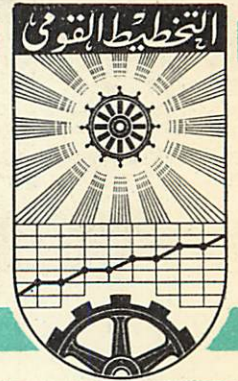


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Practical Problems of Investment:
Planning and Financing

by

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Practical Problems of Investment

Planning and Financing

- on the GDR'S example -

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0. Introduction

This memorandum is expected to give some explanations concerning investment financing in practice. The main question will be the mode of financing; that means, shall investments be financed by means of credit, by budgetary means or by own means of enterprises and associations?

This question is coming into being connected with the new economic system of planning and managing the national economy, in the framework of which much more weight is given to so-called value categories as, for instance, cost, price credit and profits. The increasing importance of value categories leads to the necessity to give larger responsibility to enterprises regarding the carrying through of the whole reproduction process including, of course, the extension of the reproduction process by means of investment.

Proceeding from this fact the now submitted memorandum deals with the practical process of preparing and financing investments. As a peculiar problem the role of credit in investment financing will be treated. Here, the author is forced to deal with a problem being still under discussion in most of the socialist countries.

1. Preparation of investment

The stage of preparation can be conceived as the connecting link between the prospective plan for developing the aggregate national economy and the yearly national economic plan in the field of investment activities. The investment preparation must be based on the prospective planning; its results are ingredients of the annual national economic planning.

The necessity to start and to carry through the preparations of investment already on the basis of prospective planning results essentially from the following:

Investments, being carried through at present, are very important for the prospective of the national economy. This, again, results from the specialities of the turnover of investment goods, that means from their long-term useful life.

The prospective planning must be therefore, starting point for preparing investment.

In the course of the preparation of investment the prospective plan will be concreted up to the fixation of the single investment measures, necessary so as to reach the aims of the prospective plan. In connection with this, a.o., such questions are to be investigated and decided as, for instance, the efficiency of investment, their several forms, whether new establishment or expanding construction, or completing investment etc.

This specification comprises also demands for special investment goods (products of construction industry, of engineering, of electrical engineering etc.) as well as demands for manpower and materials coming into being in connection with the carrying through of investment and when starting production in the new objects.

The clarifying of all these questions of preparation is to be reached in two stages.

- The first stage is called: setting of tasks

Within this stage all the aims of the national economic development fixed by the prospective plan and the government's directives have to be concreted with due regard to those investments now to be established. This stage has to contain the final national economic solution of the tasks of preparation and is expected to be the economic conception of the enterprise as well as the technical, technological, construction-technical, and construction-technological conception for elaborating the project.

The elaborated proposals have to be affirmed by a state authority; in the case of large-scale investment, being highly important for the national development, this affirmation must be given by the council of ministers.

- The second stage is called: elaboration of the project

Within this stage of preparation the conception of the first stage must be converted into the final and clear economic, technological and constructional solution.

This elaborated project is subdivided into

- i - The economic part
- ii - the technological part
- iii - the constructional part, and finally into
- iiii- the so-called graph of deliveries serving so as to ensure the close cooperation of the numerous suppliers of investment goods.

After solving all these problems the realization of the planned investment can be started.

I would like to refer you to the memorandum of Dr. Manfred Engert (Memo. No. 245, Part I and Part II), where especially the questions of preparation and implementation are dealt with in a more detailed way.

2. The material and financial assurance of investment.

Out of the measures, to be taken so as comprehensively to guarantee the development of fixed assets, structure and size of a certain demand for investment goods are resulting.

The structure of these requirements containing construction preformances and outfits is essentially destined by the following factors:

a- The structure of the demand for investment goods is a different one regarding the different branches of production.

(this depends on the different technological processes)

b- The different structure of the demand for investment goods is resulting from the chosen combination of investment forms and from the relation between investment and repairs.

(In the case of new establishments, for instance, the demand is formed by all the outfits belonging to a certain plant; in the case of completing investment the concrete demand is determined by those investments of production which shall be invested additionally etc.

c- For increasing the technical level of production very quickly an investment concentration on outfits is necessary.

d- The structure of investment demand is finally destined by technological peculiarities of the investment process itself.

For meeting the demands for outfits the production of the metal-working industry, in particular the production of engineering, electrical engineering, of the precision engineering and optics, the apparatus construction industry, and of those enterprises producing outfits of the measuring technique is of a decisive importance.

The most essential goods of the metal-working industry, from the national economic point of view, are forming the main source within the outfit balances by which supply and demand have to be balanced.

The production of the construction industry is expected to cover all the demands for constructive performances. The adjustment between supply and demand is, in this case, undertaken by the so-called construction balances.

This construction balance must be established for the republic as a whole as well as for the single districts and counties. The necessity for doing so is resulting from the fact that the production of construction industry is bound to the place of consumption and the construction enterprises, therefore, don't have fixed location. In connection with elaborating construction balances it is necessary to ascertain:

- the volume of constructive works within the planned period and within the certain district,
- the construction capacities within the district in question, and
- the difference between planned volume and available capacity.

Another point in question is the financial assurance of investment.

It is understood that for paying the investment measures, and all the other productive performances connected with them, financial means are necessary. As mentioned above the main source for financing investment must be seen in the national income.

But we have to look now at the single enterprises. The accumulation fund, mentioned in connection with the national income and available for financing investment, is not a fully centralized one. Quite the contrary! Especially at the present time and for the future it will become decentralized more and more. This fact of decentralization gives rise to quite a correct and thorough adjustment between investment plans on the one hand and financial balances, on the other, so as to adjust or to bring to tally physical and financial planning. This coincidence is given, when the sum of prices

of the planned investment, that means, the financial requirements for investment, is in concordance with the available financial means planned for this purpose.

The demands for financial means⁽ⁿ⁾ can essentially be met by the following sources:

(Please remember in this connection that the national income is distributed-primarily and secondarily-and that the sources for financing the extension of production are, therefore, decentralized)

- 1- state budget
- 2- amortizations of enterprises-in a way
- 3- planned profit shares of the enterprises or own means of non-nationalized enterprises
- 4- banking system (investment credits)

In the forthcoming time the latter source will play an ever growing role.

How that?- In the framework of the new economic system, now applied in our national economy and more directed to market (or economic) categories, the needed financial means must be achieved by the work of the concerning enterprise itself.

According to this, the profit distribution of enterprises (nationally-owned) is settled and profit must be utilized mainly for:

- 1- financing the investment plan
- 2- financing the planned increase in self-financed working capital
- 3- repaying received investment credits.

Parts of the remaining profit must be paid to the so-called appropriation fund of the association of nationally-owned enterprises by which these means are utilized so as to finance:

1. subsidies for enterprises
2. investment projects of enterprises
(additionally to self-financing)
3. increase in working capital of enterprises
(additionally to self-financing)
4. investment projects of the association and its establishments.

From this it appears that the realized profit will become more and more main source for financing investment and projecting plans of enterprises and associations as well. In that way investment financing simultaneously is going to be most closely connected with the fulfilment of the profit plan, and the self-responsibility of the associations and their enterprises regarding the fulfilment of the profit plan is going to be increased. In case of a non-fulfilment of the profit plan the association will be forced, so as to ensure the planned profit appropriation, to ask for a so-called emergency loan.

The regulation that, for the future, the association and their enterprises have essentially to take care of achieving the means of investment by themselves leads to the fact that their appropriation will take place concentrated on the centres of the respective industrial branch so as to reach high efficiency in a rather short time.

It will be the task of the association to take care:

- that the enterprises don't fritter away their means,
- that the investment projects will be prepared thoroughly,
- that they will be carried out within the shortest time possible,
and
- that the economic efficiency of the realized investment measures will influence to profit of the concerned enterprise more quickly as hitherto.

3. The role of credit in the system of investment financing

The crucial point in this connection is the following:

credit shall be utilized as one instrument so as to control:

- the planned carrying through of investment measures,
- their planned setting to work, and
- the most economical use of physical and financial means.

Concerning the GDR's investment practice the following forms of credit are used:

3.1. Pre-financing credits

These credits serve so as to bridge certain differences of time between availability of and demand for investment means, resulting from the fact that amortizations and profit can be realized later than the investment will be started.

For instance, for financing a certain investment program all those means are planned which will be available within one year. The separate amounts will continuously be realized all over the year while the aggregate amount is needed, let us say, within the first half of the year. This gap can and must be financed by means of credit.

Such a pre-financing credit is granted without interest and must be paid back in the course of the current year by means of the planned and realized amounts of amortizations and profit. If the credit will not punctually be repaid the bank is entitled to demand a rate of interest which is usually valid for overdue credits.

3.2. Credits for outfits

The installation of this kind of credit must be looked upon as an attempt. By means of it the purchase of separate machines and aggregates shall be financed so as to utilize the stimulative effect of credit for the favour of the society and in a full measure.

By means of this kind of credit there is to be reached that:

- a- fixed assets shall only be increasing ones if they are unconditionally needed and if their full utilization can be guaranteed,
- b- the new outfits become productively effective as soon as possible,
- c- the planned economic efficiency will fully be realized
- d- the control of the economic leading organs as well as of the financial organs regarding the utilization of fixed capital will become more effective.

Credits for outfits-on principle-shall only be given for the sake of providing enterprises with single machines which are contained in the investment plan. They are granted for a time beginning with the purchase of the machine and ending with the planned entry of the economic benefit; as a rule, they are given for a time of three months.

In using this credit the bank attains the possibility of a severe control regarding the planned running off of investment and regarding the actually reached benefit, too.

3.3. Credit for interim financing

This is a special credit for financing investment suppliers.

In future, supplies and performances will only be financed out of the planned means of investment, when the customer has got either complete outfits or partial segments ready for service. Up to that point of time the suppliers have to cover their financial requirements out of their working capital.

This holds true only in those cases that there are several suppliers responsible for the same investment object or the investment object is only a small and relatively slight one.

In the case of highly important investment measures a so-called main-supplier is destined to take the lead in shouldering the responsibility regarding the investment in question. For financing the main-supplier's performances as well as the performances of his second-suppliers the so-called credits for interim financing are granted by the bank.

The repayment of these credits has to ensue in accordance with the handing over and the payment of ready for service construction segments.

The credits for interim financing haven't only that advantage to be flexible and, therefore, adaptable to the material processes, but at the same time they make possible a permanent control concerning the running off of the construction process. This so, because they are granted on the basis of and in conformity with the construction cyclogram.

Interim financing credits are given in the following special forms:

1.- form : Credits for materials

They are granted for financing materials.

Construction suppliers have to repay this credit monthly in accordance with their used materials and by means of so-called credits for self-performances.

2.- form : Credits for self-performances

This kind of credit is only granted to the main-supplier and to the second-supplier "construction", in order to finance their productive expenditures; that means, for financing all those costs coming into being on the building-lot directly.

The second-supplier "construction" has to repay the credit out of the payment receiving from the main-supplier according to accounted performances.

The main-supplier will get a so-called cooperating credit so as to pay these performances.

The main-supplier itself will only be able to repay the credit for self-performances after handing over the ready for service equipment or the accountable segment of construction to the concerning enterprise. The enterprise, now, has to pay the investment by the planned means by which the main-supplier, again, will be enabled to repay the received credits for self-performances and for coordination as well.

Since the self-performances of the second-supplier and of the main-supplier must be carried out in accordance to the cyclogram, the bank will be able to recognize by means of the development of these credits ^(h) whether the investment process is running off true to the plans or not.

3- form : Cooperating credits

The cooperating credit, given to the main-supplier serves so as to finance accounted performances of the second-suppliers. (c.f. the explanations of the second form „credits for self-performances“)

This new regulation will make the construction enterprises work more economically, more reliably , and more effectively. Furthermore, this new regulation is believed to promote, as one instrument of course, the scientific and technological revolution within the shortest time possible.

4. The active function of investment financing

Investments are an important factor for safeguarding the stability of economy, since they help to establish in a large extent new proportions both between the groups of products and between the various branches of economy. Therefore, the policy of investment is undoubtedly an important factor for the development of economy.

By the investment policy a certain effect shall be reached. This certain effect can be characterized as follows:

Because of relative narrowness of both financial and physical means a maximum economic effectiveness must be reached by means of a minimum input.

What does that imply?

- 1- Financing methods have to serve so as to plan and to carry through only necessary investment.
- 2- They have to ensure that only such investment projects are realized considering technical development and forming, therefore, the most appropriate variant.
- 3- Financing methods have to ensure, finally, that planned investment measures are finished in time.

In this connection two main questions are coming into being.

- 1- Can the choice of an investment project be influenced by financing methods?
- 2- Can the safeguard of the balance of the real development during the execution of the investment plan be influenced by financing methods?

Let us consider these two questions.

4.1. The choice of investment projects and the applied financing methods

In a planned socialist economy the choice of an investment project is undertaken proceeding from the perspective or prospective planning.

Perspective planning, again, is based on:

- an analysis of development of demand (according to the branches),
- analyses of the development of products,
- the development of engineering.

Before including the various investment projects into the investment plan they must be examined thoroughly. This examination is based on technological and economic indices. Above all, there are to be examined:

- 1- The technological standard of the expected production.
- 2- The index of labour productivity and its supposed development.
- 3- The index of prime cost and profit.
- 4- The amount of investment costs.
- 5- The time of reflux; that means, the time in which the paid financial means for establishing the investment will be paid back.

What is, now, the role of finance played within the process of choosing projects?

In another connection I have already expressed that under socialist conditions of production finance cannot have the function of a primary regulation.¹⁾ Under these conditions it is not necessary to stimulate the disposition of investment by financial means, and it is impossible to do so. The very stimulation of disposition results from the comprehensive and central governmental economic planning. Socialist perspective plans as well as annual plans are not only recommendations of the government. All these plans are, once brought into play, bound to be fulfilled. Of course, also all the planned investment measures. The primary regulation is, therefore, task of the single plans themselves. It is the task of finance to find the most favourable solution for implementing the planned projects.

Therefore, the function of finance must be considered from two points of view:

- 1- From the economic and economical point of view; the economically and economically most favourable solution may be prepared and found by means of financial indices such as prime cost and their development, profit, investment expenditures, time of their reimbursement etc.
- 2- By taking into consideration the size and the importance of planned investment measures. Regarding large-scale and highly important

¹⁾ c.f. Memo. No. 539 Role and Function of Socialist Credit in Industry

measures the final decision is the business of central financial organs.

In case of smaller and less important measures the decision must be made by the enterprises themselves or by the concerned association (organization of industrial enterprises) respectively.

Let us deal with the latter point more in detail.

Smaller and less important projects are only included in the plan as far as they coincide with the general direction of an economic and technological development of the branch concerned. They are, however, not singly included in the plan. It is completely up to the enterprises and associations to choose such projects and to concrete them.

At present efforts are being made to enlarge the range of those projects which are to be chosen decentrally. Regarding these decentralized projects the role of finance must be taken into particular consideration.

Above (point 3 of the submitted memorandum) the role of credit in investment financing has been dealt with. Let us now estimate this role by checking the question of what extent credit in connection with interest might be applied and how credit can influence the choice of projects.

As mentioned above, detailed calculations of the efficiency have to be made based on standardized coefficients. By those coefficients the proportion between investment expenditures and economic results (in form of profit development) is shown. That means, by these coefficients or indicators expenditures are put into relation to that part of national income which is realized by profit. As mentioned, these coefficients are centrally standardized ones (by considering the peculiarities of the single branches, of course) and, therefore, bound to be observed by the enterprises and associations as well.

Because of the latter fact we have to state, now, that in connection with the application of those coefficients considerable stimulating effects can be attained without using interest. And, therefore, as pointed out in point 3.i. of this memorandum, pre-financing credits, as a special kind of investment credits, are being granted without any interest.

4.2. The execution of investment plans and financial control.

There are, at least, two tasks for the finance:

- 1- the financing task itself; financial means have to be available where and when they are needed;
- 2- the controlling task of finance; finance is used to control the fulfilment of the investment plan, especially in respect to the observation of time and cost.

The control of the activity due to plan is necessary in order to obtain the expected politico-economic effects in time and in the expected volume.

An especially difficult problem in economic practice is the observation of the planned investment costs. In many cases it can be proved that investment costs are exceeding ones as against the plan. Now-a-days we take pains to settle this matter and to solve this problem by giving more responsibility to the enterprises and associations as well. As mentioned earlier (point 2 of this memo.) self-financing is applied more and more in the GDR's investment practice.

An important precondition for doing so has been the so-called price reformation by which the prices of all the single industrial branches shall be brought in line with the socially-necessary working time; that means, by prices the true value shall be expressed. As known, the value -- in our opinion -- is composed by :

- | | | |
|-------------------------|---|--------------------------|
| 1- used fixed capital | = | depreciation |
| 2- used working capital | | |
| a- raw materials | | |
| b- auxiliaries | | |
| c- wage and salaries | = | material costs and wages |
| 3- earned profits | = | profit |

If there is an equality between value and price, the enterprises will be able to realize all the single value components when selling the produced goods.

Proceeding from this, they are also able to gain all the necessary means so as to finance their investment.

The sources are represented by depreciations (amortizations) and by profit as well.

When making the enterprises and associations more responsible for investment financing they can, in turn, be forced to work in such a way that the planned profit will be gained and that on the other hand, the planned investment costs will not be exceeded.

But that is only one side of the problem. Another most important item is the accomplishment of planned investment in time. By punctual accomplishment of investment measures the balance of economic development is affected, since the investment measures are adjusted with all the other plan tasks. And that in a twofold way:

- 1- the new investment projects or the invested equipments and plant are expected to produce from a certain and planned point of time goods which are needed from other enterprises so as to fulfil their plan tasks. If the planned deliveries of the newly erected productive units would not be available in time, a chain reaction would come into being.
- 2- In connection with those occurring hold-ups or disturbances the flow of profit would be hampered. By this fact a new chain reaction would be caused, since the flux of profit is a planned one and the earned means are planned to be spent on other expanding measures.

Thus, it can be seen that the observation of time is a very important item for safeguarding the stability and balance of economic development.

How to control the observation of time? - It is, for instance, quite suitable to finance larger investment by credits in advance (c.f. point 3 of the submitted memorandum). When granting credits in advance the crediting bank will get the opportunity to control the construction process of the project. If, now, the realization goes on true to plan, there will be no need for paying interest. If, however, the planned time is not observed and

the project seems not to be realized in time, the bank has the possibility to force the concerned enterprise - in an economic way - to improve its activities by demanding interest. Interest, however, must be paid out of the enterprise's profit. Thus, the profit will be diminished, and hereby the amount of the bonus fund will be reduced. This will affect, of course, the activity of the associations, the enterprises, and even the activity of the single workers. Since the bonus fund¹⁾ is expected to cover expenditures so as to finance:

1- Social expenditures on account of the workers as a group

- so, for instance, enterprise's kindergartens, libraries,
enterprise teaching establishments etc.,

2- bonus payments (premiums) to the single workers because of good work;

- so, for instances, in case of fulfilling plan targets
(or over fulfilling), making amendment
proposals for the sake of increasing
production, or improving the quality
of produced goods,
or saving materials, or replacing rare
materials (bottleneck materials) by others,
and , and, and;

3- smaller investments,

the reduction of the bonus fund will immediately affect the monetary receipts of the single workers and other social and cultural privileges as well. Thus, workers,

1) Here is included the so-called, fund for cultural and social expenditures which must be formed beside the bonus fund.

clerks, and managers can be forced in an economic way to provide for ensuring a timely ^(setting) into operation of planned investments.

5. Concluding remarks

The problem of investment financing by means of credit and the controlling possibilities arising from this are still for the time being - under discussion.

There is a certain conformity of meanings concerning credit participation in investment financing. All financial economists are in consistence, when speaking about the role of credit in the process of financing investment costs and regarding the role of credit in connection with the observation of the planned time.

But there is a special group of economists asserting that the role of credit can be and must be, therefore, a wider one. In their opinion, the efficiency of investment measures can be influenced by credits. Their opinion is based on the fact that credits are granted on conditions of their being repaid. The repayment, again, is to be ensured by means of the profit earned out of the increasing production. For ensuring, now, the repayment of credits the enterprises are forced - in their opinion - to calculate the efficiency of the planned investment measures in a prognostic way and very carefully. By means of this they would be forced, again, to plan and - in particular - to realize only such investment projects, the economic necessity and, therefore, the economic effectiveness of which is fully being proved.

In my opinion both the assertions must be taken cum granum salis.

- 1- It cannot be the same to an enterprise (or an association of enterprises, respectively) to get the financial means for implementing investment measures by the state budget and in form of final distribution or by the bank and then on conditions of their being repaid.

In case of final distribution or redistribution the superior financial organ is taking the lead in shouldering the responsibility for using the available financial means in the economic best way possible.

Of course, the enterprises can be forced to be careful, but not in a direct way. Economic levers of another kind than credit (for instance, production fund levy¹⁾) can only be used indirectly.

In case of banking financing on conditions of a repayment according to the planned implementation and - in particular - according to the planned economic efficiency of investment the responsibility is mainly shouldered by the enterprise (or association) itself, which has to take care of repaying the received credits in time; that means, in accordance with the planned setting into operation of the planned investment and in concordance with the planned reflux of invested means.

- 2- The role of credit in investment financing should not be overestimated. Credit is, by no means, the key to solve all the questions of investment financing, nor is it the key for solving the problem of economic efficiency of investment.

When investigating the influence of credit upon economic efficiency of investments, we have - in my opinion - to distinguish between large - and small-scale investments. I believe the role of credit to be indirectly proportional the size of investment.

1) c.f. Dr. Linsel, Dr. sack, special Conceptions of Socialist Economy, Part II, Memo., No. 519.

Why that? - The efficiency of large-scale investment depends on a lot of factors which not all are susceptible by the enterprises. There are, for instance, national economic factors as well as international economic factors; especially the latter are unsusceptible from the standpoint of an enterprise and even of an association. The smaller, however, an investment project, the smaller, therefore, the national economic importance, the higher, on the other hand, the possible influence of the enterprise on the economic efficiency. This must - in my opinion - be taken into consideration, when thinking about and fixing new financial methods for investment financing.

In GDR'S economy good experiences are at hand gained by the application of the so-called credit for rationalization. This credit is granted for implementing amendment proposals of the working people serving the rationalization of the production process by means of small-scale mechanization, and for financing small-scale investment measures of the enterprise outside of the investment plan. The economic effect of these measures on the reproduction process can fully be estimated by the enterprises. They are, therefore, fully responsible for the realization of those measures and also for their financing, which is to be carried through by the above-mentioned credit for rationalization.

For receiving such a credit the enterprise has to submit to the bank an exactly elaborated calculation of economic efficiency, by means of which the bank is enabled to recognize:

- a- the effectiveness of the rationalization measure on the development of labour productivity;
- b- the development of the costs of production; particularly, the costs of the most essential commodities or groups of commodities;
- c- the development of the profitableness of the enterprise; that means, the development of the relation between costs of production and return;
- d- the time the rationalization measure is expected to become effective, and connected with it the time of repayment,

Regarding a small-scale investment measure enterprises are able to answer these questions. Thus, they can be made fully responsible for financing (by means of credit and by own funds) and for the repayment of received credits.