their recent administrative and financial difficulties have achieved much publicity. To an outsider it is striking that they have survived as well as they have, and the clear scope for administrative improvement suggests that there is considerable potential in this branch of the financial system, in parallel with the success of local savings and co-operative banks both in Europe and the developing world.

21. As instruments of commercial lending their role is modest. In 1987 they had advanced approximately J$80 million to members for business purposes. They have also acted as an approved intermediary for NDB loans, different credit unions having processed 28 such loans, repayments on which were all up to date as of November 1990. In the credit union I visited they had sponsored three NDB loans, two of which were for manufacturing start ups, and the third for tourism.

22. Both the National Development Foundation and the Credit Unions are likely to remain minor players in industrial finance. Both are limited to the self employed or very small enterprises - to those would-be-borrowers in short whom mainstream banks would regard as among the most risky. But both have elements in their procedures and practises which highlight gaps within the commercial system, and a fortiori within the National Development Bank as it is currently

constituted[17]. For as long as the NDB is required to lend through the mainstream commercial and merchant banks it will be constrained in pursuing the range of functions associated with development banking by the safety-conscious approaches of the commercial sector.

Conclusion

23. In the last thirty years, Jamaica has moved from a colonial banking structure, dependent on a small number of British and North American banks, and tied into sterling, to what a recent report called "a relatively well developed institutional framework of financial intermediation", "robust, diversified and competitive", which "over the past three years in particular (1986-89) ... has shown tremendous growth and dynamism".[18]

24. Yet in spite of this relative sophistication, the sector still exhibits some of the problems which have been identified in the British and North American models. It has a bias towards "short termism", it tends to be passive in its relations to lenders, requiring stong collatersl, and it lacks the industrial specialism to support particular investments. In spite of the rapid growth of merchant banks, there is still little active merchant banking as conventionally understood, and the developmental facilities through the NDB, the Exim bank and the TDB remain limited both in size and scope. I found an awareness of these shortcomings among many of the bankers to whom I spoke, a consciousness that, in spite of its rapid growth, the financial system still reflected the Anglo-American tradition. Paul Chen Young, the Executive Chairman of the Eagle Merchant Bank made the point in the form of a question:

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17. There are useful papers on these two institutions presented to the Barbados conference op.cit. S.Lalta, "Small Business Financing: the role and performance of the National Development Foundations in the Caribbean with special reference to the NDF, Jamaica", and C.Kireton, "The Role of Credit Unions".

18. Caribbean Development Bank, Draft Appraisal Report, November 1989.

> "Should the financial system play a more active role as in the countries such as West Germany, South Korea and Japan, or should it be more passive as in the case of the United States of America and the United Kingdom? In the latter countries, the financial infrastructure is well developed with a number of financial institutions providing complementary financial services and thereby obviating the need for the more active and involved role in the countries cited. In countries where the growth sector (for example milning and tourism) requires large investments and where the sources of capital are concentrated in the financial sector, there is a strong case for the direct interventionist approach rather than the passive approach by the financial institutions. This issue is a fundemental one."[19]

Paul Chen Young puts his emphasis on large scale investment and mining and tourism. Yet if he sees the need for active banking in these fields - when tourism along with large scale manufacturing and construction have been relatively well served by the financial system - the point is doubly relevant for small and medium sized enterprises, particularly in the industrial sector. In the next chapter I consider the question of the finance of manufacturing in greater detail.

19. P.Chen Young op.cit. p.27.

Chapter 3

FINANCE AND JAMAICAN MANUFACTURING

1. In many ways the Jamaican financial system appears to have served industry well. There has been a considerable expansion of credit during the 1980s, a proportion of it going to manufacturing. In 1989 20 per cent of all commercial bank loans and advances went to manufacturers. For the two main development banks (NDB and Trafalgar) the figures are respectively 47 per cent and 50 per cent, and the merchant banks have also been substantial funders of manufacturing in the 1980s.

2. But there are still a range of financial problems for industrialist. First, commercial bank credit to manufacturing during the 1980s has grown at only two thirds the rate of commercial bank credit to the economy as a whole. As we noted earlier and as shown in some detail in Table 6 the greater part of the increase has gone into construction and land, followed by transport storage and communication, and tourism. Construction and tourism have also been prime sectors of investment for insurance companies, the near banks and the development banks. There is always a danger in deregulated markets of property based lending crowding out investment in manufacturing.

3. Further, within the manufacturing sector, commercial bank credit has been uneven, with sugar, textiles/leather/footwear and cement and clay products all showing falls in credit, and the overwhelming increases going to 'other manufacturing' as well as to furniture and wood products (see Table 7).

4. Clearly the slower rates of growth of credit to manufacturing and the unevenness between sub sectors in part reflects relative

Table 6

COMMERCIAL BANKS LOANS AND ADVANCES 1981-89

Jamaican dollars million

Constant 1974 prices

	Dec 1981 Value	%	Dec 1989 Value	%	% change in Value 1981-89
Agriculture	68	12.9	66	9.4	-3
Mining	3	1.5	3	0.5	16
Manufacturing	112	21.2	138	19.6	23
Construction & Land	64	12.1	163	23.2	154
Financial Institutions	12	2.3	7	1.0	-43
Transport, storage & communications	52	9.8	105	15.0	105
Electricity Gas & water	21	3.9	6	0.9	-70
Government services	9	1.6	54	7.8	541
Distribution	43	8.2	24	3.4	-44
Tourism	27	5.1	58	8.2	115
Entertainment	4	0.8	7	1.0	58
Professional & other services	45	8.6	31	4.5	-31
Personal	68	12.9	39	5.5	-43
Total	528	100	702	100	33

Source: Statistical Digest

Table 7

COMMERCIAL BANK LENDING TO MANUFACTURING 1981-9

Jamaican Dollars million

Constant 1974 prices

	1981		1989		% change in value
	value	%	value	%	1981-89
Sugar, rum & molasses	23.7	23	3.9	3	-84
Food Drink & tobacco	19.2	19	23.0	20	20
Paper, printing & publishing	3.8	4	5.5	5	14
Textile, leather & footwear	17.0	17	12.7	11	-25
Furniture, Fixtures & wood products	4.4	4	7.2	6	64
Metal products	7.1	7	5.5	5	-23
Cement & clay products	3.2	3	3.6	3	13
Chemicals & chemical products	5.9	6	7.3	6	24
Other	17.3	17	46.7	40	170
Total	101.5	100	115.5	100	14

Source: Statistical Digest

Note: The table uses the deflator for manufacturing industry.

rates of growth and prospective profitability of the sectors themselves, and cannot be used as prima facie evidence on the shortcomings of the financial system. But discussions with industrialists and with bankers themselves suggested that at least part of the explanation for these variations was the prospective 'security and safety' of the favoured investments.

5. There are a number of distinct issues here. There is the question of short run profitability as against the long run. There is the question of the significance of the project or sector for the whole economy and the potential divergence of the private and social rates of return from a particular investment. There are the problems of the size of firm and of the extent of collateral available.

6. A number of these points were made by manufacturers - both in discussion and through recent sector reports carried out under the STAS branch of the UNDP and later as part of the UNIDO industrial programme. There was concern expressed at the extent of collateral required by the commercial banks, and the inadequacy of some of the development finance procedures. But the overwhelming complaint was reserved for a second area of the financial system - namely the cost of funds. A number of the businesses with whom we talked were paying upto 40 per cent on overdrafts - a real rate of some 20 per cent. Table 8 shows a range of interest rates holding in 1990. They fall into two main categories - market rates which for the firms we talked to ran from 10-20 per cent in real terms (30-40 per cent in current prices), and subsidised development finance rates which (excluding the credit unions) ran from negative rates of some 8 per cent to positive rates of 4 per cent (12-24 per cent in current prices). The IMF and the World Bank have both pressed the Jamaican government to end the separation of these two categories by raising the rate on development funds to the Treasury Bill Rate and the Government have recently agreed to this. Industrialists were in some despair at having the cost of funds pegged to interest rates whose level had become a key instrument for the short and medium term goals of macro structural adjustment policies.

7. One manufacturer also raised a third general theme - namely the lack of industrial expertise within the lending institutions to advise on the restructuring 'package'. He had found that some US banks had engineers and sector specialists on their staff - something which was markedly lacking in Jamaica. Our visits confirmed this absence of sector specialisation and hands on advice - even in the merchant banks and the development banks. The absence of such specialism increases risk - both at the project and the sectoral level. It adds to the pressure on banks to follow their policies on safety and security, and for their lending as a whole serves to raise the interest rate. These functions - as we saw in Chapter 1 - may be beyond the scope of individual banks, and may be supplied by other private or public institutions (private consultants for instance) but whatever the source there remains a gap in Jamaican economy taken as a whole of hands-on industrial expertise integrated with the flow of funds from the banks.

Internal financing

8. Given these limitations on the financing structure and cost of capital in Jamaica, it is perhaps surprising that finance has not been more of a constraint to the expansion of industry in the last four years. Part of the explanation is that those who were constrained are no longer in business, and those who remain have found some way round the constraint. There is also evidence that one factor permitting expansion has been the quantity of internal funds generated within the manufacturing sector. There are no flow of funds figures, nor is there data on sectoral profits. But some indication of orders of magnitude is provided by the size of operating surplus. As Table 5 of Chapter 2 shows, operating surplus in 1989 was running at twice the level of investment in industrial machinery and equipment, and six times that of the increase in advances of the commercial banks to manufacturing. On top of this are depreciation provisions at a level higher than that of the commercial bank advances. So that in spite of the

Table 8

INTEREST RATES 1990

		%
Government:		
Bank rate (all year)		21
Treasury Bill rate (Dec)		24
Commercial Banks:		
weighted commercial credit rate (Dec)		28
weighted loan rate (Dec)		28
weighted deposit rate (Dec)		20
development rates on NDB funds mid 90		17
end 90		24
Merchant Bank:		
overdraft		39/40
National Development Bank:		
loan rate mid 90		14
end 90		21
borrowing rate		7/8
X-M Bank:		
export loan rate		15
National Development Foundation:		
loan rate		15
Credit Unions:		
NDB loan rate to Credit Union League		7½
Credit Union League loan rate to Credit Union		9½/10
Credit Union loan rate to borrower		12
Credit Union Deposit Rates		6
Trafalgar Development Bank:		
loan rates	J$	20/24
	US$	16 (borrower taking foreign exchange risk)

undercapitalisation of many firms, some at least are likely to have been in a position to provide substantial funds of their own.

9. The critical factor lying behind these figures is a change in the level and rate of operating surplus during the 1980s. Diagram 2 shows the level of operating surplus in manufacturing doubling in 1983, and broadly holding its new level until the end of the decade. At the same time the rate of surplus as measured against estimated fixed assets also rose. Assuming an average depreciation of fixed assets of eight years, we can calculate the real value of fixed assets from the annual level of the consumption of fixed capital, and compare it to the level of operating surplus. This is done in Table 9. The rate of surplus to fixed assets shows a rise from a range of 23-31 per cent between 1979-81, to one of 70-90 per cent between 1983 and 1989. What appears to have happened is that structural adjustment policies led to a sharp increase in the rate of profit which by the late 1980s had encouraged a rise in investment, and provided the internal funds necessary to finance it.

10. The problem for the 1990s however is that this profit boom was not the result of productivity increases. Manufacturing value added per worker fell in real terms by a quarter between 1979 and 1989., and in 1987 fell to little more than 50 per cent of the 1979 level. Rather the rise in profitability was primarily caused by a fall in real wages. Diagram 1 graphs the rise operating surplus (from 12 per cent to 33 per cent of manufacturing value added between 1979 and 1988) and the fall of real compensation per worker (down 48 per cent over the same period). So while operating surplus per worker rose by 62 per cent over these nine years, real wages dropped by half.

11. In spite of the high level of unemployment, this continuous downward pressure on real wages cannot be sustained. Wages at the large 807 factories are already at levels which the manufacturers themselves said were below what they considered as a living wage. If

Diagram 2

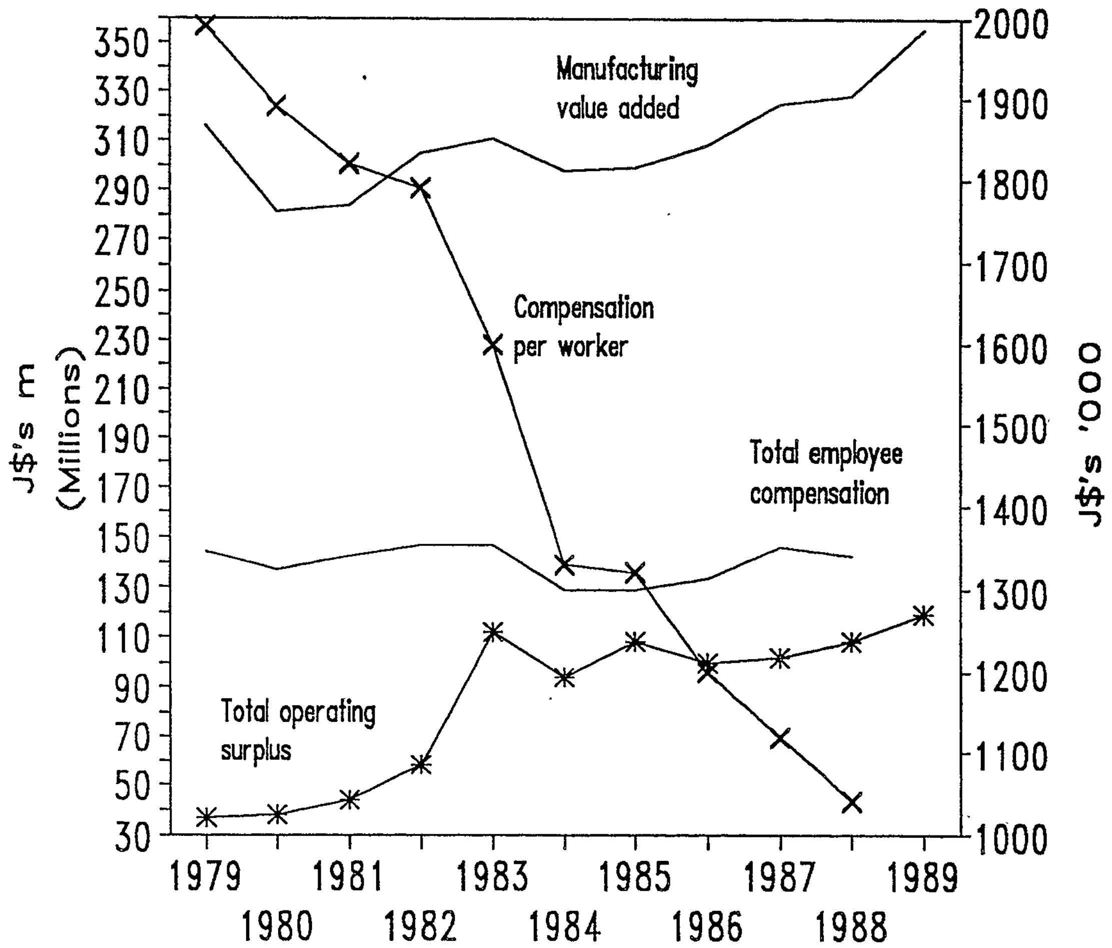

Table 9

RATE OF OPERATING SURPLUS IN MANUFACTURING 1979-1989

Jamaican dollars millions

Constant 1974 prices

	Operating surplus	Consumption of fixed capital	Imputed value of fixed assets (col 2 x 8)	Operating surplus as % of fixed assets (col 1 as % of col 3)
1979	37	20	160	23
1980	38	16	128	30
1981	44	16	128	34
1982	59	19	152	39
1983	112	17	136	82
1984	94	16	128	73
1985	108	16	128	84
1986	100	14	112	89
1987	102	15	120	85
1988	109	15	120	91
1989	119	21	168	71

Source: Statin

real wages stabilise or increase (as the experience of other export platforms suggest that they will) and if protective barriers are further dismantled, then the focus of policy will have to move to productivity. This in turn will underline the need for new investment. Sub sector studies of footwear, packaging and furniture in recent years all point to the need for capital to modernise machinery quite apart from the soft investment for firms pursuing flexible specialisation. At the same time any cut in profitability will reduce the internal funds available, increase the demands for external funds and throw into relief the weaknesses of Jamaica's financial system for the task of industrial restructuring. In short the high level of profitability in the banking and manufacturing sectors has served to deflect attention from the problems of industrial finance. During the early 1990s, with further deregulation of financial markets, these problems are likely to become more evident.

12. The way they re-emerge in part depends on the industrial strategy followed. If this continues to be based on large firm mass production, then the shortcomings of existing institutions and their lending criteria will be less serious. But there are limits to this path as a strategy for continued industrialisation in Jamaica's case - as the difficulties of 807 and Fee Zone clothing exported already indicate. If on the other hand there is a move towards a strategy of flexible specialisation - with greater emphasis on small and medium firms, then there need to be complementary initiatives in the financial system.

13. Although such initiatives are required right across the financial sector, an important starting point will be the development banks. Unfortunately for Jamaica, its experience of development banking has been a chequered one. The problems of the late 1970s have left a traumatic residue and prompted a conservatism in development banking policy. But it will become clear that Jamaica was not alone in these difficulties, nor in its reactions to them. It is equally clear that the problems which the development banks

were set up to address have not gone away either. It is of the first importance that these experiences are re-examined and learnt from. The following two chapters are accordingly devoted to development banking, internationally and then in Jamaica.

Chapter 4

THE EXPERIENCE AND LESSONS OF DEVELOPMENT BANKING

1. Development banking has been one of the innovations of third world financial systems. Intended as a complement to commercial banks, they grew rapidly between 1950 and 1980. In 1983 the World Bank had records of 137 of them. There is an International Journal of Development Banking, as well as considerable South-South co-operation in the field - one of the leading Jamaican development bankers for example played a central role in establishing a development bankers for example played a central role in establishing a development bank in Zambia. When in the late 1970s and 1980s unemployment rose in many advanced industrial countries, European regions set up their own development banks, informed by the experience of developing countries[20].

2. The purpose of these banks, as their name implies, is to act as agents for those parts of the development process which the market and private banks fail in some measure to provide. They supply primarily medium and long term loans and were organised to assess loan requests on the basis of project viability rather than the strength of collateral. At the same time they became involved in projects which had a development potential that exceeded their expected market returns. Many of the banks adopted shadow pricing in their project evaluations, and almost all applied broader development criteria in their assessments. Governments and international agencies turned to them to promote particular development initiatives like small firm schemes and regional investment programmes, or to support strategic industries. The banks commonly found themselves acting as lenders of the last corporate resort.

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20. R.Murray, 'Local Space: Europe and the New Regionalism', Centre for Local Economic Strategies, February 1991, pp. 25-30.

3. From the first there was an inherent tension in development banks between their balance sheet on the one hand and their development objectives and close links to government on the other. Though their purposes were developmental, they found themselves judged by commercial yardsticks, levels of arrears and rates of return. What is interesting about development banking experience is how particular banks have negotiated this tension, for it is a tension which lies at the core of the development process, and which is most acutely reflected in the work of these banks.

4. Until the mid 1970s most of the banks managed some sort of compromise. Their main source of funds were governments and aid agencies. Since they were seen as first and foremost a channel for cheap finance, they were restricted in the finance they could raise in the open market. They could neither match commercial rates to borrowers, nor did they have the access to private savings of the commercial branch banks, building societies and insurance companies. On the other hand, the fact they were offering loans at interest rates below those of the commercial market meant that they found no shortage of clients for their funds, and could pick and choose between them. They might apply development criteria and use shadow prices in their assessment. But in conditions of domestic and international expansion they could also expect a profitable bottom line.

5. An assessment made of development banks at this time found them to have a good profit performance, although their finance had gone to mainly well established enterprises they had had little impact on the promotion of small and medium enterprises (SME's) and had failed to act as catalysts for new entrepreneurs and enterprises[21]. In spite of this the banks could argue that they had performed their

21. W.Diamond and R.Gulhati, 'Some reflections on the World Bank Experience with Development Finance Companies', World Bank Economic Staff Working Papers, No.145, 1973.

development functions as required. The fact they built up an expertise in project assessment, advice and support, coupled with the low cost of their loans meant that they were able to back projects which the commercial banks might not have done, and in particular to give the long term funding which even established companies so often lacked. Within some limits, carrying out these development functions was consistent with good commercial practise. To be an effective development bank did not mean it was necessary to show a loss.

6. The end of the so called Golden Age in world economic growth in 1973, coinciding as it did with the oil price rise and then the recession of 1974/5, disturbed this compromise, and the inherent difficulties of the original model were further highlighted by the second oil price shock and world recession from 1979/81. The rise in real interest rates, and the contraction in international and domestic markets led many of the clients of development banks to have repayment problems. To take a not untypical example, the Pakistan Industrial Credit and Investment Corporation (PICIC) saw its rate of arrears rising from 2.9 per cent of its portfolio in 1971 to 46.3 per cent in 1981, forcing it to borrow US$72 million from the State Bank in 1980.[22] It was as if the water level had suddenly been lowered, exposing rocks which had hitherto been invisible.

7. What were these rocks? The IENIN report "Industrial Lending Through Financial Intermediaries" identified the main problems of development finance institutions as follows:

- the banks lent mainly to established borrowers rather than new entrants, and these borrowers depended on protection and other biases, which meant that they could not hold their own in the competitive conditions of the 1980s.

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22. N.M.Uquali, "Loan Recovery Problems of PICIC: an analysis" International Journal of Development Banking, Vol.1, No.1, January 1983.

- the banks failed to raise independent resources through attracting private savings because of their poor portfolio performance and thus remained dependent on public funds.

- they are mostly owned by governments, which has meant firstly special privileges such as access to foreign exchange and government re-finance programmes, in exchange for credit policies that have been loose and/or politically motivated.

- they had limited or non existent branch structures, and have focussed on one type of finance - long and medium terms loans - with little provision for working capital or equity participation.

8. A 1989 report by the World Bank on lending to small and medium enterprises over 15 years, came to much the same conclusions for Development Finance Institutions in Africa. DFI's lacked a branch structure; they could not offer the range of services available from commercial banks and hence received the less 'vibrant and viable' clients: there was government interference with credit policies and client selection, and with managerial appointments. They also had inadequate capacities in appraisal, supervision and collection[23]. These are the arguments that have underpinned the World Bank's turn against the original model of development banking which they had done so much to foster.

9. The Bank's response has been to encourage the withdrawal of development banks into the wholesaling of funds, by becoming so called apex institutions. The 1989 World Bank review of SME lending found that 42 out of the 70 loan programmes reviewed made use of apex operations, particularly in recent loans to Africa. In Africa the recent apex institutions were located mainly in Central Banks,

23. World Bank, Industry Development Division, World Bank Lending for Small and Medium Enterprises: Fifteen Years of Experience, Industry and Energy Department Working Paper, Industry Series No.20, December 1989.

whereas in Latin America they were predominantly in development banks. They operate through a range of approved 'retail outlets', the number ranging from 4 in Asia to 20 in Latin America and the Caribbean, with the retailers processing the loans and generally submitting proposals to the apex institutions for approval. The main outlets are the commercial banks, who accounted for 72 per cent of the loans disbursed as recorded in the 1989 Review. They have branch networks, the advantages of a wide range of services, working capital facilities, debt collecting experience, and a capacity for rapid response[24]. The commercial banks are now seen as the main channels for development finance with the apex units set up to complement and support them.

10. Not all apex units are in development banks, nor have development banks transformed themselves wholly into apex units. But the trend throughout the 1980s has been clear - particularly as far as World Bank lending is concerned, - which is to replace DFI's by commercial banks in the front line of development finance.

11. In parallel with this, the development banks which remain as active financial retailers have responded to the crisis of development banking by themselves shifting away from the original model. Some have cut down industrial investment. Others have sought to broaden their access to funds by increasing their own spreads and thus their reinvestible surplus, and by linking up with deposit takers, and HP companies. Many have tried to diversify their functions, moving into insurance, leasing, consultancy services and computerisation. Since part of their problem was that private banks and near banks were moving into medium and long term lending, the development banks have responded by expanding into the fields of their commercial rivals. They have themselves sought to become

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24. J.Levititsky, World Bank Lending to Small Enterprises: a review, World Bank, Industry and Finance Series Vol.16, 1986, p.20.

financial supermarkets in line with the commercial trend in the 1980s.

12. These have been strategies for survival. With governments caught in their own debt crisis, and with international financial institutions reducing support to public economic institutions, the development banks have increasingly had to behave as if they were commercial banks. This has meant that they have been in danger of losing their long term developmental identity[25]. Just as the World Bank programme of apex funding through commercial institutions results in the screening of projects through commercial bank procedures, so the direct development banking function has itself been drawn towards a more commercial banking model. The World Bank reviews report the improved performance of these new models - but it is a performance judged against the commercial criteria of arrears levels and profit rates. The development achievement is more difficult to assess. What has happened in short is that the tension between developmental goals and commercial practise whose early compromise was exposed by the economic crises of the late 1970s and 1980s has been resolved by and large through a shift to the commercial pole. This in no way solves the tension at the heart of development finance, any more than the wholesale adoption of development criteria would do, irrespective of the state of the balance sheet. In both cases the problem is collapsed rather than worked through.

13. Unsurprisingly, the most detailed discussion which has continued to address the tension has been from within the development banking community itself. Its main concern is how the original model could be modified to give the banks a more robust base for them to

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25. For a discussion of how commercial requirements have come to dominate over long term developmental goals, as well as for the problems of operating with an exhaustive and unconstrained list of aims, see the discussion of Punjab Small Industries and Export Corporation (PSIEC) in C.P.Sharma, Industrialisation and Development Banking, Deep and Deep Publications, D-1/124 Rajouri Gardens, New Delhi, 110027, 1989, Chapter 5.

continue to pursue development goals. There have been five main issues:

a) sources of funds

Development banks have been criticised for their dependence on government and international aid funds. This cannot be taken as a criticism of development banks as such, but rather the terms under which they were constituted. The Cyprus Development Bank, for example, was restricted from diversifying its sources of funding by government policy. Its management had to convince its Board and the government of the case for diversification, and for floating an international bond. It was government policy rather than the bank's which was at issue. In the Cypriot case there was an interest ceiling of 9 per cent which restricted the bank's spread, and one of the most common suggestions is that development banks be allowed a wider spread in order to self finance their expansion. Other measures proposed have included joint ventures with commercial banks, the sale of bonds to insurance companies and non bank financial intermediaries, or the intermediation of public pension funds (which has been one of the innovations of development banks in the UK). A number of these may carry a cost in terms of developmental goals - in the sense that they will require the development bank to care first for their balance sheet and the confidence of their commercial customers. The point is, however, that in each case a balance can be struck between public and commercial sources. It is not a necessary feature of a development bank that it is restricted to public funding.

b) interest rates

The policy of providing low cost funds as a means of encouraging industrial development has been attached, and thus one raison d'etre of the development banks. It is argued that it encourages capital intensive investment, that subsidised capital delays the moment when firms come face to face with deeper problems, and that the firms in any case have an incentive to arbitrage the funds when the market borrowing rates exceed the development bank's lending rates. These

criticisms again relate less to development banks as institutions than to particular financial policies which may be pursued through other institutions. As we have seen some development bankers have argued for higher rates and a bigger spread, not least to support consultancy and other services for clients. The point they make with force is that the development banks should be in a position to provide long term funds at stable rates which are insulated from the short term movements of market rates determined by macro economic policy. Indeed they would argue that it was one of the functions of development banks to provide just such an insulation for industrial projects from short term fluctuations. Furthermore, their project orientation and involvement makes it less likely for arbitrage to take place.

c) clients and uses of funds

The criticism that in general development banks have veered towards lending to established companies argues for a structure that encourages more developmental lending rather than a withdrawal to commercial banking practise. It was this criticism of the commercial banks that was a major argument for development banks in the first place. When the development banks have lent to new business and more vulnerable projects the resulting higher failure rate has also been used as a basis for criticism rather than for a consideration of how such lending can be carried out efficiently, within a range of social costs that accords with publicly agreed criteria. It is one of the main functions of a development bank to lend to those who face restricted entry to the commercial banking system. It is to be expected that their failure rates will be higher than the commercial average. The question is how best to manage this type of risk investment, rather than how to avoid being involved in it.

d) the conduct of business

It has been recognised that development banks could be more effective in their SME lending if they had a more extensive branch structure

than commonly exists. It is also acknowledged that their arrears collection is often less effective than that of the commercial banks, not least because development banks lack working capital facilities which would allow them to keep a close watch and a continuing control over the borrowers. A more fundamental issue is the length of time taken by development banks in assessing and approving projects, and the degree of advice and support they give to their projects. Time, of course, is not necessarily a good measure of effectiveness. Yet the European experience discussed in the first chapter suggests that the care and depth of initial project preparation is a critical requirement for successful project lending. This takes time, and the central question for the banks is less the time taken for approval than the nature and process of project preparation. In as much as development banks are not lending first and foremost on the basis of collateral, then they can be expected to take longer in project approval. Just as the quality of a university degree is not measured by the length of time it takes to achieve it, but rather by the quality of the learning it engenders, so a similar perspective needs to be applied to development project finance.

e) political influence

Perhaps the most common criticism of development banks is that they are too often a political instrument, serving particular interests, not least the personal interests of those in or close to power. African development banks in particular have been charged widely on this account, their management and individual lending policies being first and foremost determined by political considerations. With patrimonial states this would be expected, though it should be remembered that in such states a commercial bank is not immune from these practices. Two points need to be made on this subject. First it is not clear what the economic cost are of such practices. A recent assessment of development finance institutions in Kenya for example found that the Industrial Development Bank in the country had shown above average rates of return on loans (though not on equity), and administrative costs which were in line with those for DFI's

elsewhere in Africa[26]. Secondly, in as much as development banks are required to pursue non commercial goals, some measure of political influence is a necessary part of its operation. The issue which must be addressed is how such political influence can be governed to prevent it from declining into corruption, or serving narrow political ends. Industrial development can be set back just as much by political as by economic short termism.

14. Reviewing development banking experience as a whole, the two central questions are how to manage developmental and commercial objectives, and how to prevent development banks becoming part of a patrimonial politics. The problems experienced in both these areas have been major reasons for the retreat towards commercial practises and institutions during the 1980s. But if the concerns of long term development are not to be neglected, then what is required is close investigation of development banking mistakes, in order to see whether a new model can be constructed. Henry Ford used to say that positive knowledge depended on negative knowledge, that only by making mistakes could anything worthwhile be created. The Japanese have a similar approach, seeing mistakes and breakdowns as the foundation for their policy of continuous improvement. Unfortunately the strength of the neo-liberal attack on the public sector during the 1980s has meant that mistakes made in public services have been taken as evidence against the state and in favour of private market solutions. But what is already evident in many fields of public policy is that the limitations of the market that led to the growth of the state in the first place have re-emerged. This is certainly true in the field of development finance. The question then becomes not one of plan versus market, nor public versus private sector, but how private and public sectors can be organised to achieve the desired development ends. There is no blueprint answer to such questions. Much depends on the history and point of development of each particular country. It is within such a context that I turn now to look at development banking in Jamaica.

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26. B.Grosh, Performance of Development Finance Institutions in Kenya, 1964-89, Institute for Development Studies, University of Nairobi, Working paper No.250, July 1987.

Chapter 5

DEVELOPMENT BANKING IN JAMAICA

1. The fortunes and changes in development banking internationally appear to be mirrored quite closely in Jamaica. An initial venture in the 1960s, the Development Finance Corporation, over-extended itself and was closed in 1969, with the J$4 million 'good accounts' in its portfolio being transferred to a new body the Jamaica Development Bank. The JDB's initial share capital of J$10 million was entirely government funded. By 1981 it had risen to J$46 million, with a further J$46 million loan fund availability. During that period it made loan approvals of J$200 million, J$121 million of which was to industry, but by that date had accumulated losses of J$44 million, and was closed down as a lending institution by the new Government. It was replaced by two apex institutions, one for agriculture, a second for industry and tourism. The latter, the National Development Bank, had by March 1989 committed J$435 million of funds through approved financial institutions (AFIs), they had disbursed J$329 million and had loans outstanding of J$270 million or 11 per cent of the combined productive sector loan portfolio of the eleven commercial banks. As of that date there were no arrears on the bank's loan portfolio, nor provisions for bad debt, rather an accumulated surplus of J$38 million which has grown steadily since 1985. As a wholesaling bank it has been strikingly successful.

2. How do we assess the performance of the JDB? Too often banking studies and international donor assessments limit themselves to quantitative assessments of the bank as supplier: disbursement ratios, lending against target, bad debt provision, rates of arrears and level of profitability. These are all necessary for control purposes, but their limitation is that they do not deal with the effects of the loan. Neither do estimates of job creation. Numbers of jobs in projects funded do not tell us how many jobs were lost as

the result of the competition of the new investment, the sustainability and wider impact of those jobs, and their quality. What is needed is an analysis of performance on the basis of the experience of the borrowers. Who were the borrowers, how much support did they get financially and in other ways, how did such support compare to that on offer from commercial banks, how did the investment fare, did emergency working capital finance in any way achieve its objective of short term survival? Some assessment of externalities is also needed to take into account the impact of an investment on a particular sector or area. In short the developmental impact of a loan cannot be taken for granted. A bank may be performing well in terms of its formal management and balance sheet results, while critical industrial opportunities are not taken up because of lack of funding. Similarly a bank who provides such needed funds, may appear unsuccessful on its balance sheet.

3. Unfortunately there is little data on the effect of JDB loans, and it would now be a major job to reconstruct such qualitative studies. A number of the JDB's executives at the time with whom I talked said that the bank had been very much a developmental bank in its culture and operations, and that their support had led to the establishment and growth of firms which otherwise have gone unfunded. Certainly as far as manufacturing is concerned the JDB does appear to have directed its funds in accordance with its mandate. 60 per cent of the funds went to industry and of that 31 per cent went to new industry, 46 per cent in small loans of under J$100,000. They also adopted a sector strategic approach towards tourism, undertaking a study of 45 hotels in the mid 1970s, and then lending to 24 of them. Such a pro-active approach allows not merely the identification of fundable projects, but an assessment of the requirements of the sector as a whole. Finally, one externality from the JDB which was recorded by those who had been involved, was the contribution the Bank had made to the creation of entrepreneurs. Former executives had later successfully moved into the private sector, a contribution which likewise did not appear on the balance sheet.

4. It is as well to register these points even if we cannot examine them in detail. For the financial losses, and the problematic managerial practises identified in the Auditor Generals' two reports in 1978/1979 have tended to swamp the positive contributions that the JDB made, which were clearly felt as such by the staff, and which for five of its first six years were consistent with financial profitability. Even in 1975, the JDB was still showing net profits in spite of a J$1.25 million provision for losses, and had by that time approved J$86 million in loans. What then went wrong? Those who have defended the JDB's record emphasise mainly external factors. Those who are critical of it point rather to its managerial conduct. I can do more than make an initial indication on the basis of the discussions I have had and records that were made available to me.

5. What the evidence suggests is the following. The JDB initially performed relatively well, in spite of a J$0.5 million provision for losses in 1973, caused partly by their programme of lending to small scale industry. From that year the country's economic position began to deteriorate, with the oil price rise, monetary instability and international recession. In October 1974 the JDB set up a special loan facility of J$10 million for the Government to provide working capital finance for businesses suffering a liquidity crisis, and almost 200 loans were approved and disbursed quickly, with the Bank suspending normal detailed lending appraisals and approval criteria. A further J$12 million were lent in this way for working capital purposes in 1976 at the Government's request. Thus the JDB incorporated into its ordinary balance sheet J$22 million of loans which were in effect seen by the Government as grants to an industry in crisis. I have no detailed evidence on how much of these working capital loans were repaid. Much was not. We need only note at this point that the working capital funds processed in this way amount to 50 per cent of the JDB's accumulated losses in 1981.

6. In spite of these special loans, the ever worsening macro situation and depression within Jamaica particularly in 1976 and 1977

led to sharp increases in arrears. Delinquency rates in the JDB portfolio rose from 3 per cent in 1974 to 30 per cent in 1977, and the bank itself was often reluctant to foreclose for developmental reasons. Furthermore the two devaluations in 1977 hit the Bank in three ways. First, they lost J$1.3 million on those loans on which they had taken the foreign exchange risk (a figure that rose to J$2.5 million by the end of 1978). Second, where the exchange losses fell on the borrowers, this further weakened their capacity to repay JDB loans. Third, the demand for loans fell because of borrowers' reluctance to take on new foreign exchange risks.

7. The JDB was therefore caught in a double pincer movement. On the one hand, it rescheduled interest and principal repayments, capitalised interest, refinanced operations and provided permanent working capital in order to minimise closures. Even then this was not sufficient, and a number of borrowers disappeared abroad, leaving assets whose value had already fallen as the result the crisis. On the other hand, there was a shortfall of new borrowers. Aggregate lending by the JDB in 1977 - in spite of the Bank accepting ever greater risk - was still 18 per cent down on target, a fall of almost half on the 1976 loan approvals figure, and there was a further 44 per cent fall in 1978. These figures are moreover in nominal terms, and relate to loan approvals. The fall in disbursements was even higher.

8. The pressure to maintain some level of lending - a micro Keynesianism through direct investment funding - as well as a concern to keep their existing customers afloat, led to a relaxation of procedures. In order to speed up lending, assessments became looser, the managers circumvented the loan committee, they approved loans in excess of the recognised limit, they accepted inadequate security and released funds prior to the normal checks and processes being undertaken. The Bank appears to have been like a ship caught in a gale, when normal procedures were suspended as the crew tried to hold to their course.

9. It is difficult at this distance to assess the effect of all this on the morale of the staff. The Chairman and Managing Director resigned in 1978, the Auditor General conducted an inquiry into the Bank's operations, and the Public Accounts Committee held sittings on the matter. It is hard for an organisation under such public scrutiny to sustain its morale internally, particularly when losses had risen to J$6 million in 1977 and J$40 million in 1978. Among the claims made against the Bank at this time were ones of corruption. The Auditor General's Report noted that loans had been made to projects involving members of the chief executive's family, bank officials authorised loans for companies in which they had an interest, and the staff mortgage loan scheme was found to have been ill-administered. Yet my clear impression from the discussions I have had and the documents examined was that corruption was not a major issue, any more than was direct political interference in the granting of particular loans. The problems of the JDB were not those of a patrimonial institution in a patrimonial state. They were much subtler than that.

10. What was at issue was how a general economic crisis was to be managed and its costs distributed. Under conventional banking rules, the costs fall on the borrower, the borrower's employees, and the creditors. Banks will seek to take first charge on the assets, and demand a level of collateral which ensures that even in a general collapse they can realise the value of their loan. As private companies they are concerned first and foremost with their own survival, and not with wider economic consequences. This is not the case with a government. Just as there is a public interest in central banks acting as lenders of last resort to the banking system in order to prevent a general economic collapse, so there are times when it is in the public interest for the state to act as lender of last resort to industries whose collapse would have negative multiplier effects, and whose prospects in the long run are still sound. It is one of the lessons of successful contemporary industrialisation that short term fluctuations commonly conflict with

long run growth. Recent recessions have taught us that in matters of industry it is often much easier to destroy than to create.

11. There is a clear case then for a policy of industrial intervention of the kind followed by Jamaica during the 1970s recession. There is also a case for the policies of the JDB itself which had made it so vulnerable. For example, the small investors to whom its lending was geared are particularly exposed during a downturn. For its borrowers more generally the JDB required on average only a 1:1 level of collateral, much lower than commercial banking practise. This is a level which was developmentally justified, but which at the same time left the JDB open to losses at times of recession and the fall of asset prices. Its reluctance to foreclose on those in arrears was a further instance of its developmental priorities. All reacted adversely on its balance sheet.

12. What the record of the JDB suggests is that the prime reason for the size of its losses were its own commitment to developmental policies, and its use by the Government as a conduit for working capital funds. One was a case of accepting risks for the sake of development, the other of pursuing counter-cyclical policy, and putting the long term before the short. At a time of deep recession, both showed up as large losses in the financial accounts. This point is hidden when the bank is judged according to general banking procedures, rather than in the wider context of the general economic crisis in which it found itself. Had the JDB not acted as intermediary for the government's working capital loans, had it avoided lending to vulnerable sectors, and had it insisted on the normal levels of collateral, I suspect that its performance would bear comparison with the commercial banks. But that would have been to abrogate its development aims. What is confusing in such a case, however, is that the social costs of an economy in a time of recession - costs in this case of a counter cyclical kind - are realised in the accounts of a single quasi-commercial institution, the JDB. They cannot be read as if they were the accounts of a

private bank. They must rather be seen as if they were government expenditure paid for by taxes and justified by the economic and social benefits of the policy.

13. Seen in this way, the questions then become not whether or not the JDB was efficiently run - it appears to have been a vigorous institution until it ran into the political difficulties of the late 1970s - but rather whether the JDB was a suitable vehicle for carrying through the Government's development policies, and how if at all it could have managed the crisis in a way which was less damaging to its internal workings and in the end to its existence. These questions lie at the heart of the tensions in development banking more generally, and in this sense the JDB experience brings out in a particularly stark form the central dilemmas of this branch of economic policy.

14. The problem for public development banks is that each of their actions - whether it be the foreclosure on a firm, or the fact that internal procedures have somehow not been complied with - is held to be in the political sphere, the responsibility of the government, and thus open to public debate whereas these same actions would be unquestioned in a private bank. The development banks are part of a politicised economy, in a way in which the market economy is not. The market exercises its own disciplines, it has its own politics, but it does so somehow behind our backs, intangibly, outside immediate human control. Secondly, development banks are judged primarily on the basis of market based criteria. Whatever is said and accepted about social benefits and non market development goals, it is the financial accounts on which political judgements first rest. They are computable. They carry with them the common sense and cultural imprint of a market economy. Loss making, subsidy, unsecured loans, arrears and contamination rates, are all part of an ethical vocabulary of the market economy, separate from and juxtaposed to the value laden words of the non market sphere - gift, charity, support, help, grant, welfare spending. These two languages are political facts, and part of the problem for development banks is

that they have often been operating in one sphere (the market) using the language and accountancy of another. However much governments and economists appeal to social cost benefit and long term development criteria, political assessment will be drawn to the judgement of the market.

15. A new model of development banking needs to place these issues at the centre of its concerns. It needs to find means for avoiding what I have called 'the confusion of economic languages'. It needs to see how far it can separate the commercial from the social in its accounting, how it can develop objectives which are detailed and which command political support, and how it can insulate itself from the short termism of the 'politicised economy'.

16. If the JDB reflected the experience of many of mark 1 development banks in the 1970s, the National Development Bank (NDB) which took over, is a good example of the apex institutions of the 1980s. In one sense it can be seen as a retreat from dilemmas faced by the JDB. In another it has been the refocussing of development banking in Jamaica on one of the multiple functions ascribed to development banking, that of the provision of low cost long term finance. This function it has ably performed. As can be seen from Table 10, 88 per cent of its outstanding loans are for terms of over 5 years, 45 per cent to manufacturing.

17. With respect to the criticisms made of development banks more generally, the NDB has solved a number of them by working through the commercial banks - the latter's working capital lending allows the banks to keep closer control over the borrowers, they have effective collection and arrears management procedures, and their intermediation of the loans provides some protection from possible patrimonial influence over particular loans. The NDB undertakes its own appraisals of projects - which consider them from a developmental and not merely a commercial point of view. They have also developed

procedures which allow them to process applications from commercial banks in an average of four weeks, as well as undertaking their own direct review of final borrowers to ensure the effective use of funds. Although relying primarily on public funds, the NDB has floated a bond for J$30 million reflecting the strength of its balance sheet, and its low exposure to risk. Since the AFI's bear the risk on individual project loans, the NDB's risk is on default by the AFI's, which is currently unlikely, and although the NDB bears the foreign exchange risk on loans channelled through it, these risks are themselves guaranteed by the Government of Jamaica. It has thus become a robust institution in performing the functions assigned to it.

Table 10

NATIONAL DEVELOPMENT BANK: OUTSTANDING LOANS, MARCH 1988

Jamaica dollars million

	Medium (1-5 years)	Long (Over 5 years)	**Total**
Tourism	5.1	91.3	**96.5**
Manufacturing	11.5	79.7	**91.2**
Services	3.1	4.6	**7.7**
National Development Foundation	-	3.2	**3.2**
Total	**19.7**	**178.9**	**198.6**

Source: NDB

18. The main criticisms made of it relate to functions it does not perform. Other than the small amount of money advanced through the National Development Foundation and the Credit Unions, there is a charge that the Bank's funds do not go to new entrants, nor does a sufficient proportion go to smaller firms. There are no figures on either of these . In real terms the average size of NDB industrial loans is more than double that of the equivalent figure of the JDB in the early 1970s, though the NDB's average does not take into account loans made through the NDF. More seriously, the loans made through the commercial banks are necessarily to clients who meet the commercial banks' own lending criteria, particularly with respect to collateral, and this is undoubtedly a limitation. Another way of putting these points is that the wholesaling system is not geared to risk investment. The NDB does not take equity in firms, and uncollatoralised risk is largely screened out by the system. The newly launched Jamaica Venture Fund is aimed at this problem, and the NDB has played a significant part in the establishment of the consortium behind the Fund.

19. The above criticisms of the NDB should be seen less as criticisms of the Bank itself, but of the function it has been established to perform. The point is similar to that made about the JDB, that it was their functions rather than their mode of operation which was the main issue. It may be said that the narrower brief of the NDB made it easier to manage than the JDB, and this is probably true, particularly when that brief could be judged in terms of normal banking performance criteria and procedure, but even so there is still much that can go wrong with apex institutions, and the NDB has ensured that they have gone right.

20. The NDB now faces a new challenge with the agreement by the Government of Jamaica that interest rates on concessionary finance be raised to Treasury Bill rates. This will still offer firms an incentive to apply for NDB funds, but the gap between the NDB and normal commercial bank lending rates will be substantially narrowed. Two questions arise. The first is whether the gap will discourage

the demand for NDB funds, particularly where such an application may be more demanding in its appraisal, and take longer for approval and disbursement than in the case of a commercial bank loan. The second is what will happen to the profits derived from the increased spread between international donor rates and the final borrowing rate. It has been suggested that commercial bank margins on NDB funds be increased from 3 per cent to 5 per cent. Given that the system has been working well on a spread of 3 per cent the economic case for such a rise is doubtful. In this case the NDB itself would benefit from a large increase in its internal funds. Since one part of its function - cheap loans - stands to be curtailed, the ensuing returns from a much larger spread promise to provide resources for some extension of lending, or diversification of function. I will take up this point in the following chapter.

21. Jamaica then has had one development bank which was ambitious in its scope, and registered major losses on its accounts, and another which was limited in function, and has shown four years of profits. When they are considered in terms of their developmental functions, both have exhibited limitations. In exploring how these limitations can be addressed, there are important lessons to be drawn from both.

Chapter 6

OPTIONS

1. For the past thirty years, the debate between markets and planning has been at the heart of development policy. Time has moved the debate forward but has not resolved it, since experience has highlighted the limitations of both positions in the debate. Unregulated markets continue to bias an economy towards the short term, to endanger ecological balances, to be profligate with non renewable resources, to increase inequality and unemployment, and, among producers and consumers, to confirm the power of the strong relative to the weak. These have all been evident results of neo-liberal policies over the past two decades - in both developed and developing countries - and have led to critiques by consumer, labour, green and minority groups as well as by governments and intellectuals in developing countries[27]. At the same time, the model of central planning has itself been irreparably punctured. In addressing the defects of the market model, it has generated weaknesses of its own - of innovation and the capacity to restructure, of labour organisation and commitment, of administrative sclerosis and over-centralisation. The collapse of this model in Eastern Europe and many post socialist developing countries suggests that the main alternative to the market had been mis-specified.

2. As these limitations became recognised, softer versions of both polar approaches were developed. Social cost benefit analysis was applied to project appraisal in order to accommodate the acknowledged weaknesses of unregulated prices. The approach remained a micro one, and faced problems of quantification, partiality and public resources. It could take account of social valuations and the

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27. For a recent assessment of neo-liberal policies see C.ColClough and J.Manor (eds) States or Markets? Neo-Liberalism and the Development Policy Debate, Oxford 1991.

implications of strategic alternatives, but it did nothing to generate them. By way of contrast there emerged an 'objectives-based" approach, which started not from monetary values but particular material objectives and then considered what was necessary to achieve them within given financial constraints. This is now being applied in such fields as transport planning in Europe[28], and is well exemplified in Japanese and South Korean industrial policy. It gives primacy to the material aspects of development rather than the financial ones - to issues of technology, product quality, organisation, co-ordination, system improvements, and the skills of the labour force. It leaves open of course what the objectives should be and what are the best means to achieve them, but these become primary questions that cannot be answered adequately by formulas of market competition and getting the prices right.

3. The above remarks are a necessary preface to any consideration of a policy for finance and industry in Jamaica. The controversy over development banking in Jamaica, for example, reflects the wider debates on markets and planning and has to be addressed at that level. Pragmatism is not enough.

4. There are three broad options of relevance to Jamaica in the field of industrial finance:

a) **liberalisation and deregulation.** This has been the central thrust of Structural Adjustment Policies in the 1980s, and has involved the dismantling of exchange controls, the introduction of an auction system for foreign exchange, the replacement of the JDB by the commercial banks as the prime retail institutions for concessionary lending, and the reduction of the gap between concessionary lending rates and the rates on commercial loans. The trend has been towards breaking down the

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28. For a recent pioneering study in the field of developed country transport see: Keith Buchan, Wheels of Fortune: Strategies for Transport Integration in the South East of England, Stevenage, 1990.

divisions between different financial markets, limiting the role of development finance institutions, and allowing a reconstituted market to determine which parts of industry survive.

b) **the modified market.** This approach suggests that there is a case for public sector institution to provide funds for industry on criteria which reflect the social costs and benefits of particular projects, with any resultant short fall on the agency's commercial books covered by advances of public funds. The emphasis is on strong SCBA appraisal techniques and a public retailing facility. This was the model used for development banks until the late 1970s.

c) **the objectives-based approach.** This starts from goals, and considers alternative ways in which they can be met. The goals would include strategic aims, for example the sectors of industry which Jamaica wishes to develop, and also functional goals such as how such industry is to be financed. Such an approach has been the basis of much development planning. Its problem has been less the objectives than the way they are pursued. Most development plans are primarily a framework for central government spending, they are geared to what governments can do for enterprises rather than what enterprises can do for themselves, and they do not emerge from strategies developed in common with the principal agents on whom implementation depends.

5. Of these three, the first two are narrower in scope than the third. They have clearer sets of criteria and in this sense are more manageable. Both, however, suffer from the limitations that I have alluded to earlier. The objectives based approach is the most difficult of the three. It requires sophisticated indicators and systems of measurement, an adaptive institutional structure, a means for involving all parties to the production process in strategic planning and its implementation, and a level of collective morality which is a necessary condition for a common project of this kind to work.

6. For many countries the demands of an objective-based approach may be too high in the short term. One of the first two options is at times the most effective way of asserting some organisational discipline on a bureaucratic state and on industrial firms that have used such a state to promote their particular interests. The new President of Haiti for example has advocated privatisation as a means of weakening a corrupt state apparatus. But not all countries and all parts of the public sector are like this, and liberalised economies soon throw up the problems that led to the development of a public sector in the first place. It is here that an objectives based approach has particular relevance.

7. It is Jamaicans who are best placed to assess which of these options is most applicable in the current circumstances. Unfortunately the country's indebtedness and its dependence on the IMF and aid donors has meant that the choice has been imposed by external agencies, who have consistently underplayed the limitations of their preferred option (liberalisation and deregulation). With respect to industrial finance the donors have largely abandoned the second approach, and failed to explore the third. The purpose of this report is not to make the choice - that is a matter for the Government. It is rather to insist on the real choice that exists. The policies of the first two have been well rehearsed. This chapter will concentrate on the third, linking it in to the discussion of flexible specialisation.

The objectives

8. I assume to begin with four objectives:

- that Jamaica wishes to develop a competitive manufacturing sector;

- that industry seeks to economise on its use of finance, by raising the productivity of its fixed and working capital;

- that the industrial finance required should be available at stable interest rates reflecting the long term social rate of return;

- that manufacturers have access to 'real services' as a necessary complement to 'financial services'.

The first of these objectives is the most general. The subsequent three may be read as secondary objectives designed to further the first. Note that none of them presuppose particular organisational forms to achieve the goals - public or private enterprises, banks or business service companies, large firms or small. The approach intentionally leaves open the question of form in contrast to strategies which start from specific types of organisation as a proxy for detailed strategy.

Economies in the use of capital

9. One of the lessons of Japanese methods of production is the importance of policies to increase total capital productivity. I discussed this earlier in Chapter 1 as a feature of the flexible specialisation approach to finance - that the starting point should be how finance is used, and hence with the demand for finance prior to considering its supply. Some of the economies can be made within a firm - through improved stock control, Just in Time systems of production, total quality control, improvements in the speed of changeover, strengthening two way linkages to the market. These improvements can be assisted by management consultants, advisory services, and management education.

10. Some, however, depend on co-operation between firms (allowing full utilisation of lumpy equipment for example) or on the organisation of the productive system. By productive system I mean all stages and infrastructures that go into the production and distribution of a final product. Thus each sector draws its inputs from a number of domestic and overseas suppliers, and similarly sells to a range of clients outside its sector. The flow of goods is inter-sectoral as well as intra sectoral, and there are many ways in

which the lack of a co-ordinating body at the sector and productive system levels interrupts the flow of production. One of which the Government of Jamaica is acutely aware is the delay and cost of passing inputs through customs. Another is the insecurity of access to foreign exchange. Both factors encourage manufacturers to expand their inventories, stocking up when foreign exchange is available, and at all times keeping a material reserve in case of unexpected import delays. As a result stock turns decline and working capital requirements increase. It is as well to remember that halving the time taken in customs clearance of imported inputs is equivalent to halving the rate of interest on the working capital involved.

11. The current Jampro/UNIDO programme of sector studies is examining how such improvements can be made. The furniture study makes clear that the potential gains from these measures is substantial, and that the smooth flow of materials through the productive system in Jamaica is of parallel significance for the financial economies of individual firms alongside action within the firms themselves.

12. One area of government activities which needs to be extended to focus attention on these issues is that of industrial statistics. The regular publication of studies and statistics monitoring progress of stock turns, and the factors contributing to them should be given priority. At the moment there are no comprehensive statistics of stock levels in industry, the national figures published are of net changes in stocks and are based on a sample of larger firms. For the purpose of a programme aimed at reducing the capital requirements of industry this is clearly inadequate.

Consortia and the cost of capital

13. If one of the dangers of an unregulated market is short-termism it is important that manufacturers have access to long term funds at stable rates of interest. As far as the level of these rates is

concerned, there are two factors to consider. The first is the long run social rate of return on manufacturing investment. I have seen no estimates of this. Given the removal of protection on the one hand, and the importance attached to manufacturing by the Jamaican government on the other, I would expect it to be less than the 8-20 per cent real rates of interest that will face industrialists after the rise in concessionary rates.

14. The second factor is subsidies. Concessionary funds have included a substantial subsidy element to borrowers - indeed real interest rates have often been negative. Attaching subsidies to the cost of capital is however, less effective than providing it in forms which encourage production efficiency. I will discuss these efficiency measures in a moment. For the moment I will restrict myself to the question of the cost of capital. It should be positive, it should not be tied to short term commercial rates and in so far as the long-term rate is lower than the commercial rates (which it is currently likely to be) then any fear of arbitrage should be dealt with by channelling the funds through one or more institutions which have procedures adequate to supervise the spending of the loan.

15. Even if the lending rate for concessionary funds is to be tied to Treasury Bill rates, there is still scope for some action by manufacturers to reduce their borrowing costs. One possibility is for manufacturers to set up their own merchant bank, seek agreement from the NDB that it be recognised as an approved financial institution, thus receiving wholesale finance at 3-5 per cent beneath the agreed final lending rate. The bank would be jointly owned, and require initial capital of only J$250,000 (the level stipulated for merchant banks under current financial regulations), to which the NDB could add a further J$250,000 as a reserve fund. This would therefore be a co-operative bank, which shouldered the full risk on the funds borrowed from the NDB. The advantage would be that a co-operative bank, operating in a manner similar to the loan consortia in Italy, could be expected to have costs less than those allowed for

by the 3-5 per cent spread. COFIM, the financial consortium in Modena, for example, charges 0.5 per cent on each loan guaranteed which is sufficient to cover its costs as well as contributing to reserves. In addition to its self assessment procedures it limits its risks by restricting the amount of loans to 5 per cent of the borrowers total sales plus the equivalent of J$12,000 for each worker. It also requires a promissory note from each borrower worth 15 per cent of the value of the guarantee. Some such safeguards could be introduced to the merchant bank. If by establishing a structure of mutual obligation and detailed industry knowledge, such a bank was able to reduce the risk of default, the savings could be past on to borrowers in the form of a lower rate, an expansion of the co-operative's capital or both.

16. An alternative would be to establish a financial consortium directly on the Italian model, guaranteeing 50 per cent of loans to consortium members and reducing the borrowing rate from commercial banks as a result. It would be possible to employ guarantees for the commercial banks' own funds, and for the concessionary funds channelled through the commercial banks. The constitution of the COFIM consortium is attached as Appendix 2.

17. The advantage of either of these forms from the viewpoint of the NDB would be that the projects they received would be screened by industrialists, and would also incorporate the element of peer group pressure which has been a factor in so markedly cutting the failure rates in the Italian system. Since the procedures also promise a means for improving projects and spreading good practise within the industrial community, there would be a good case for the NDB to encourage such mutual institutions by giving a 2 per cent discount on concessionary funds lent in this way. This would offer the promise of a final borrowing rate of 3-5 per cent under the normal rate for these funds.

18. It would be advisable to start any such schemes on a pilot basis. The initiative would be with the manufacturers. But if they proved successful (and mutual guarantee schemes have had a good record in developing country agriculture[29]) then a number of such schemes might develop. Sectoral schemes could be considered - a clothing manufacturers merchant bank for example, or ones based on locality. Some might specialise in working capital loans, others in the NDB's medium to long term funds. In some instances loans could be backed by a loan consortium and be processed through a manufacturers' merchant bank.

19. Jamaica has already had experience of guarantee schemes, and they have been a feature of a number of World Bank country programmes particularly as a means of increasing commercial bank credit to small firms. They have had a mixed record, however, principally because the guarantees have been provided by development banks, central banks or other quasi publics. There has been mistrust by the commercial banks that they would be able to invoke the guarantees without lengthy bureaucratic procedures, and they have thus commonly continued to insist on collateral (of 100-130 per cent in the case of Jamaica, in some cases with further compensatory deposits in spite of

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29. One of the most notable examples has been the Grameen Bank in Bangladesh. All borrowers have to be members of a group of five people, which has to be approved as reliable by a bank worker, following a six week period of training. The group is responsible for loans made to members of the group, and the loans to group members are staggered, so that a loan to any one member is dependent on the prompt repayment of loans by previous borrowers within the group. As a result the Grameen Bank's arrears rate is 1.6 per cent, compared to an average of 39 per cent for 38 other third world schemes. In general group schemes perform better (from the arrears point of view) than individual schemes. See: M.Hossain, Credit for Alleviation of Rural Poverty: the Grameen Bank in Bangladesh, 1987 available from International Food Policy Research Institute, 1776 Massachussetts Avenue, N.W., Washington DC 20036; German Foundation for International Development, Promotion of Self Help by Savings Banks, Economic and Social Development Centre, ZWS, Berlin, 1987, pp.121-127; P.Mosley and R.Prasad Dahal, "Credit for the Rural Poor: a comparison of policy experiments in Nepal and Bangladesh", Manchester Papers on Development, Vol.III, No.2, July 1987.

the existence of guarantees)[30]. The main lesson of the Italian experience is the importance of shifting both appraisal and guarantee obligations to a community of borrowers, with whom an individual borrower has different relations than he or she does with the state.

Financial and real services

20. Another feature of the financial system in continental Europe is the provision of real as well as financial services. These real services include information (about sectors, overseas markets, new technologies and technological capacities) hands-on managerial skills, training, project preparation and implementation, as well as a variety of accounting and payment services. In Chapter 1 I suggested that the Mondragon group of co-operatives had been particularly successful because its group bank had linked such services to the projects which the bank financed. In Germany, the industrial banks have long had sectoral expertise and sent in their own managers to borrowers in difficulty. Development banks too have supplied turnaround management, and consultancy services to clients.

21. The World Bank, on the other hand, reports poor results on its various technical assistance programmes to entrepreneurs designed as a complement to financial assistance to SME's. Foreign advisers were either unable to transfer their know how to counterparts, or stayed too long. Specialised service centres (in Bangladesh, Sri Lanka and Pakistan) took a long time to establish, and those in operation (Pakistan, Thailand, Kenya and Turkey) were costly and underused[31]. The Bank put much of the blame on the public institutions used as delivery agents:

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30. Jacob Levitsky, World Bank Lending to Small Enterprises, Industry and Finance Series, Vol.16, The World Bank, Washington, 1986 pp.23-4.

31. Ibid. pp.33-37.

> "Many TA programmes have been chronically disfunctional, only partially implemented, subverted from their original objectives or never initiated. A main reason for failure is management and staffing problems within implementing organisations...... high turnover of management, shifting government mandates, and endemic inability to attract, retain and motivate high quality staff...... Staff members tend to be either new graduates with little real expertise to offer entrepreneurs or long term civil servants who have lost much of their enthusiasm"[32].

The exceptions to this general picture were some of the sector specific agencies (such as the Clothing Industry Training Institute in Sri Lanka, as well as the Small and Medium Industry Promotion Corporation in Korea, which focussed on textiles, ceramics and plastics firms) and two public extension services in Mexico and Portugal. The latter operated with considerable autonomy from the civil service, had their own salary structure, and formed an active link with the credit programme - helping clients to prepare projects, and advising them on credit availability.

22. The Bank's response to this generally poor record of achievement was to suggest not repeating such projects. "The Bank's comparative advantage in providing technical assistance for entrepreneurs is questionable". It commented that "many of the most successful projects have included only minimal TA components, with a few exceptions, the success or failure of credit components has not been dependent on TA programmes for entrepreneurs"[33]. Yet the criteria for success explicitly excluded the firm level results of SME programmes. They were limited to the achievement of targets for the 'institutional delivery systems', the strengthening of these institutions, jobs created, costs per job, and the "correction of market imperfections that limit small entrepreneurs' access to credit"[34]. The European evidence starts from the other end, considering the factors behind the success of groups of enterprises,

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32. The World Bank Industry and Energy Department, World Bank Lending for Small and Medium Enterprises: Fifteen Years of Experience, Industry and Energy Department Wroking Papers, Industry Series, No.20, p.46.

33. Ibid p.51.

34. Ibid p.12.

and finding that the effective provision of real and financial services is of importance to the SME's.

23. Where the Bank is right I think is in identifying the weakness of service institutions that are controlled centrally by the state, and operate according to civil service procedures, and to broad, generic briefs. Where it is wrong is not thinking through the general conclusions drawn from the successful cases. Both those they cite and the European examples suggests that it is important for real service centres to be close to the clients - the Italian real service centres are controlled and part financed by local industrialists. Those technical services located in banks are also well positioned to provide information for the banking section, and to provide preparation, training and follow up help for the borrowers. Many of them have benefited from acquiring sectoral expertise.

24. In Jamaica, the main public sources of technical assistance and entrepreneurial training are located in Jampro. Jampro has a number of able sectoral advisers and runs a Design Centre. I was not in a position to assess these parts of Jampro's services, other than to be impressed by the quality and commitment of the staff with whom I worked. Where I suspect there is a gap is between these services and the banking system. Whereas the National Development Foundation operates two divisions, concerned respectively with banking and training, the links between these functions, similar to those in the Mondragon bank, are largely absent from other parts of the Jamaican financial system. There is virtually no industrial sector expertise in the commercial or merchant banks. One or two of the merchant banks provide hands on managerial support to clients in difficulty as well as assistance in preparing feasibility studies, but this is exceptional. The NDB as a wholesaling bank lacks these specialisms. It remains, like the financial system as a whole, project based, rather than pro-active in industrial sectors.

25. What can be done to repair this ommission? The commercial banks to whom I talked, saw themselves as too small to afford sectoral specialists, although I suspect the lack of such specialists reflects a particular approach to lending, as much as the overall limitation of size. Given the scale of industrial lending by the commercial banks, it would be valuable to run a pilot scheme of sectoral specialism in one of the larger commercial banks. The Trafalgar Development Bank says that it intends to appoint sector specialists, and this, too, is to be welcomed. One of the briefs for the JAMPRO/UNIDO sector studies should be to identify where gaps in the provision of real services exist for each sector, and how the gap can most appropriately be met. In some instances it may be that sector service centres would be a useful development - but where this is the case it is strongly advised that any such centre emerge from agreement within the industry and that it be controlled and partly financed by its users. A final point of initiative would be the NDB itself. It stands to increase its income from the larger spread it will receive as a result of the rise in lending rates on concessionary funds. It can use this income to establish a range of services whose costs would be prohibitive for a purely commercial institution. Alternatively it could locate such services in a new public retail branch.

Development banking: extending the model

26. There is a strong case for considering the re-introduction of quasi public retail development banking in Jamaica. The limitations of the current wholesaling model are recognised both by banks and industrialists, and have already been discussed in this report. The NDB is not adequate as it currently stands not because of what it does and how it does it, but what it does not do. Those firms and projects which do not meet normal commercial and merchant banking criteria are screened out of the current system, save for those very small firms funded through the NDF and the Credit Unions. The new Venture Fund may fill part of the risk capital gap, but like the Trafalgar Development Bank, will be restricted by its purely commercial criteria. There are no turnaround agencies for firms in

difficulty, nor banks which offer sustained technical support for particular projects. There is, as I have noted, a major gap in the availability of sectoral expertise with a brief for proactive programmes of sectoral restructuring. All these have been features of successful industrial and development banking elsewhere, and their omission is a major weakness in the current Jamaican financial system.

27. How could these functions be performed without running into the problems of the 1970s model of development banking? Much would depend on the ethos established in any new institution and this cannot be manufactured. For this reason I would advance by steps. I would leave the NDB as it is. It is running well according to its brief. In addition to it I would favour starting a new retail institution,the Jamaica Enterprise Board, structured in a similar way to the NDF but geared to SME's rather than the very small firms for which the NDF caters. To ensure its autonomy the new board should be a not-for-profit enterprise, limited by guarantee. It should be given a clear mandate to undertake a proactive role and allowed the freedom to diversify into those fields of finance and support services necessary to fulfil its objectives. Like Mondragon it would have two divisions, one the banking side which would be expected to break even, the other a technical support and training side which would be in part self financing, and in part supported by internal and external grants. It would be expected to develop sectoral expertise, to act as an information resource for the industry, and to encourage the growth of sectoral service centres of the kind discussed earlier.

28. It would be advisable for such a board to start small, with a capital of J$40 million and a staff limited to 20. Given the profitability of the commercial banking sector in recent years, the private sector should be asked to contribute to the initial funding, with matching funds from the Government and aid agencies. In the long run any financial system has an interest in a thriving real economy, and the proposed bank is intended to contribute to that end.

A similar principle of matching private and public sector contributions should apply to loan funding over the first five years, with the public sector contributing a greater proportion in the initial period and the private sector playing a more substantial part as the bank becomes established.

29. How would such an institution fit in to the existing financial and 'real service' structure? In part it is intended as a complement. The banks and non bank financial intermediaries would be asked to contribute to it not as a profitable investment, but because it undertook functions which the current structure did not, functions which are necessary for the long run development of Jamaican industry. It is implicit in such a proposal that responsibility for the social interest of the economy should not be left solely to the government and international aid agencies, but should be seen as a responsibility of all the major economic agents.

30. It should also be recognised that in part the new Board would be competitive with existing institutions. This is true of its relations with the Trafalgar Development Bank. The Board would be different from the TDB. Being a not-for-profit, and seeking grant funds to finance complementary project services, the Board would have a much broader development remit than the TDB. But as a loan agent it would compete with the TDB, as it would with other commercial and merchant banks in its proposed role as an approved financial intermediary for the NDB. Similarly some of its sectoral and training functions might overlap with those offered by Jampro. The Board might well employ clothing specialists for example, and run sectoral training courses.

31. In traditional administrative theory such arrangements are seen as wasteful duplication. But it is the essence of the new public administration that there should be pluralism within the public sector, and indeed a measure of competition between the public and

the private. Competition implies duplication, though in practise specialisation will prevail. In this sense it is to the good of both the new Board and the TDB that there is a measure of competition between them. The same would apply to the Board and Jampro, or any other public agency providing these services. Each will tend to find the things it does best. Each may be encouraged to innovate and experiment, as well as co-operate. For the Board in particular, if it cannot raise loan and grant funds on the strength of its performance as an institution, it will fail.

32. What is important is to preserve a clear distinction between the balance sheet and non balance sheet items. I have already touched on training and support services. But there are other development functions that the Board might be called on to perform: the supervision of an integrated local development plan; the regeneration of an area of dilapidated property; the support of venture enterprises which fall outside normal commercial risk; the rescue and turnaround of a strategically significant firm. In each of these cases the Board should conclude a separate contract with the Government or aid agency, whereby the Board acts as a managing agent for the project, charging a fee, and is assessed on the basis of its effectiveness in carrying out the project. It should be seen as part of its function to undertake such projects - but the costs of doing so should be kept separate from the Board's accounts.

33. I am aware that there is still a shared trauma surrounding the last years of the JDB more than a decade ago. But I have argued that there is a cost in leaving a trauma unexplored - a cost in this case of omission, of what is not being done which needs to be. This is the value of starting with objectives rather than with the market or with particular institutions. The objectives I have outlined suggest the need for a new institution. But it is an institution whose structure should be informed by an analysis of the failure of the JDB. One of the purposes of this report has been to offer an analysis of this failure. There may be other readings. What is of the first importance however, is that all concerned with the

development of Jamaica should not fear institutional failure, for it is only through experiencing failure, managing it and learning from it, that robust institutions can ever be built.

Chapter 7

A TEN POINT PLAN

This report has suggested that a flexible specialisation approach to industrial finance requires a change in the relationship between bankers and manufacturers, a recognition of the need for complementary technical support along with finance, a project oriented rather than collateral oriented approach to lending, institutions whose structure and purpose allows the appropriate information and trust to reduce the risks of an investment, and an emphasis on the mutual help that manufacturers can give to each other in the field of project assessment and the raising of finance. All this depends first on an awareness by industrialists, bankers, and the government, that there are other models of banking than the 'Atlantic' one which may be more appropriate for Jamaica. None of them can be developed mechanically. They depend on a different way of looking at industrial production and at the financial process. Building new institutions without this change of outlook would be unlikely to bring about the necessary changes. Indeed, as a rule of thumb, it is often advisable to start with existing institutions, and people working within them, rather than place immediate hopes on new structures. Like trees, institutions take time to grow, and that growth much depends on the preparation that precedes them. The recommendations which follow have been framed with this in mind.

1. The Report

The first step is that this report should be fully circulated and discussed. I suggest six stages:

- distribution of the draft report to those who have contributed to its writing, inviting comments;

- discussion of the report with concerned individuals and groups, in both the public and private sector;

- the holding of a one day meeting on the report, with short commissioned papers on the main subjects covered and sessions devoted to:

    - industrial finance in Jamaica

    - lessons from Jamaica's development banking

    - policy alternatives and recommendations.

- revision of the report in the light of discussions.

- submission of final report to the Government of Jamaica.

- publication of report as part of Jampro/UNIDO series of industrial studies.

2. Industry research

There is still little systematic evidence on the financial needs and difficulties of Jamaica's manufacturers. Studies of industrial finance concentrate almost exclusively on the suppliers of funds rather than on the users. The recent JAMPRO/UNIDO furniture industry study cited one of the most efficient of Jamaica's furniture firms which faced an interest charge of nearly 80 per cent of its wage bill, because a) they had a work in process total of more than one half of annual sales; b) they faced a slow pre and post factory materials flow as the result of customs delay and unsatisfactory transport infrastructure; c) they had a 36 per cent interest charge on an overdraft facility which matched the value of work in process. More systematic evidence of this kind is needed to highlight the problems of industrial finance.

I suggest that future sector studies of this kind contain a section on industrial finance, critically analysing the use of funds in the manner of the furniture sector report, the cost of funds, and the source of capital supply. They should identify where management accounting is inadequate for working capital management, and examine the main interruptions to flow within the sector, including customs, transport and distribution.

It would also be valuable if the ISER at the University could complement their valuable studies on Jamaica's financial system, with

follow up work on the users of fund, particularly among the small firms financed by the National Development Foundation, to examine the value of the technical and training support supplied by the NDF along with finance.

3. A pilot sector strategy working group

Building on the Jampro/UNIDO programme of work, it would be valuable for Jampro and Ministry of Planning and National Development to establish a pilot sector project to exemplify how industrial planning for sector specialisation can work in practise. One way this could be done is to establish a working group of 6-8 professionals working for six months together on the strategy for one sector. The group would comprise officers from the Ministry of Planning, from Jampro, the National Development Bank, from other relevant parts of the public sector (which would vary according to the sector), from industry, the private banks, and from the trade unions. Each would be financed by the sponsoring institution, with the administrative overheads covered out of public funds. It would be critical to have a team leader with experience of industry, and the dynamic leadership of a team.

The team would be expected to visit and study all parts of the sector - from the raw materials through to final sale, and to become acquainted with the latest developments in the sector internationally. They would be supported by visiting specialists, and funds would be required for selected visits overseas.

The first four months would be devoted to preparing a draft report; the following month to discussing this report throughout the industry and with all economic agents from other sectors who have dealings with the pilot industry. The final month would be spent revising the report and submitting it to the government.

Among the aims of such a project would be to establish a consensus around a detailed sector strategy of all the main parties involved, and to build up specialist expertise in and working relations between those parties.

One of the issues for the sector strategy would be industrial finance. Means of meeting financial needs might vary between sectors - in some cases a new sectoral institutions might be appropriate, in other existing banks would have their own proposals.

It is important that the financial sector is represented on the working party, with nominations from the commercial banks and the NDB. After the six months of the working party operations, it would be hoped that the banking members would continue as sector specialists within their sponsoring organisations as the core of small teams for a three year trial period. In the NDB the task of the specialist would be to encourage projects within the sector to be submitted to the NDB through the AFI's in accordance with sector strategy.

4. Co-operative merchant banks and consortia

Immediate steps can be taken by the manufacturers to explore the feasibility of establishing (i) a manufacturers merchant bank; (ii) a financial guarantee consortium. In the first case the NDB would be required to recognise the co-operative venture as an AFI, and consider sharing an element of the risk with the new bank. In the second case the consortium would access funds from commercial and merchant banks who were a party to the scheme. If a group of manufacturers decided to go ahead with one or both of such schemes, it may be valuable for one of them to visit the Caja Laboral in Spain and local Italian financial co-operatives of this kind.

5. Overseas banking alternatives for SME's

A two year project should be conducted (perhaps by the ISER at the University with bilateral or multilateral funding) to consider the relevance of the German and Italian financial systems as they relate to the funding of small and medium sized firms. The purpose would be for those who have already done valuable work on the Jamaican and

Caribbean financial systems to examine closely the operations of European local, regional and co-operative banking and to be in contact with academic researchers in those countries. It would be useful for a secondment from the NDB to be attached to this team, or for some other form of close operational attachment between the project and the NDB to be established.

6. Commercial banks and pro-active industrial banking

A key current policy issue concerns the use of increased spreads on concessionary funds. The prime facie case for raising the spread of 3 per cent for commercial banks is not strong, without a commitment by these and other AFI's to take positive measures to address the problems identified in this report, notably the absence of pro-active industrial banking.

7. NDB and support services

The increases in spread remaining with the NDB should likewise be used to address the wider absences of the development banking system in Jamaica. One of these would be the strengthening of the consultancy, training and support services around individual projects submitted to and funded by the NDB.

8. A new retail facility

A feasibility study should be undertaken on the establishment of a Jamaican Enterprise Board, on the lines proposed in Chapter 6.

9. National statistics and flexible specialisation

At the moment the system of national accounting is primarily geared to the macro management of the economy, rather than the promotion and monitoring of a strategy of flexible specialisation. The absence of

disaggregated figures on stocks, fixed investment, and the flow of funds, is of particular concern. It is proposed that a one year project be mounted (again funded by bilateral and multilateral donors) involving a staff member from Statin working with domestic and overseas university specialists, to consider the statistical implications of a policy of flexible specialisation, including issues of industrial finance.

10. Training and industrial finance

A review needs to be undertaken of current training programmes available to bankers from the viewpoints discussed in this report. Consideration should be given to the setting up of a pilot two year, part time course for those involved in industrial finance, to cover a) contemporary developments in industrial management, with particular reference to flexible specialisation, and b) comparative institutions for the financing of small and medium sized industry.

Timescales

I have not put time scales on the above. Some are open to the initiative of the parties concerned, who will set their own time scales (for example the industrialists in considering some form of common financial facility). But the first priority for the Government is to establish a measure of common agreement on the problems and the range of possible solutions. This can be most immediately advanced by the discussion and revision of the present report, a process which should be completed with additional and more detailed agreed recommendations, by the end of 1991.

Appendix 1

Flexible Specialisation

Over the past twenty years the regime of mass production that has been at the core of twentieth century growth has run into increasing difficulties. Its emphasis has been on productivity achieved through long runs of standardised commodities, using special purpose machinery and semi skilled labour. In a world of exchange instability, market fragmentation, and the growing importance of innovation as a means of competition, the hierarchical organisations and routinised systems of the mass producers have been ill adapted to what has been called 'the new competition'. The mass producers have found themselves crowded into the low margin end of the market, subject to undercutting from low wage economies, and to displacement by the quality, innovative producers. The United States and the UK who were the dominant economies of the mass production era, now find themselves with increasing trade deficits, and with institutions which make it difficult for them to respond adequately to the new challenge.

The successful economies have been Germany, Japan, Sweden, parts of Denmark, as well as middle Italy (the so called 'Third Italy'), which in Emilia Romagna has the fastest growing region in Europe over the past twenty years. Each of them have based their manufacturing success on production systems quite different from those of the Atlantic mass producers. Each are different but with certain common features. Together they have come to be known by the term 'flexible specialisation'.

The chart overleaf summarises the main contrasts between the mass production and flexible specialisation (FS) models. At the heart of FS is the adoption of general purpose machines and production methods which allow rapid changeover times from one product to another. A die press which takes 8 hours to change in a General Motors plant, can be switched in 4 minutes by Toyota. Programmable CNC machine tools are similarly allowing small batches to be produced with minimum down time.

Features of old and new production systems

	Fordism	Flexible production
1. Production concept	Mass production. Economies through fixed capital & labour productivity within the production process.	Flexible specialisation/flexible automation Economies through working capital productivity between production processes and in distribution.
2. Technology	Machinery purpose built and dedicated R&D functionally separate and discontinuous	General pupose, adaptable machinery R&D integrated with production and continuous Importance of design.
3. Products	Limited range of standardised products	Product variety & specialisation for 'niche' markets
4. Inputs	Materials and energy intensive	Materials and energy saving/information intensive
5. Work process & skill	Fragmented and standardised tasks Strict division between mental and manual labour. Semi skilled workers	Open ended tasks/semi autonomous groups and decentralised responsibility/closer integration of mental and manual tasks/core of multi skilled workers linked to sub-contract semi skilled labour
6. Payment systems	Rate for the job Formalised pay bargaining	Payment for the person/rising income for skilled core More informal wage settlement
7. Organisation and management	Managerial hierarchies Centralisation Multidivisional	Flatter hierarchies Centralised information & planning systems with decentralised production. Networks, sub-contracting, franchising.
8. Markets and customers	Domination of manufacturers over retailers, of producers over users. One way relations/mass advertising	Domination of retailing/two way relations between customer and manufactuter/firm rather than product advertising.
9. Suppliers	Arms length/stocks held 'just in case'	Two way relations/stocks arrive 'just in time'
10. Competitive strategy	Competition through full capacity utilisation and cost cutting Tends to over production, stock piling and mark downs	Competition through innovation Response to falling markets through diversification, and innovation

These changes have upended the old forms of production. For instead of having to produce for stock to gain economies of scale, flexible producers can produce directly for the market. Electronic Point of Sale techniques (EPOS) provide instant feed back of market demand. Manufacturers can now try out a variety of products, and - with short delivery times - produce in volume those that go well. In clothing and footwear, as in consumer durables, the life cycle of products and fashion seasons are becoming shorter. Product variety and 'market niching' is challenging the standard, mass produced commodity in sector after sector. And instead of production pushing through products on to the markets, the market is pulling through the products in response to its demand.

In Japan this has been called the Just in Time principle of production. It applies to intermediate as to final goods, the final demand being fed back to component suppliers who are likewise required to produce only what is immediately required by the market. Component delivery beside the production line has cut out the warehouse, and cut down the working capital locked up in stocks. Whereas Western car companies turn over their stocks (of inputs, work in progress and final goods) between 25 and 30 times a year, Toyota has a stock turn of 90, that is to say its stock changes on average once every four days. Working capital productivity takes its place beside labour productivity as an equal not a handmaiden.

Another aspect of working capital management is a new concern about quality. US studies of manufacturers quality suggest that 15-40% of manufacturing costs can in one way or another be traced to problems of quality: defective goods, re-runs, time spent in adjustment and fitting machine defects, customer returns, large quality departments. The Japanese have adopted the principle of 'getting it right first time'. They have brought statistical quality control to the shop floor, and given responsibility for quality as well as machine maintenance to the operator. This has entailed an upgrading of jobs and a multi-skilling of labour and stands the traditional 'Taylorist' organisation of work on its head.

A similar approach has been adopted with suppliers. Instead of handing down detailed specifications and asking suppliers to bid on cost, the post-Fordist firms looks for a supplier's capacity to innovate, working within broad specifications, and with the quality, and just in time principles that are required throughout the chain of production.

The Japanese have understood that Taylor's principles of Scientific Management, which centralise information and planning, and enforce commands through strict hierarchies and market discipline, are quite unsuited to an age where innovation and adaptability have become so central. Japanese managerial structures are therefore marked by decentralisation, to the shop floor, to plant managers as to suppliers. Central management is concerned with long term strategy, systems development, monitoring, and corporate diplomacy rather than co-ordination and command. Hierarchies are flatter, and horizontal linkages prevalent. Problems should be settled at the levels they are experienced not rise up to be resolved at the top.

The electronic revolution has been part of the new flexibility, but in general it has been 'software' rather than 'hardware' which has been most important. Many Japanese firms operate with a lower level of technology and older machinery than their American counterparts. US firms in their turn have found that new machinery does not ensure success if they have not taken on board the lessons of corporate organisation, of job design, of product design and innovation, and of a shift in seeing labour as an asset rather than a cost.

Indeed it is the change in attitude towards labour which conventional management has often found most difficult to accept. The surplus economies draw on pools of cheap labour for parts of their sub contracting, but they are not based on it. Many Japanese, German, Swedish, Danish and Italian firms pay substantially higher wages than the British and American firms whom they outcompete.

Inter-firm Networks

The above amounts to a new micro economics of the firm. The emphasis shifts from quantity to quality, from economies of scale to economies of scope, and to the economies of turnover time. But the logic of the new competition drives the demand for co-ordination outside the boundaries of any one firm. In Japan and Germany the co-ordination is organised by the larger assembly firms around which cluster hierarchies of subcontractors. In some countries it is the retailers who provide this dynamic planning function, in others like the Italian clothing industry, it is designers and distributors. Industrial associations, formal networks, cartels and consortia all contribute to this planned co-ordination, supported by different levels of the state. It is the economies of system, rather than of plant or firm size that have become critical.

The Third Italy is particularly noted for its small average firm size. Table 1 indicates the success of Italian firms in world export markets - but it is a success of smaller firms grouped in specialised industrial districts. In the shoe industry the average size of firm in Italy is 17 workers, in furniture it is 5.7, in clothing 5.3. Prato, a town near Florence of 160,000 people, has 14,000 clothing firms, yet accounts for one quarter of the world market in suit cloth. Ceramic tile production is centred in the small Emilian town of Sassuolo, woollen clothing nearby in Carpi. But these concentrations of firms are organised as if they were part of a single firm. They have specialisms between them. They share the kind of common services normally provided by functional departments and head offices. But at the same time they have the advantages of formal decentralisation, namely a capacity for innovation. The clothing firms of Prato alone produce more than 80,000 new patterns a year. The Italian experience suggests that in spite of the pressures for globalisation deriving from the need for international marketing, small firm industrial districts can be internationally competitive if they find ways of co-operating amongst themselves.

A decentralised state

Italy, like Germany and Japan, has also seen an important role for the state, particularly local and regional government. In Emilia Romagna the regional government helps finance common services, they contribute to training programmes, and to the encouragement of financial and export consortia. They also seek to ensure - by action in the labour market - that inter firm competition takes the form of innovation rather than wage cutting.

In the successful Baden Wuerttemberg region of West Germany, the regional government set up an innovation network of 1,000 academic research scientists, engineers and technicians to contribute directly to local technological innovation. Massachusetts - one of the US states to have taken on board the need for post-Fordist industrial policies - has established a network of small, specialist agencies to encourage innovations, manage company turnarounds, training, medium firm expansion and venture capital funding. Flexible specialistation, has, in short, grown side by side with what we might call a new type of flexible state.

Appendix 2

CONSTITUTION

OF

THE CONSORTIA OF

SMALL AND MEDIUM

INDUSTRIES IN THE

PROVINCE OF MODENA

(COFIM).

Translated by Amelia Mills
March 1989

COFIM
Credit Consortium of small and
medium industries of the Province
of Modena
- cooperative society limited -
n. 11988 reg. firms tribunal of Modena

41110 Modena, Via Ganaceto, 134
telephone (059) 22 25 29

Constituted through the initiative of

- AIA (Carpi Clothing Industries Association)
- AIM (Modena Industrialists Association)
- API (Modena Small and Medium Industries Association)

and under the auspices of

the Chamber of Commerce, Industry, Crafts and Agriculture of the Province of Modena.

Constitution

approved with deliberations of the Constitutive Assembly of 9.4.1979 and modified with deliberations of the Extraordinary Assembly of 11.12.1979, of the Extraordinary Assembly of 27.4.1981 and of the Extraordinary Assembly of 7.5.1984.

CONSTITUTION

Art. 1 - LOCATION OF OFFICE

The Cooperative Society of limited responsibility named:

- COFIM - CONSORTIUM OF CREDIT BETWEEN THE SMALL AND MEDIUM INDUSTRIES OF THE PROVINCE OF MODENA - Cooperative Society of limited responsibility.

is located in Via Ganaceto 134 c/o the Chamber of Commerce, Industry, Crafts and Agriculture of Modena.

Any change of address of the office is at the discretion of the Board of Directors.

Art. 2 - DURATION

The Society will continue in existence until 31.12.2010 but could be extended beyond this.

Art. 3 - PURPOSE

The Society exists to assist and facilitate its own members with financial transactions with banks dealing with liquid assets and real estate leasing.

To achieve this aim it will give real and 'non real' guarantees, and also guarantees to third parties and may join cooperative Consortia

or federations, associations, and other consortia whose activities may be useful to the said Cooperative Society. The Society may perform all the legal procedures and contracts of a movable and real estate nature and any other activity, even if not strictly provided for in the Constitution, provided that they are useful to the realization of the aims of the Society.

In the case of movable and real estate operations the Society may provide the necessary guarantees to facilitate the lease of movable goods and real estate.

Guarantees from third parties will be accepted to be used together with the credits given by the members, as well as those sums of money or those financial guarantees that will be offered or loaned to the Cooperative Society with no profit purpose by public or private societies, which will however renounce any right of petition and any recovery action. The funds of the Society may be invested in shares. and bonds.

In particular, the Society may proceed, according to the guide-lines indicated in the present constitution:

a) to draw up one or more agreements with Credit and Financial Institutions;

b) to establish one of more Risk Funds;

c) to determine the guide-lines for the use of the credits pledged by the members and third parties.

The Cooperative Society has aims of mutuality, hence:

a) it does not seek profits;

b) the division of reserve funds between the members is forbidden within the period of existence of the society;

c) the entire residual assets after the liquidation of the society will have to be distributed for purposes of public benefit.

Art. 4 - AGREEMENT WITH CREDIT INSTITUTIONS

The Board of Directors may conclude agreements with one or more Credit Institutions with the aim of aiding the granting of credits to its own members. The agreements will have to conform to the following principles:

a) the member who intends to obtain the credit on the conditions proposed by the Bank to the Cooperative Society will have to apply to the latter, which will forward the request to the **Sub-Committee**, reference to which follows in Art. 14;

b) the aforementioned Sub-Committee will proceed with the selection of the applications for the granting of credit;

c) the Cooperative,in guaranteeing the credits to its members, will arrange to collect the Bank guarantees, to which the said members and third parties are committed and will establish as a security at one or more Banks, one of more risk funds. To these funds will also be assigned all or part of a percentage, which will be calculated in addition to the interest that the credit beneficiaries will pay to the Banks, and will be fixed in the agreements with the said Banks. All the sums that would have been collected by the Cooperative Society, for whose aims this arrangement has been made, will flow to the risk funds.

d) the cooperative, as a guarantee of the short or medium term credit given to its members which has been requested for the realization of projects of restructuring and re-conversion according to the programmes provided for by the law of 12.8.77, n. 675, will request a contribution according to the availability of funds referred to in law 675/77, and will constitute an appropriate risk fund with its own autonomous management;

e) the agreements will fix the guide-lines for the granting of the guarantees on the part of the members, their duration and the manner of their termination;

f) if the Credit Institution having had recourse to the risk fund(s) to pay for eventual defaults, finds an insufficiency of the said funds, it will have to avail itself of the guarantees granted by the members of the Cooperative Society. In this event, it will first have to contact the said Cooperative Society, which will arrange to divide proportionally between the members the burden of the non-fulfilling member within the limits of the guaranteed responsibilities of each. The Credit Institution will have the right to pursue the guarantor members who have not spontaneously answered the request for the pro-rata payment as above, up to the limit for each of them of the credit guarantees given;

g) the agreements concluded with the Banks will have a limited duration; otherwise they will have to include the right of Cooperative Society to withdraw. In exceptional cases it may be that the conclusion of bank agreements will require prior examination of the requests of finance by the Credit Institution. The approval of such agreements will be the duty of - according to the constitution - the Board of Directors, which will, however, adopt the relative deliberation with the majority in favour of at least half plus one of the appointed members.

Art. 5 - MEMBERS

The number of members is unlimited and not less than the limits fixed by the law.

The members may be:

a) ordinary

b) corporate.

The following may be members, ordinary or corporate: the small and medium firms with industrial or related activities, provided that such activities take place in the province of Modena, even if the company office is in another province. The firms registered according to the law 25/7/1956 n.860 and its subsequent modifications may not be members (Registrar of Craft Enterprises). Corporate members, unlike ordinary ones, do not have the right to benefit from credits, but may become ordinary members simply by following the formalities indicated in art. 6 of the present Constitution.

Also enterprises that do not qualify as small and medium industries, are members without the right to benefit from any credit on the basis of Cofim conventions, so are public and private societies and physical persons who:

a) make monetary contributions to risk funds or to the interest rate relief on the Cofim credit, or in order to contribute to the administration costs of Cofim;

b) give their own guarantees to Credit or Finance Institutions in the interest of Cofim or its member.

The admission to the Cooperative Society must be approved by the Board of Directors. Their decision is not subject to appeal. All the members are bound to respect the rules of the present Constitution.

The responsibility of the members to the obligations of the society is limited to the amount of the undersigned social quota, except that provided for the guarantees referred to in art. 6 which follows for the relations with Credit/Finance Institutions, with which the Cooperative Society has concluded agreements.

Art. 6 - OBLIGATIONS OF MEMBERS

Members are obliged:

a) to pay the social quota subscribed;

b) to pay the variable quota necessary to the ordinary administration referred to in article 9 below;

c) to release directly via the rightful or legal representative a guarantee of an amount not less than Lire. 1.000.000 = (ONE MILLION) as a guarantee of all the operations authorised by the Cooperative Society towards the Credit Institutions, with which the Cooperative Society has concluded agreements on the conditions and according to the guide-lines that will be fixed in the said agreements;

d) moreover, in the event of the member obtaining the concession of a credit authorised by the Cooperative Society, to release a further guarantee of an equal amount equal to 1/15 of the credit obtained;

e) in the event they are granted a credit, to release a bail of the amount of Lire 1.000.000 = (ONE MILLION) that will be deposited care of Cofim until the deadline of 12 months following the extinction of the said credit. The obligation to pay such bail

will be established each time by the Board of Directors. Such sums will be set aside and put into the Risk Fund or to deal with administrative costs.

f) to pay an increase in the annual rate of interest equal to at least 0.50% on each operation effected through the Cooperative Society and to eventual further amounts at the discretion of the Board of Directors. Such sums will be set aside and put into the Risk Fund or used to cover administrative costs.

The guarantees referred to in paragraphs c) and d) will have total priority in relation to any other guarantee given by the same member firm and will guarantee the global amount of the operations of credit obtained with the assistance of the Cooperative Society. As a replacement of the guarantees similar personal obligations may be pledged by a third party(ies) especially if administrators, representatives or participants of the member firm, or shares officially quoted may be paid; such a possibility, to be considered exceptional, may only be carried out with the prior approval of the Restricted Committee, and after consultation with the Board of Directors.

In the place of the guarantee, the administrators of the society might accept a credit in money. The corporate members, not being able, unlike the ordinary members, to benefit from credits on the basis of Cofim agreements, are obliged only to the remittance of the said (reduced) social quotas.

Art. 7 - WITHDRAWAL, EXPIRY, EXCLUSION

The members cease to be members of the Society by withdrawal, expiry and exclusion. Every member has the right to resign from the Cooperative Society only in the case in which he/she does not have a

current operation guaranteed in his/her favour; the resignation will be communicated to the said society through registered letter.

In the case of the death of the owner of an individual member firm, the social bond expires and in the case of a member of the Cooperative Society being a firm, the expiry of the social bond will be when the said society becomes insolvent or is liquidated.

The expiry takes place by right also in the case:

- of prohibition, disqualification, criminal offence that may imply the prohibition even temporarily from public offices of the owner of an individual firm or of even only one member of the firm constituted in the form of a society of persons and of the President of the Board of Directors or Unique Administrator of the firm constituted in the form of a society of capitals;

- of cessation of the activity of the firm for whatever reason.

Exclusion takes place following a decision of the Board of Directors in any case in which the member:

a) does not comply with the obligations deriving from the law, from the present constitution or indeed with the deliberations of the Assembly of the Board of Directors;

b) is insolvent.

The decision concerning the exclusion must be notified to the person/firm concerned through registered letter with confirmation of receipt within 15 days from the said decision. Within 30 days from

the date of receipt it may be contested in front of the Group of Arbitration. The guarantee obligation of the expired, deceased or excluded member will remain valid, in relation to the Credit Institution for all the insolvencies that may happen within the 12 months following the date of the withdrawal, expiry or exclusion, provided that they are related to lines of credit granted before the recess, expiry or exclusion. In the case in which a member firm is refused the concession of a credit requested through the Cooperative Society and has no other existing loans, the Board of Directors, after consultation with the Restricted Committee, may immediately render the guarantee no longer valid. Withdrawal from the society for whatever cause, given the mutualistic aims of the society, will not give right to the liquidation of the withdrawn social quota, which remains annexed to the capital of the Society.

Art. 8 - SOCIAL CAPITAL

The social capital is made up of:

a) the social capital (in variable measure) divided into shares of the nominal value of L.200.000 each for the ordinary members and of L.50.000 each for the corporate members;

b) the reserves.

The transfer of shares is prohibited.

Art. 9 - FINANCIAL YEAR

The financial year goes from 1 January to 31 December of each year. At the end of each financial year the Board of Directors will prepare

the budget, including the statement of the account and the balance sheet.

The eventual surplus is incorporated into ordinary reserve or used to increase the risk funds; exceptionally, the administrators reserve the right to create new risk funds with the ordinary reserve. On the quotas there are no interest dividends distributed. For the ordinary management the Board of Directors may require the payment of a contribution, from every member once a year only, for a total amount equal to the 0,50% of the guarantees obtained through the cooperative society.

Art. 10 - MEMBERS OF THE SOCIETY

The following are members of the Cooperative Society;

- the President of the Cooperative Society;
- the Assembly of the members;
- the Board of Directors;
- the Sub-Committee;
- the Internal Audit;
- the Group of Arbitration.

Art. 11 - ASSEMBLY

The Assembly of the Cooperative Society, formed by the members or by representatives of the firms, societies or member corporations or their agents, is convened in Modena, but not necessarily at the office of the society, at least once a year; this is to be decided by the Board of Directors or the President, or by request of at least one third of the members. The conveying of the Assembly, whether ordinary or extraordinary must be notified to the members through:

- letter to be sent at least 10 days before the day fixed for the meeting;

- bill-posting of the notice of the meeting in the office of the cooperative; this is to be displayed at least 15 days before the date fixed for the assembly and/or publication of the notice of the meeting on the information bulletins of the Chamber of Commerce of Modena and of the Associations of Firms promoters.

The notice of the meeting must include the agenda, place, date and time of the assembly and may include also the date of the eventual second meeting which may take place the day immediately following the first.

The assembly may take decisions in the first and in the second meeting.

The assembly is presided over by the President of the Board of Directors, if the said assembly does not otherwise provide.

Art. 12 - VOTES AND MAJORITY

Each member has only one vote. Every member can be represented by another member through written delegation, but each delegate cannot represent more than five members.

According to art. 2372 of the Civil Code the administrators cannot act as delegate.

The vote cannot be given by correspondence.

The assembly proceeds to the annual approval of the accounts and gives the general directives for action by the Cooperative Society The decisions of the assembly are valid with the presence, also by delegation, in the first meeting of 2/3 of the voters and with a number of votes in favour equal to at least half plus one of the present members, or in the second meeting, whatever the number of members present, also by delegation and with the number of votes in favour equal to at least half plus one of the members present. Minutes of the assembly will have to be compiled and written in the appropriate book.

Art. 13 - BOARD OF DIRECTORS

The Board of Directors is composed of up to 15 members, elected by the ordinary assembly and chosen from among the ordinary members. The said assembly can establish that the nomination of a maximum of 4 more members is left to one or more public institutions, chosen by the Directors elected by the Assembly among those indicated in Art. 5 of this Constitution.

The Board of Directors remains in office for three financial years. The Administrators are exempt from giving bail and have no right to remuneration.

The President and one or more Vice Presidents of the Board of Directors are nominated by the said Board. The President may delegate all or part of his powers and his functions to one or more Vice Presidents.

The Board of Directors, apart from deciding (without possibility of appeal) on the requests of admission to the Cooperative, is responsible for the ordinary and extraordinary administration, for the execution of the statutory rules and of the decisions of the assembly.

It will nominate the members of the Sub-Committee choosing them from among its members. It may also cancel membership of this committee and decide on the rules of the said Committee. The meeting of the Board of Directors is convened by the President at any time that he or she regards opportune or when at least one third of the Directors apply in writing. In the latter case the assembly must be convened by the President not later than 30 days from the request.

The meeting is called by letter to be sent at least 5 days before the assembly.

The guide-lines of the elections are established by the said Board. Its decisions are valid in the first meeting in the presence of the majority of the Directors and in second meeting in the presence of at least 1/3 of the Directors. In the first as in the second meeting the decisions are valid only if taken with a vote in favour by at least the majority of the members present and, in any case, with the vote in favour of at least 5 Directors.

Minutes of the decisions of the Board of Directors will be drawn up, and will be transcribed in the appropriate book and these minutes will be read at the beginning of the following meeting.

Art. 14 - SUB-COMMITTEE

The Sub-Committee consists of 6 members of the Board of Directors, of which one, nominated by the said Board, acts as President.

A representative chosen by the Chamber of Commerce, Industry, Crafts and Agriculture of Modena, the President of the Board of Directors of the Cooperative Society, the Vice presidents of the said society and one or more experts nominated by the Board of Directors can also participate in the deliberations of the Sub-Committee, without voting rights.

No delegation is permitted for these meetings.

The Sub-Committee will be valid with the presence of at least three members and decisions must always be unanimous.

It is the Committee's concern:

a) to decide on the applications for bank credits requested by the members and on all the problems concerning the credit applications;

b) to decide on the acceptability of the guarantees and of the shares, referred to in art. 6. For the decisions about guarantees by third parties and about payments of shares, the Credit Institutions will have to give their assent and the Sub-

Committee will have had to previously seek the opinion of the Board of Directors.

c) at any moment and with the unanimous agreement of the President of the Sub-Committee and of the President of the Board of Directors or his or her delegate the guarantees relative to the overall quantity of guarantees and those relative to the risk fund can be revoked according the timing and guide-lines fixed in the agreement with the Credit Institutions. In such cases the President of the Sub-Committee must immediately communicate with the Credit Institution concerned and must convene as soon as possible a meeting of the Sub-Committee to re-examine the position.

The amount of credits, the procedures of investigation and the rules of conduct of the Sub-Committee will be established by the Board of Directors in an appropriate internal regulation.

Minutes of the deliberations of the Sub-Committee will be drawn up to be transcribed in the appropriate book.

Art. 15 - REPRESENTATION

The signatory and the representative of the Society is the President of the Board of Directors, who therefore can perform all actions that are included in the aims of the society.

In case of the absence or impediment of the President, all his or her powers belong to the Vice President(s). The Board of Directors can delegate as signatory another Director provided that the relevant legal norms are observed.

Art. 16 - INTERNAL AUDIT

The Internal Audit is composed of three active members and two deputies.

Non members can also be elected as auditors. The nomination of one or more auditors can be attributed to the financing public institutions.

Art. 17 - GROUP OF ARBITRATION

The Group of Arbitration is composed of three members elected by the assembly.

The Group of Arbitration decides on the resolution of all controversies that might arise between members and the Cooperative Society and its administrative bodies.

Art 18. - TERMINATION AND LIQUIDATION

The society ceases to exist for the reasons provided for by the law. In the event of the Cooperative Society being put into liquidation, the assembly will elect a liquidator, who will take care of the cancellation of all relationships in which the Cooperative is listed as creditor or debtor, whether towards third parties or its own members.

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