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REPORT ON PROPOSAL FOR SOUTHERN AFRICA-AMERICAN ENTERPRISE FUND (SAAEF)

Prepared For:

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT
SOUTHERN AFRICA

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GLOSSARY

AEFs	American Enterprise Funds established in Eastern Europe pursuant to Public Law 101-179,the SEED Act of 1989.
AGF	Africa Growth Fund
CDC	Commonwealth Development Corporation
CEO	Chief Executive Officer
CMA	Common Monetary Area
DBSA	Development Bank of South Africa
DEG	Deutsche Investitions-und Entwicklungsgesellschaft
DFI	Development Finance Institution
EBRD	European Bank for Reconstruction and Development
EDESA	Economic Development for Equatorial and Southern Africa
EF	Enterprise Fund
EIM	Equity Investment Management, the management company for the TVCF
EUR	Eastern Europe, including the countries of Poland, Hungary, Bulgaria, and the Czeck and Slovak republics
FRP	Federal Procurement Regulations
GVCF	Ghana Venture Capital Fund
IFC	International Finance Corporation
IFIs	Intermediate Financial Institutions
ISA	Initiative for southern Africa
KECC	Kenya Equity Capital Corporation

LAAD	Latin America Agribusiness Development Corporation SA.
MESBIC	Minority Enterprise Small Business Investment Corporation
NAIC	National Association of Investment Corporations
NGO	Non-Governmental Organization
NIS	Newly Independent States of the former Soviet Union
NSA	New South Africa, a group supporting the development of black-owned enterprises in South Africa
OPIC	Overseas Private Investment Corporation
PTA	Preferential Trade Area for Eastern and Southern Africa
PVO	Private Voluntary Organization
RFP	Request for Proposal
SAAEF	Southern Africa-American Enterprise Fund
SADC	South African Development Community
"SAR" or the "Region"	Southern African Region consisting of eleven countries: Tanzania, South Africa, Swaziland, Angola, Namibia, Zambia, Zimbabwe, Botswana, Mozambique, Lesotho and Malawi
SBICs	Small Business Investment Companies
SEED	Support for East European Development Act of 1989
SIDI	Societe d' Investissement et de Developpement International
SMEs	Small and Medium Business Enterprises
TA	Technical Assistance
TDFL	Tanzania Development Finance Company, Ltd.
TVCF	Tanzania Venture Capital Fund

USAID	United States Agency for International Development
USG	United States Government

EXECUTIVE SUMMARY

Background

USAID is developing an Initiative for Southern Africa (ISA) project which addresses a broad range of development concerns. The objectives of the ISA include building and sustaining a regional economy and strengthening individual economies while working to enhance regional cooperation and integration. Under the broader heading of strengthening the regional economy are such supplemental goals as increasing the amount of investment in the region from both indigenous and outside sources, assisting the growth of small and medium sized enterprises (SMEs), creating jobs, empowering local black entrepreneurs, and building a private sector capable of serving as the engine of growth.

With this as a context, and following testimony in October 1993, the House Foreign Affairs sub-committee on Africa requested USAID to examine the American Enterprise Fund structure as a model for addressing these needs in the southern Africa region (SAR or Region). This model, as developed in Eastern Europe (EUR) and the New Independent States (NIS), creates a venture capital fund which works in conjunction with local financial institutions to make available long-term capital to indigenous SMEs on a profit-driven basis.

USAID consultants carried out a prefeasibility study during the months of October-January 1994. The study reviewed the experience with the design and early implementation of the EUR, NIS and African venture capital funds, as well as the experience of the Minority Enterprise Small Business Investment Company (MESBIC) in the United States (See Annex A); assessed the appropriateness of the EUR model for the SAR; and, in November 1993, conducted a brief, two-week field assessment in six selected countries in the Region (South Africa, Zimbabwe, Zambia, Botswana, Mozambique and Swaziland).

SAR Development Impact

The study confirmed that -- while the experience with the EUR enterprise funds is still limited -- the funds are having an important developmental impact in the countries where they have been established. A venture capital fund in the SAR would have similar developmental potential, and by filling the need for long-term capital, could meet many of the goals of the ISA:

- helping existing SMEs to grow and expand, as well as establishing new SMEs in the Region, with attendant positive effects on employment generation;
- providing investment capital for SME start-ups and expansions;
- mobilizing additional investment capital from other local as well as overseas sources;
- strengthening the financial sectors in the SAR; and
- providing an impetus for an improved enabling environment in SAR countries. (see Section II,B).

Field Assessment

The field visit assessed the political, economic and security environment in the six countries. While constraints exist in several of the countries visited as well as elsewhere in the Region -- e.g. weak financial sectors and lack of experience with equity financing -- the study concluded that the conditions exist in most of the region for successful venture capital investment. The single most important constraint appeared to be the need for long term capital. Most disadvantaged in this respect are the small-and medium sized, African-owned enterprises, which lack access to long term financing.

More specifically, the need is for long term equity financing. Typically, SMEs are familiar with debt financing. Many have, in fact, succeeded in overcoming the historical obstacles (e.g. collateral requirements) and obtained short term loans. In fact, SMEs are frequently overextended in terms of prudent debt/equity ratios. The next logical step for these SMEs to grow and expand is to seek long term equity financing from investors willing to share the risks in return for potential downstream rewards. A venture capital fund would precisely meet this need, as well as the requirements of businesses in the start-up stage.

Based on a limited market review in these countries, the study concluded that a Southern African/American Enterprise Fund (SAAEF) could be viable and implemented successfully, assuming a strict management approach that clearly delineates and balances development and fund profitability objectives. Accordingly, we recommend that USAID undertake a full feasibility study of a venture capital fund for the SAR.

Proposed Fund Purpose and Structure

The purpose of the fund would be to provide long term equity and debt capital for African-owned small and medium-sized enterprises in the Region, both existing and new or expanding companies. The fund should have the option of investing its resources directly in southern African companies -- including privatized companies, joint ventures, etc.-- or indirectly through existing intermediary institutions which service SMEs (e.g. banks and other financial institutions, existing or newly formed venture capital or other private development corporations, leasing or franchising companies, or private voluntary organizations). The advantages and disadvantages of the direct and indirect approach to Fund resource investments are described in Section IV, E. The balance of direct or "retail" investments and indirect or "wholesale" investments in the fund's portfolio will vary from country to country and should be left to fund management discretion.

A major objective of the proposed Fund is to mobilize additional investment capital for investment in the Region, specifically investments in new and expanding SMEs. As in the case of the EUR and NIS funds, therefore, the SAAEF will be encouraged to leverage the initial USAID-provided capital in several ways. First, the Fund's direct investments in operating small and medium firms will, in time, demonstrate the feasibility and profitability of venture capital financing for SMEs in the SAR, and thereby attract additional investments to the Region. Secondly, the fund will look for attractive co-investment opportunities with existing institutional and individual investors. Thirdly, the Fund will offer to manage investment capital resources of other local institutions (e.g. pension and insurance funds) as well as foreign investors (e.g. DFIs) who may be looking for professional venture capital management.

Fund Capitalization

The optimal size of the Fund depends on the capital needs of the target business community in the SAR, as well as the leverage the fund will have on other capital contributions, and USAID's available resources. Each of these questions deserve further study. At the pre-feasibility study level, however, our estimates are that the unmet requirements for long term capital in the eleven countries of the region are between $800 million and $1 billion over five years. Assuming a leverage factor of 4-to-1, a fund initially capitalized at $200 million or $4 million for ten countries per year, would be minimally necessary to make a significant developmental impact. A life-of-project of fifteen years is recommended.

The initial capitalization of the fund should make provisions for start-up costs, including the incorporation of the Fund, the establishment of headquarters and regional office(s), and initial operating costs, including management and staff salaries. Provision should also be made for deal-specific assistance (which should eventually be reimbursed by investees), and for a research program to provide information on industry, financial markets, pricing and other related data. These start-up, TA and research expenses should be accounted for separately from the funds provided for venture capital financing.

USAID Role

The need for a reasonable USG oversight role is apparent both in the experience with the EUR and NIS funds and with prior USAID venture capital experience in Africa. Other issues such as setting fund objectives, executive compensation and incentives, conflict resolution, monitoring and evaluation will arise due to the juxtaposition of a private sector-type investment fund with more traditional economic and social development objectives. Therefore, it is suggested that a small senior USAID board, possibly with inter-agency representation, meet semi-annually to review and resolve these and other policy issues.

Recommendations

The basic Enterprise Fund model currently in place in EUR and the NIS is an excellent starting point for structuring a similar fund in the SAR. Its design, negotiation and implementation have been discussed extensively by USAID, the host countries and

Congressional staff and, as a result, the model has become a known vehicle for direct USG investing in the private sector of emerging market economies.

Nevertheless, the needs and economic conditions of the countries in the SAR are sufficiently different from those existing in EUR and the NIS, that several important modifications should be considered to adapt the basic model to the SAR. Specifically:

- The SAAEF, like the EUR and NIS funds, should be incorporated in the United States as a non-profit corporation. A regional fund, as distinguished from the country-specific funds in EUR and the NIS, is recommended, to serve the eleven countries of the Region.

  The U.S. headquarters office can perform important liaison functions with the venture capital investor community in the United States. The proper management of venture investments, however, requires a close proximity to the markets. We therefore recommend that the management and day-to-day operations of the fund be situated in the Region. Three countries -- South Africa, Zimbabwe and Botswana -- have the necessary environmental and logistical conditions to provide regional offices for the fund. At this (pre-feasibility) stage, the study recommend USAID consider two regional offices for the fund, one to cover the northern tier of the SAR countries and one for the southern tier, each with slightly different sectoral foci.

- In the case of the EUR and NIS funds, the Board of Directors is appointed by the President, and the Board in turn selects the fund's management. As with these funds, the management of the proposed SAAEF fund management should have a combination of contacts with the U.S. venture capital community, and familiarity with the Region. Given the prevailing conditions in the SAR, however, the study considers venture capital experience with SMEs and familiarity with the Region to be paramount requirements for fund management to have. We therefore feel that a Request-for-Proposal approach provides the best assurance of identifying competent, experienced management for the proposed fund for southern Africa. (See Section III, E, 4).

- A serious effort should be made to have maximum African participation on both the Board of Directors and in the management of the fund. Though scarce, our preliminary assessment is that the requisite experience and talent is available in the Region as a whole.

- Experience with the EUR funds indicates that the needs for technical assistance (TA) to the target beneficiaries of the funds, i.e. SMEs, were seriously underestimated in the case of the EUR funds. Our assessment suggests that an *"a fortiori"* situation exists in the SAR, *viz.* that there is a widespread need for technical assistance and training for African-owned SMEs.

The study proposes two types of TA: deal-specific TA to be provided by the SAAEF under the project; and TA and training for the African SME community at large, focusing on business management, financial management and such skills as marketing, in order to "empower" African businessmen and to increase their role in the economies of the region. The latter type of TA and training should be provided separately from the SAAEF and funded under existing or future USAID mission programs. Such TA is not a *sine qua non* for the feasibility of this project, but to the extent it is provided, it will help USAID, through the fund, to reach more of the target firms and to increase the fund's developmental impact.

Lessons Learned

The study devoted considerable attention to the experience of existing venture capital funds in EUR, NIS and Africa. That experience is discussed and summarized elsewhere in the Report, but it may be useful to state two "lessons learned" here which have important implications for USAID:

- Venture capital has the potential of making significant contributions to economic development. It is very much needed and wanted by SMEs in the Region. However, venture capital is a specialized form of financing, very different from more traditional approaches, such as debt financing. It requires a longer term commitment of capital, a different mix of technical and management skills, and carries significantly greater risks for the investor. Most importantly, as a development tool, venture capital financing implies a greater reliance on the private sector than USAID is currently used to. One of the most critical requirements for success in this project, therefore, is the need to carefully define, agree and stipulate in advance precisely what will be the respective objectives, expectations and roles of USAID and the proposed private venture capital fund management.

- Once the Fund's objectives are defined and an investment policy is formulated , the success of the SAAEF will depend on many factors, including: the size of the Fund and its ability to attract additional capital; the location, structure and local participation in the Fund's activities; the enabling environment in the countries where it operates; the need to provide technical assistance and training for the target beneficiaries; etc. But the single most critical ingredient of success is management.

  Experience with venture capital financing in the United States, EUR, NIS, Africa and elsewhere teaches that fund management must be: 1) experienced specifically in venture capital financing; 2) familiar with SME financing; and 3) intimately familiar with the region where the fund operates. Once fund management with the requisite experience and qualifications is identified, it must be given maximum autonomy, flexibility and incentives to pursue the fund's objectives.

Conclusions

The study concludes that a full feasibility study should be undertaken as a basis for the detailed design of a fund for the SAR. Such a study should, in particular:

- define USAID's (developmental) and the Fund's (financial return) objectives;
- perform economic and financial analyses for the proposed Fund, as well as an analysis of its expected social and developmental impact;
- verify the demand for venture capital for SMEs, and the existing sources of such capital in the Region; review structural alternatives, including the location of the Fund's headquarters and regional office(s);
- examine the relative merits and opportunities for direct and indirect investment of the Fund's resources;
- assess the availability of competent management, especially within the SAR; and
- evaluate the need for technical assistance and training, both deal-specific TA, and TA and training for potential SME investees at large.

I. PROJECT BACKGROUND

A. The Enterprise Fund Model

1. The Seed Act of 1989

The SEED Act of 1989 provides for the creation of American Enterprise Funds (EF) to promote private sector development in designated countries through loans, grants, equity investments, feasibility studies, training, insurance, guarantees and other measures. The EF design, negotiation and implementation has been reviewed and discussed extensively by USAID, the host countries and several Congressional subcommittees and, as a result has become a known vehicle for direct USG investing in the private sector of emerging market economies.

Seven ongoing and proposed European Funds have total planned grant obligations of $580 million, over a four to five year period, while five ongoing and proposed Newly Independent States (NIS) Funds have planned obligation levels of $720 - $770 million over the next four years. This amounts to an average of $113 million per country. These funds are country-specific, as distinguished from regional funds.

2. Purpose of an Enterprise Fund

The purpose of the EFs is to help in the development of indigenous emerging market economies by providing a wide range of debt and equity investments, supported by appropriate technical assistance, targeted at small and medium enterprises. The funds are not intended to compete with the local private sector for- profit financial institutions. Rather, they are designed to address a market imperfection, providing investment capital to commercially viable and developmentally beneficial enterprises that would otherwise be unable to secure adequate financing from the existing market. As such, they may take higher calculated risks than available market sources of capital, as long as the client enterprises are projected to be commercially sound.

The EFs are established as not-for-profit corporations in that they do not have shareholders and do not distribute dividends. The revenues generated by the funds pay the funds' expenses and are used for reinvestment in new projects and activities in the designated countries. Each EF is managed by a Board of Directors, set by Presidential appointment, and is comprised of top U.S. business persons and experts on the designated countries, as well as indigenous citizens of recognized stature. As a matter of operating philosophy, the EFs are run as investment corporations and seek to make a reasonable return on EF investments. The Board of Directors and executive management of the funds have maximum flexibility in the manner in which the funds are structured and in strategic and operating decisions, subject to the AID grant agreements.

In actual practice, the EFs have been used for equity and loan capital and, in more limited circumstances, for technical assistance. In many respects, they resemble true venture capital funds, in that they are able to provide long term equity or quasi equity (subordinated debt) financing to growth oriented companies, taking higher risks with the expectation of obtaining higher returns over a longer period than is involved in more traditional debt financing. They also differ from bankers or lenders in that venture capital funds must provide a higher level of business, financial, management, and other technical assistance in order to realize a higher return, while protecting the funds against the risks involved.

B. Role of Venture Capital in Development

Nurturing new techniques for the mobilization of investment capital is a central issue many development agencies have been focusing on. No one professes to having found the best model; however, a variety of initiatives are being tried. What we do know is that a number of conditions must exist to make the mobilization of capital for investment in high risk local entrepreneurial enterprises likely to happen. We identify six such conditions.

- The enabling environment of government regulation, tax law, private ownership, corporate law, trade tariffs, foreign exchange controls, and policy advocacy for private entrepreneurship must be firmly in place. Venture investing looks to a long term payback which, in turn, requires a reasonably stable and supportive basis for planning.

- Knowledgeable, experienced fund managers must be recruited. Typically, these people will possess practical business experience and will have developed extensive financial and technical skills. They must be objective in making investment decisions and be able to act independently from external influences. Ultimately, they must be at risk personally in exercising their business judgement. If successful, they must be rewarded appropriately. If the fund fails, they will also forego their reward.

- The ability to develop a list of interesting and appropriate investee candidates, known collectively as the "deal flow", must be evident. We believe that start-up new ventures are not generally appropriate for formal sector venture investing during the early stages of a venture capital fund in the developing world of Africa. The deal flow is more likely to be from existing, proven entrepreneurs with established businesses ready to expand significantly or to take on an important new product or partner.

- The venture fund management must be able to identify specific areas in the investee company's operations for which they have the expertise to add value and assist materially in the investee's rapid growth. This may be in improving the overall quality of management, accounting procedures, planning and control, establishing inventory procedures, technical operations or creating markets.

- The venture capital fund managers will either have to raise investment funds locally or attract foreign sources. Pension funds, banks, insurance companies and private individuals are usual local sources. Also, Development Finance Institutions (DFIs) may be willing to take an equity share. Since a key developmental goal is to strengthen local financial capacity while building replicable institutions, we believe significant local involvement in the fund is essential.

- Finally, disinvestment strategies, or exit options, must be identified and negotiated up front, when the investment is made. The usual exit route for the venture fund is an initial public offering on a stock exchange. This route is not possible at present in most African countries. Other strategies, such as management buy-outs, possibly through redeemable/repayable investments known as "earn-outs", bank refinancing, corporate acquisitions or private placements must be thought through.

C. Applicability of Enterprise Fund Experience to Southern Africa

A review of the experience of the EFs in EUR, and a field survey of conditions in the southern Africa region suggest that a Southern Africa-American Enterprise Fund could have a significant and highly beneficial effect on the region. The impact would also be unique, in the sense that few other projects could have so positive, widespread and timely an effect. Indeed, increasingly, investors, managers and entrepreneurs, as well as development officials are exploring how to include development objectives as a compatible component of venture capital projects.

1. Sustainable Economic Growth

The experience in EUR indicates that such a fund would lead to the establishment, or strengthening of, a wide array of SMEs in all sectors of the countries in the region. The southern Africa fund would have the same emphasis on SMEs and therefore could be expected to create a number of loan and other programs aimed at SMEs. The small business lending programs established by the EUR funds in several countries are generally regarded as the most successful aspects of those funds. The number of loans made by or through the funds, to SMEs in those countries, has been very large and the default rate relatively low. Given an equally urgent need, and equal credit worthiness of the SMEs in southern Africa, there is every reason to believe that an emphasis on servicing the needs of SMEs would be equally successful in the Region.

The experience in EUR also suggests a potentially beneficial effect on employment generation: the EUR funds used employment generation as one criterion for the selection of sectors in which to search for investments, keeping statistics on the number of jobs created in the companies they invested in.

2. Mobilizing Investment Capital

A second major development impact is the provision of long term capital in an environment where such capital -- needed for business start-ups and expansion -- has traditionally been scarce. The need for such capital is described in Section II,B,5. The Fund's resources would, by themselves, do much to alleviate that need. More important, however, is the multiplier effect a capital fund would have, in terms of leveraging additional capital to meet this demand. This leverage occurs at two levels:

- By investing in projects and institutions which traditional investors might consider too risky, and demonstrating the feasibility of doing so successfully, the Fund's example will, over time, reduce the perceived risk of such ventures, and attract other investors to the equity and risk capital arena. This has been the case with the small business lending programs in EUR, where the fund-initiated programs have been copied and/or matched by state-owned or private, local banks in Poland, Hungary, and the Czech and Slovak republics. Also, the U.S. MESBIC industry demonstrates the impact of a government approved program.

Newly interested investors would probably include joint ventures, in part with U.S. investors.

- The EF mechanism has the potential of attracting additional capital from other donors, development finance institutions and other institutional investors. Such additional capital may be managed as separate funds by the same management, e.g. the Polish Equity Fund was capitalized approximately one third by the Polish AEF and two thirds by other investors, including the EBRD.

3. Strengthening the Financial Sector

A third important development effect lies in the potential of a southern Africa fund to strengthen the financial sectors in the Region. As explained in Section II,B,7,d. on the enabling environment, the financial sector was found to be relatively sophisticated in only two or three countries in the Region. Elsewhere, major improvements are needed to facilitate business transactions and particularly to attract investors.

The operation of an EF in these countries could do much to promote the introduction of new financial instruments and generally to accelerate the formation or development of money and capital markets. The need for a capital fund to develop appropriate exit strategies could, for example, lead the fund to invest in the nascent stock exchange in Swaziland, to help strengthen the exchange in that country.

The EUR funds have also succeeded in creating new financial institutions; for example, the Polish fund has invested in commercial banks and in a mortgage bank to promote residential construction and home ownership. The Hungarian Fund has invested in a merchant bank, which was intended to support privatization, and develop the capital markets in that country. In southern Africa, a fund could provide capital to, and thus help establish, venture capital companies, leasing companies, franchising companies, as well as strengthen existing Development Finance Institutions (DFIs) and non-government organizations(NGOs).

For example, in Swaziland, a Fund could support the Small Business Growth Trust (SBGT), an organization created by USAID which has been providing financial support to SMEs successfully for some time and has gained a strong positive reputation throughout the government and private sector. SBGT has applied to become a financial institution and is considering providing equity financing for leasing, franchising, etc. to its target clientele.

4. Impetus for Policy Reform

Lastly, a capital fund in southern Africa could have an important developmental effect on the enabling environment which -- although improving in all countries visited by the assessment team -- still needs to be improved in most countries of the Region. Specifically, the Fund's initial entry into a country, and subsequently specific investment transactions will help to identify the policies, regulations and practices that constitute obstacles to investments and other business activities in that country. For example:

- a small business lending program might lead to a review of collateral requirements and more modern lending approaches for SMEs generally;
- the Fund's interest in privatizing or privatized companies could help to focus on asset evaluation and other policies; and
- the Fund's interest in developing the capital markets in a given country may help the authorities there to focus on the need for appropriate disclosure regulations.

D. Lessons Learned

USAID has accumulated a large body of experience in using venture capital as a development tool, through the creation or financing of public venture capital institutions. In EUR and the NIS, Enterprise Funds have been established in six countries: Poland and Hungary in 1989, the Czech and Slovak Republics in 1990, Bulgaria in 1991, and Russia in 1993. In Africa, USAID has reviewed twenty venture capital initiatives over the last seven years and has given start-up grants and/or invested operating capital in four operating funds in the region.

The successes and constraints which have become apparent in the process of establishing institutions which attempt to unite private sector profit-driven discipline with public sector development goals suggest a number of lessons which should be taken into account in the formation of a new fund. The first of these is the central importance of uniting private and public sector objectives, to use the discipline of profitability to maintain the fund's financial viability while incorporating USAID input to achieve development ends. To this end, it is necessary to establish clearly and up-front the respective roles, expectations and objectives of the private fund and USAID.

A second point is that the success of previous attempts at venture capital institutions has been conditioned to a large degree by the quality of the management. While other factors, including size, structure and location of the fund, the degree and quality of local participation, the availability of viable exit strategies, the enabling environment, and the demand for TA also have had a considerable effect, it has been the ability of the management teams to deal with these factors that has determined whether goals of profitability and developmental impact have been met. To achieve this, it is necessary to put in place management which meets the criteria of experience in venture capital, experience working with SMEs, and familiarity with the region in which the fund operates. Once this management is identified, it must be given the widest possible autonomy and flexibility to meet fund objectives.

Third, the fund structure must take into account the high need for TA, both to allow the deals to go smoothly, and to improve the quality of the overall environment in which the fund operates. Investments by the fund must be undertaken in accordance with profit-driven motives, and the long-term profitability of the fund depends on the ability of investees to bring financial rigor to their accounts, which in turn requires a high degree of business skill.

USAID's experience with venture capital funds, and the "lessons learned" from this experience, are discussed in detail in Annex A.

II. FIELD ASSESSMENT

A. Introduction

In the context of this study, a three person team independently visited two countries each, for a total of six countries in the Region (Botswana, Mozambique, Swaziland, South Africa, Zambia and Zimbabwe). This section contains the rationale for establishing an EF in the SAR. It describes the political and economic conditions in the Region; the need for long-term capital financing; the special case of SMEs; and the enabling environment for business growth in the countries visited. Annex C provides key macroeconomic statistics for the eleven countries in the Region.

B. Rationale for an Enterprise Fund in Southern Africa

1. Political Conditions

Most of the countries in southern Africa are in transition from single party, centrally managed, socialist economies to pluralistic democracies with market driven, private enterprise economies. Democratization is proceeding in southern Africa more quickly than in the rest of sub-Saharan Africa. A fundamental political transformation from decades of instability and one-party systems is taking place as the rights of the people to choose their leaders is being affirmed. On December 1, 1993, the South African government signed a "one-man one-vote" bill effectively ending decades of apartheid; Namibia, Mozambique, Tanzania, and Zambia have had free, generally fair and accepted elections recently, and have popularly chosen leaders. These fragile democratic experiments, the embattled dos Santos regime in Angola, and even the more established democracies of Botswana and Zimbabwe, are all dependent on achieving real economic improvement in the daily lives of their citizens in order to maintain their legitimacy.

2. Economic Environment

As the USAID "Initiative for Southern Africa" policy document points out, southern Africa offers the greatest potential for economic growth in all of Africa. The predominance of English as a common language and English law as the basis of the legal systems provides the foundation for an attractive private sector enabling environment. The relatively strong and sophisticated economies in Namibia, Zimbabwe, Botswana, and especially South Africa, can provide financial and business services to the other countries in the region. The concentration of essential minerals, fertile agriculture and a regional population of over 120 million provides abundant opportunities for entrepreneurial business activities requiring financing. It is expected that economic growth in the region will have spill over effects on the rest of Africa in terms of increased trade, positive externalities such as the growth of service industries, and the force of successful examples.

Although some of the countries in southern Africa do have relatively well developed financial systems and reasonably attractive enabling environments for private sector development (Botswana, South Africa and Zimbabwe for example), most do not. It will take some years for all the financial institutions and market structures to be put in place. In the meantime, there are African entrepreneurs with proven skills and ideas for viable businesses and many believe there is a reasonable amount of indigenous capital to fund at least some of these investments. The problem is that the two do not currently come together to make and build profitable businesses which create wealth, higher per capita incomes and a better quality of life.

3. Regional Collaboration

A recent shift in thinking has taken place regarding the importance of private sector development to overall growth. Success of private enterprise is dependent on a stable, level, less protectionist playing field to stimulate investment, increase exports and promote further integration into the world economy. Structural reforms being undertaken in many countries could make the region more inviting for investors. Malawi, Tanzania, Zimbabwe, Zambia, Lesotho and Mozambique have all put together investment promotion policy packages which offer a range of incentives ranging from tax holidays to foreign exchange preference to investor assistance centers. Tanzania, Zambia and Mozambique are also engaged in ambitious privatization programs in order to bring entrepreneurial drive to their economies. However, to the extent that inefficient or unfriendly regulatory environments and market-distorting policies still exist, they lower the attractiveness of the region for investors.

The last few years have seen poor overall economic performances for the region, due to the worldwide recession and worsened terms of trade for raw materials and agricultural products. The region has experienced domestic distortions caused by inappropriate policies, low worker skill levels and productivity, narrow productive bases, capital flight, regional conflicts, corruption, and high population growth rates. Sovereign debt has remained at relatively constant levels, and swallows a large share of scarce foreign exchange reserves in the form of interest to service such debt. A consensus has emerged that the way to reverse these trends is through increased regional integration to take advantage of relative comparative advantages and promote balanced growth. A number of regional organizations exist to promote partnerships for economic growth, including the Preferential Trade Area (PTA), the Southern African Development Community (SADC) and the Common Monetary Area (CMA).

4. Poverty Alleviation and Political Stability

The pressures for jump starting sustainable economic development in the Region are becoming unavoidable. Political stability, poverty alleviation and human lives are at risk. Assertive action is required to reduce the obstacles to private sector growth.

The obstacles are many and they affect mainly microenterprises and especially formal sector SMEs, the very segment of the business community which holds the greatest promise of contributing to the creation of additional jobs which lead to improved standards of living. Within this group of SMEs, those owned by black African entrepreneurs are at an even greater disadvantage, mainly because of their lack of access to capital which has stifled business formation and growth as well as the acquisition of business experience. Wealth creation in the formal sector supports a larger multiple of people in the informal or traditional sector. Over time, greater economic opportunity leads to empowerment which promotes political stability and access to education, improved health care and social well being.

5. Need for Capital for Private Sector Development

The field team visited six countries and held interviews with over 150 government officials, businessperson and representatives of business associations and financial as well as non-financial institutions. Based on these interviews the Team concluded that the entrepreneurial opportunities for viable business investment in the region are enormous and still largely under-served by existing sources of capital. While it would take a full feasibility study to more fully quantify the investment potential, the overall impression obtained from persons knowledgeable about the countries visited was that of a region waiting for investors with capital and know how to take advantage of the opportunities.

In some countries, such as Botswana, South Africa, Tanzania, Zambia and Zimbabwe, the investment potential is already being explored, by donor agencies (IFC, OPIC), development finance institutions (CDC, DEG, FMO, PROPARCO, SWEDEFUND), private banks (Equator, Meridien, Standard Chartered, Barclays) and private investors, both corporate and individual. But these existing initiatives seemed dwarfed by the still remaining potential. Even in countries like Mozambique, which is just recovering from years of civil war and socialism, the opportunities are significant in such sectors as fisheries, light manufacturing, forestry, tourism, not to mention the rehabilitation of the physical infrastructure.

While the investment climate, specific sector opportunities and entrepreneurial acumen varied among the countries visited, the lack of access to equity capital continues to be the major impediment to business growth, according to merchant bankers and banking executives in Botswana, South Africa, Swaziland, Zambia and Zimbabwe. In some countries, e.g. Mozambique, lack of equity capital is also a major factor, but at this time political and regulatory issues loom larger as obstacles to economic growth.

Some steps are being taken to increase the access to equity capital and long term debt finance.

- In Botswana, there are investment opportunities for joint ventures and for expansion of the financial sector. There is strong government interest in creating a regional financial center along the lines of Luxembourg for the European market. The capital requirements would be substantial, as would the development potential for business growth.

- In Mozambique, in spite of the political uncertainties and regulatory obstacles, the business opportunities are thought to be significant, ranking only after South Africa and Zimbabwe.

- In South Africa, the Development Bank of South Africa (DBSA) estimates that 40% of South Africa's GDP originates from SMEs. Equity financing needs have been estimated at $300 million and loan financing requirements have been estimated at $1 billion. Other business organizations, such as the New South Africa (NSA), a group supporting the formation and encouragement of black owned businesses, reported a critical shortage of equity financing for new business formation. NSA provided one of the Field Team with a large portfolio of new projects in need of equity financing.

- Development Bank of South Africa (DBSA), which targets SMEs, pointed out that entrepreneurs are more common in the informal sector than in the formal sector. The dynamism of these micro and small informal enterprises, in terms of turnover, profitability and employment growth is, in fact, constrained by the lack of access to adequate financing. DBSA noted that black-owned enterprises operating in the formal sector suffer from a lack of access to financing.

- In South Africa, Theta Securities (Pty) Ltd. organized an investment fund targeted at financing disadvantaged African construction companies. The fund was capitalized at $10 million, fully subscribed, and experienced an excellent repayment record and yield to the investors. Daan Wandrag, Theta Managing Director, welcomes additional capital participants in the marketplace and noted that access by disadvantaged Africans has been severely hampered by a non- proactive approach by the financial community. The mobilization of public and private resources are a critical requirement to extend the market economy to an increasing share of the population.

- In Swaziland, the Managing Director of Meridien Bank said that his bank had turned down four or five projects over the last 12 months for lack of equity financing; two of those required $400,000-450,000 in equity financing. The Director of the Public Enterprise Unit feels that with better access to capital, Swazi entrepreneurs could compete much more effectively with, and even replace, South African investors who are attracted by the positive investment climate in Swaziland.

- In Zambia, potential equity providers would reap returns by financing small scale farmers who require working capital to purchase crops. External financing is also required for expansion of the enterprises to create export revenues, without the formality of land ownership as a collateral base. Creative financing strategies are required to develop the investment potential in the agricultural sector.

- In Zimbabwe, the overwhelming consensus of experienced business leaders and development finance officials is that a large demand exists for equity financing, as well as for medium-term debt finance for small and medium black owned enterprises. To help address this shortage, two years ago the Central Bank took the leadership, along with other local and Development Finance Institution (DFI) investors, to establish the Venture Capital Company of Zimbabwe (VCCZ). While VCCZ's investment focus is primarily on small enterprises, its resources are limited and a critical shortage of equity finance remains for small and medium sized firms.

- During the field research, the Zimbabwe Development Bank indicated that it currently has at least fifteen "commercially viable" projects that are not moving forward due to the lack of equity finance. Additional evidence of the need for equity capital in Zimbabwe comes from the experience of Hawk Ventures which made some 27 equity investments in just over four years, with no publicity other than word of mouth. Hawk Venture management indicated that the need far outstrips the availability of such financing.

6. The Special Case of SMEs

If the African continent is to awake from its several decades-long drift toward centrally managed economies, and the resultant economic decline, the best hope is to revitalize its private sector. The best engine for economic growth in any country is small business. Whether in the third-world or in the U.S., dollar for dollar it is the small enterprise sector that provides for most innovation, the highest incidence of job creation, and the lowest cost per job created.

Expansion of equity capital for such firms is essential to finance the risk aspects of business opportunities. Sound financial structures will be required for these enterprises to grow, which in turn requires stronger financial markets with access based on the merit of the business proposal is required.

Owner equity capital is commonly created through long term savings, earnings and capital gains from other successful investments, and most frequently from the gain in the value of real estate. The necessary policies, regulations and land registry systems have not existed in most African countries to encourage the creation of private capital. These conditions are gradually improving. However, creation of adequate entrepreneurial equity capital from existing sources will take decades. In the interim, traditional financial institutions will not lend or invest funds if the entrepreneur can not provide an appropriate level of owner equity capital as a means of sharing the highest business risks.

While the financing shortage exists for all types of capital, both debt and equity finance, including short term loans and working capital, it is most acute for long term financing, such as is normally provided by owner equity or venture capital. In fact, the Field Team found that many businesses utilized excessive short term debt because of the lack of equity capital, which would allow a safer financial structure. The burden of short-term debt stops business growth or slows it down significantly.

While SMEs can and should be the engine of economic expansion, job development, savings and capital creation, they have been the least successful in accessing the capital they need to start and expand their businesses for several reasons:

- limited personal "wealth"(i.e. funds from family, friends and business associates), which is the principal source of start up capital;

- marginal access to banks and other financial institutions in the countries visited, since banks prefer not to lend to SMEs, as other attractive investment alternatives are available at a higher return and with less risk. In general, the size, investment criteria and flexibility of these financial institutions are not particularly well suited to foster the growth and development of indigenous African SMEs.

- lack of business "know how" to prepare proper business plans and present their ideas to existing financial institutions that have equity or term debt investment vehicles.

7. The Enabling Environment

Achieving sustainable economic growth in southern Africa, as elsewhere in the developing world, requires a vigorous private sector to innovate, take risks, allocate scarce resources, and in that process, create jobs and wealth. The better the enabling environment, the more active the contribution the private sector can make to sustainable economic growth.

The field trip, and secondary-level research in Washington, led to the conclusion that the business environment in the region is gradually but steadily improving, though much still needs to be done to improve conditions to a sustainable level. For example:

a. Commitment to Democracy

A positive enabling environment for business assumes, initially, a government committed to democracy and free markets. Preferably, that commitment should be evident from a track record of several years. In a region undergoing considerable political evolution, the absence of a clear and positive policy to support private sector development from all political parties in positions of leadership can severely limit economic growth, since investors seek to avoid uncertainty.

The political environment was judged to be sufficiently favorable and stable for the proposed fund to operate in all countries of the region, with the exception of Angola, where the political and security situation is considered too precarious.

Obviously, there are uncertainties in other countries such as Mozambique and South Africa, where elections are expected in 1994. In Mozambique, for example, the Team was told there are some $300 million in approved investments that are not being acted upon. In South Africa most prospective South African and foreign investors tended to view the investment climate as favorable and only a few seemed to be in a withdrawal or wait-and-see mode.

b. Favorable Macro-economic Environment

For investment capital mobilization to become an engine for sustainable private sector economic growth, the macro-economic environment and government economic policies should be favorable, at least in critical respects, such as:

- a positive economic growth rate, or the prospect for same;
- controllable inflation;
- liberalization of exchange rates, price controls and other restrictions on the flow of capital;
- monetary and fiscal policies to provide positive real interest rates and to encourage savings and investment.

The macro-economic environment in the region has been improving.

Several countries showed impressive growth in 1991 (though this was followed by slower growth and even declines in 1992, due to the world-wide recession and drought in the region). Although inflation continues to be a problem, liberalized policies on trade, exchange rates, and price controls, and sound monetary policies are in effect in most of the region, again with exceptions: in Mozambique, for example, custom duties are fairly high on a narrow base of products while contraband is rampant and uncontrolled, discouraging would-be investors from producing certain goods locally.

c. Supportive Climate for Business

A government attitude should prevail which relies on the private sector to generate economic growth while focusing government efforts to support the creation and maintenance of a positive business climate. A private sector-oriented public policy can be reflected in an enlightened investment code, an active privatization program, a one-stop location to interact with investors, an efficient process for issuing the necessary approvals, generally minimal bureaucracy and delays in decision making, and clear legislation and regulations that are not subject to frequent unpredictable changes.

A favorable business climate also requires policies and incentives necessary for the country to compete effectively for domestic and foreign investments, such as: protection against expropriation; the ability to transfer capital and profits; unrestricted access to domestically produced or imported raw materials and spare parts; a reasonable tariff structure and the absence of uncontrolled contraband; enforceable property and contractual rights; reasonable corporate and individual income tax rates, etc.

The legal and regulatory framework is improving steadily.

Most of the countries visited appear to be firmly committed to a private sector-driven approach to economic growth, Angola and Zambia being the exceptions. Swaziland, for example, has just adopted a new investment code and recently amended its constitution assigning a much greater role to the private sector.

Several countries have active privatization programs, though progress is variable. Elsewhere, the investment code and other laws and regulations in effect are still vague, and "grey areas" lead to ad-hoc interpretation, facilitating corruption on the part of government officials charged with their implementation.

Specific laws and policies in individual countries may act to discourage investors or particular investments. For example, in several countries investors cannot acquire title to land but only long term leases since the government owns all or most of the land. While these leases can and often are routinely renewed, the process of issuing them can be poorly coordinated among issuing agencies and the resulting uncertainty can be disconcerting to potential investors.

Infrastructure continues to be a problem in some countries.

In Mozambique, Zambia and other countries not visited, much of the transportation, road, electrical, water and telecommunications infrastructure has been destroyed during periods of civil war or non-investment.

d. Well-Developed Financial Sector

A formal financial sector comprising public and private, financial and non-financial institutions in sufficient numbers to provide diversity and competition, ably staffed and managed, is essential to an attractive business climate. Such a system should include a central bank to provide minimal supervision and regulation of financial institutions, commercial banks, and a basic money and capital market. The latter should include a basic stock exchange and related brokerage services, as well as a regulatory framework dealing with registration and disclosure.

The state of financial market development in the region is uneven.

Financial market development ranges from very rudimentary in Mozambique (no money or capital market, too few private banks, no stock exchange or securities exchange regulations, etc) to quite sophisticated, e.g. in Botswana, South Africa, Swaziland and Zimbabwe where there are private commercial and investment banks, insurance companies, pension funds, capital markets and the other financial institutions required to build sustainable economic growth.

8. Need for Technical Assistance and Training

In order to build bridges for investment capital flows and to increase the participation of indigenous Africans in the process, the field assessment concluded that substantial technical assistance (TA) and training is required. Specifically, TA and training will be needed at three different levels:

a. Deal-Specific Assistance to Client Companies of the Fund

Venture capital financing, by definition, requires investee companies to prepare detailed business plans, to negotiate the terms of the proposed investment, and to accept a high degree of external investor management involvement in the entrepreneur's business.

Such TA is normally provided by the venture capital fund, or other financial institution, which provides the financing, as part of the cost of doing business. However, the field assessment found that the black-owned SME target entrepreneurs frequently need assistance even with the preparation of loan applications for commercial banks. There is no question that these entrepreneurs will need assistance and training to apply for long term and risk capital financing, which is even more difficult to assess than loans.

A research program is also needed in order to provide information on industry, financial markets, pricing and other related data. This information is the basis for investment decision making and management. In developed economies, private sector firms develop and sell on demand such information.

b. Financial Management Training

The successful establishment of an Enterprise Fund in Southern Africa presumes a relatively sophisticated level of education, skills and experience for entrepreneurs and financial sector professionals who will administer the Fund.

The Fund's staff needs to have specialized training in evaluating business plans, evaluating business risks, finding co-investors, and structuring and negotiating investment terms. At the Fund management level, actual experience with venture capital transactions and the management of venture capital funds is essential. The team found few Africans fully qualified in these disciplines, although there is a nucleus of experienced financial professionals on a regional basis to build on. TA will be required to develop these skills.

Broader training will be needed for entrepreneurs and employees of SMEs who are the prospective beneficiaries of an equity capital fund. Skills needed at this level may include: general organizational management; production and quality control; financial management; marketing and sales; and possibly importing and exporting.

In further illustration of the need for fund management training in South Africa, a number of banks are making a concerted effort to identify commercially viable black-owned projects in which to invest. The primary concern expressed by these institutions was that a critical need exists for some technical assistance and training, in the areas of business plan development, financial management and marketing.

c. General Business Education

To take fuller advantage of the business development potential in the countries visited, far more emphasis needs to be given to general business education and skills training. In most countries visited, courses offered at secondary and university level do not produce the skill level required by prospective entrepreneurs.

In most countries, there are business associations that provide some short-term training, but such training is often under-funded and is not on the scale needed to provide the requisite training required in the region.

Even where the requisite education and training is available, it is not always offering appropriate business management training and frequently is not producing graduates with such training in sufficient numbers to manage existing and would-be African businesses. Black Africans, in particular, do not have access to higher level education in all of the countries visited.

III. PROJECT DESCRIPTION

A. Project Goal

The Project goal is to increase the role and participation of indigenous small- and medium-sized enterprises in the sustainable development of the southern Africa region.

B. Project Purposes

The Project purposes are to:

- increase the SMEs' access to long-term debt and equity capital;

- leverage USAID resources by mobilizing additional capital from domestic as well as foreign (including U.S.) institutional and individual investors;

- improve the policy and regulatory environment in the countries of the southern Africa region, so as to attract additional foreign and domestic investment;

- provide such technical assistance and training to SMEs as they may need to undertake new or expanded investments;

- solidify the U.S.-African business partnership to provide African entrepreneurs with access to U.S. goods, services, technology and management know-how.

C. Project Outputs

The Project outputs will be:

- a fully capitalized and staffed Southern Africa-American Enterprise Fund (SAAEF);

- additional existing and newly created institutions in the southern Africa region which provide long-term debt and equity financing to African-owned SMEs;

- increased numbers of SMEs using long-term debt and equity financing;

- increased numbers of jobs created by SMEs which obtain financing through the SAAEF;

- functioning US-African business linages, including joint ventures between Africa SMEs and U.S. businesses.

D. Project Inputs

The project inputs include:

- a USAID grant commitment in the range of $200 million to be made available to the SAAEF in even annual tranches over five years, for direct investments and co-investments in existing and new SMEs, and indirect investments through new or existing intermediary institutions servicing African-owned SMEs;

- included in the USAID grant, or in a separate development grant, should be funds to cover initial SAAEF start-up costs (e.g. incorporation, selection of Board of Directors and management), deal-specific technical assistance, and the costs of a Fund research program to provide information on industry, financial markets, pricing and other related data.;

from separate USAID/W or USAID mission programs, technical assistance and training for the Africa SME community a large, focusing on business management, financial management and suc'. business skills as accounting and marketing.

E. Detailed Description

The rationale for the detailed recommendations which follows is contained in the Project Analysis Section, immediately following this Project Description. Subject to a full feasibility study, the proposed SAAEF would have the following features.

1. Fund Location

One regional fund is proposed, as distinguished from a series of country-specific funds. It is anticipated that the SAAEF will be established in Washington, D.C. as a non-profit corporation. The corporation's headquarters in Washington will coordinate with the USG and U.S. industry to promote joint ventures, technology access, and other investment promotion activities. One or two investment offices, constituting the operating management of the SAAEF, will be located in the southern Africa region. One would cover the northern tier countries; the other the southern tier of the Region. The three locations where infrastructure, logistics, communications and international financial regulations are sufficiently favorable to support regional investment offices are Johannesburg, Harare and Gaborone.

2. Fund Size

An initial capitalization in the range of $200 million, to be paid in annual tranches of $40 million per year over five years, is recommended.

3. Life of the Project

The Fund would be fully liquidated after fifteen years. Upon liquidation, the USG would have the option of returning the original capital to the U.S. Treasury or reinvesting in projects that are a priority at that time. Capital gains would be returned to the USG subsequent to a profit split with SAAEF management as provided in the USAID grant agreement.

4. Fund Management

The overall structure of the Enterprise Fund model as set forth in the grant agreement between USAID and the Russia American Enterprise Fund provides an excellent basis for structuring the proposed fund for southern Africa.

The Request for Proposals (RFP) process is suggested to select the Fund's management and staff. Management should be selected to meet the following minimum criteria:

- experience in direct financing of small-and-medium sized businesses;
- demonstrated ability to develop a focused investment strategy;
- demonstrated creativity to develop exit strategies applicable to a developmental environment;
- demonstrated sensitivity to the social economic environment envisioned in a post-apartheid Southern African Region;
- demonstrated ability to develop a well-defined investment strategy to meet the key strategic private sector goals of the USG
- inclusion of Black Africans as stakeholders in the management of the investment company in substantive roles;
- willingness to establish an operation and live in the region; and
- demonstrated knowledge of the marketplace with practical strategies for accessing opportunities and identifying entrepreneurs.

A majority of the Board of Directors members should be chosen on the basis of specific experience in venture capital/small business lending area. Others will be Presidential Appointees who provide access and linkage to U.S. financial, manufacturing and service industries based on larger value added.

An investment committee should be established to work in conjunction with the management team guiding it in the development of an investment policy and detailed portfolio strategy. It will also act as a quality-control function by reviewing transactions for the soundness of proposed deals and ensuring that they meet strict financial, economic and policy criteria.

Due to the need for a strong link to the local business environment, the investment committee and Board of Directors should include well educated black Africans who are experienced entrepreneurs, and financial policy executives in the public/private sectors as well as bankers and accountants to help guide policy and provide valuable input.

An incentive compensation plan should be established that provides for salary caps and bonuses tied to increases in net asset value or profits.

Fund management should seek to implement a proactive investment monitoring style that emphasizes a "hands-on" approach to portfolio management, which may include specific technical assistance or representation on the Board of Directors of the investee company.

5. Investment Philosophy

In accordance with the Project's goals and objectives, the Fund's mandate and investment philosophy will be targeted at small- and medium-sized businesses. These firms represent the greatest potential for growth and employment generation and yet they are the most disadvantaged in accessing capital and technical assistance. Within the group of SMEs, the target beneficiaries are black African entrepreneurs, men and women.

Two basic approaches envisioned are:

- direct (or "retail") investment -- including co-investments with other financial institutions or individual investors -- into established or new operating companies at the $1-3 million level. Eligible direct investment will include corporate restructuring, such as buy-outs; venture capital financing for companies that do not have access to public equity or debt financing or institutional funding; and special situations, such as privatization, credit enhancements, corporate joint ventures, lease financing and secondary market vehicles.

- indirect (or "wholesale") investments in new or existing intermediary institutions, which provide financial services or resources to the target SMEs, e.g. commercial banks, venture capital and other investment companies qualified to on-lend to specific private sector businesses; leasing or franchising companies; PVO's, etc.

Fund management will have discretion in deciding on the portfolio allocation between the two categories of investments.

6. Operational Guidelines

The Fund should make equity and debt financing available. The types of investments would include common and preferred stock, term loans, subordinated debentures with equity features and other types of financial assistance, such as performance bonds and loan guarantees. In any case, the Fund's charter should make it clear that its primary purpose is to provide long term working capital financing.

The Fund should have the option of investing in start-up, expansions and established companies in the main commercial centers of the Southern African Region. In practice, the Fund will probably start by investing in existing businesses to establish a record of successes, and then proceed to include start-up companies in the future.

The portfolio strategy should be developed to include the allocation of a percentage of investments to larger transactions. An important pre-condition to such investments should be the presence of qualified and demonstrable development benefits to the target group, e.g. large-scale employment generation, and/or U.S. Trade promotion initiatives, e.g. the creation of African-US joint ventures.

A critical component to be integrated into the funding strategy is the provision of management technical assistance in a strategic partnership between the management of the Fund and the entrepreneur. Additionally, the Fund should have an investment research capability to provide the market place "value added" information for among other things, conducting due diligence on investment opportunities.

7. USAID Oversight

Control over all USAID funds granted to the SAAEF should be accomplished through:

- development of its corporate charter, bylaws and procedures at the outset;
- appointment by the A/USAID of its initial Board of Directors;
- participation of the A/USAID on the Board of Directors by appointing an observer;
- establishment of an SAAEF reporting system which emphasizes USAID development objectives; and
- plans for annual Project evaluations with a view toward assessing progress toward Goal and Purpose achievement.

8. Leveraging Investment Capital

A major objective of the proposed Fund is to mobilize additional investment capital for investment in the Region; specifically investments in new and expanding SMEs. As in the case of the EUR and NIS funds, therefore, the SAAEF will be encouraged to leverage the initial USAID-provided capital in several ways:

- direct investments in operating small and medium firms will, in time, demonstrate the feasibility and profitability of venture capital financing for SMEs in the SAR, and thereby attract additional investments to the Region;
- through ttractive co-investment opportunities with existing institutional and individual investors.

by managing investment capital resources of other local institutions (e.g. pension and insurance funds) as well as foreign investors (e.g. DFIs) which may be looking for professional venture capital management.

To the extent that funding is generated from other sources for management through the SAAEF system, the source of such funds should negotiate its own conditions with SAAEF management for its use. The SAAEF, as an independent non-profit corporation, should enjoy complete latitude in such negotiations for alternative funding sources so long as agreements reached do not interfere with its ability to accomplish USAID objectives with USAID funds. Generally, it seems preferable for any funds raised from alternate sources to be segregated in "parallel" investment funds which may be focused on specific country, sector and industry niches, with the SAAEF being a co-sponsor and manager of such parallel funds.

9. <u>Evaluation</u>

There should be annual evaluations of the progress of the SAAEF toward meeting its goals, including both the Fund's and USAID's development objectives. A comprehensive, mid-term evaluation of the Fund's performance in meeting its objectives should take place five to seven years after its inception.

10. <u>Technical Assistance and Training</u>

As elaborated further in Section IV and in Annex A, past experience with the Enterprise Funds in EUR and in Africa indicates that technical assistance and training will be required to reach the target population (black African-owned SMEs), and for the target group to take full advantage of the facilities offered by the proposed Fund.

Some of the requisite assistance - i.e. "deal specific" assistance in the preparation of viable business proposals - can be provided and absorbed by the SAAEF itself as part of the cost of doing business.

Extensive needs were identified in several countries for TA, training, and education for the target business community at large. While TA and training are not considered a "*sine qua non*" for the viability of the proposed Fund, they are essential if the project is to achieve its fullest impact on the target beneficiaries. Therefore, such a TA and training program should be considered as a parallel USAID project, not integral to the Fund itself. Also, since the TA needs and requirements vary from country to country, and since USAID in several countries in the region already has such programs in place, no attempt has been made to quantify such a program.

IV. PROJECT ANALYSIS

As this project is still at an early stage of development, full-fledged project analysis has not been undertaken. This section provides the rationale for the recommendations contained in the Project Description (Section III) and outlines additional work to be done during a full feasibility study.

A. Overview

From a practitioner's point of view, venture capital is more a process than an activity. Venture capital involves the investment of funds in business ventures where higher than "traditional" degrees of risk are accepted because higher than standard rewards are expected. Venture capital must be "patient" capital. No return, or even debt service, is generally expected on investments for several (usually four to ten) years. Investment is often in the form of equity or shared ownership rather than straight debt. The providers and recipients of venture capital form a close, often intense relationship over a number of years during which the providers inject not only capital but also add value by way of management assistance and direction to the businesses in which they invest.

B. Fund Location

It is generally recognized in venture capital circles that, in order to successfully execute the venture capital process of deal origination, transaction monitoring, and evaluation and due diligence, a presence close to the market is preferable to remote locations. This provides the venture capital investment professional valuable insight into market trends and other factors that may negatively impact performance. Proximity to the market allows the investment professional to respond to entrepreneur concerns quickly, both to add value and to minimize the prospect of losses on the investment.

For these reasons, one or two investment offices in the southern Africa region are strongly recommended, in addition to the Fund's headquarters in Washington. While this structure implies additional costs - particularly in the early years - it is clearly preferable to a fund that would be managed entirely from a U.S. base. Based on the field team's assessment of the political and economic environment, the enabling environment for business activities, and the infrastructure (including inter-regional and international transportation and communication facilities) three country capitals were tentatively selected as possible sites for the Fund's regional investment offices: Johannesburg, Harare and Gaborone.

C. Target Capitalization

The optimal size of the Fund depends on the capital needs of the target business community in the SAR, as well as the leverage the fund will have on other capital contributions, and

USAID's available resources. Each of these questions deserve further study. At the pre-feasibility study level, however, our estimates are that the unmet requirements for long term capital in the eleven countries of the region are between $800 million and $1 billion over five years. Assuming a leverage factor of 4:1, a fund initially capitalized at $200 million or $4 million per country per year, would be minimally necessary to make a significant developmental impact.

Another approach to establish appropriate fund size is to estimate the desired portfolio mix at the outset. For example, a sample mix might include investments in various intermediary financial institutions such as commercial and savings banks, merchant banks, leasing companies, venture capital companies as well as direct investments in privatizations and joint ventures with U.S. and European multinationals. The sample portfolio mix presented in the following table would result in a target Fund capitalization of between $250 and $300 million or $25 to $30 million per country. Even assuming a more conservative leverage factor of 3:1, a fund size of this range could mobilize more than $800 million in investment capital for the Region.

SAMPLE SOUTH AFRICA REGIONAL PORTFOLIO

Investment Class	Number of Investments	$ Millions Financing per Client*	Total Financing
Operating Companies	20	$ 1.5	$ 30
Financial Companies	30	5.0	150
Privatizations	10	5.0	50
Joint Ventures	10	5.0	50
Totals	70	$ 16.5	$ 280

*Total financing represents three rounds of financing for operating companies, one round of financing for financial companies and joint ventures, and two rounds for privatizations.

The number and size of investments an Enterprise Fund can make will be constrained by the size of the investment fund itself. Obviously, the larger the investment fund, the more investments it can make. Ideally, the fund manager should establish a target number and size range for those investments for a given capitalization level. These should take into account the need for a sufficient staff size to conduct due diligence and perform monitoring responsibilities for each investment. It is important to set target investment sizes and amount of follow-on capital anticipated per transaction.

Sources of funding have not been explored in this report. However, several alternatives may be available, which could leverage USG resources. Options would include coordinating available USG Executive Department programs for more financial impact, partnership with other governments and multilateral agencies and inclusion of public and private institutions in the Region.

D. Management Selection

Experience with venture capital companies in the United States, and with the Enterprise Funds in EUR and Africa suggest that fund management is possibly the most important aspect of successful venture capital activities. The selection of Fund management is therefore critical.

In the case of the EUR and NIS funds, the Funds are established as non-profit corporations in the United States. The companies' Board of Directors is composed of U.S. and "host country" citizens appointed by the President of the U.S. The Board, in turn, selects the CEO and other corporate officers. The process has worked well: The Presidential appointments have ensured the selection of Directors with the necessary experience and reputation in the U.S. financial community to provide the Fund with a network of contacts in the U.S. that greatly facilitates marketing and networking , both in terms of locating potential U.S. investors or joint ventures, and in terms of generating interest on the part of potential investors in the Funds.

On the other hand, the EUR/NIS approach to management can be time-consuming, requiring many months when you include both the appointment of Directors and the selection of Fund management. The process also favors venture capital specialist with U.S. ("Wall Street") experience, which is not necessarily the most relevant to the SMEs in EUR or other regions. The Presidential appointments also can result in over-politicizing the fund, and correspondingly lessening USAID control.

This study of the conditions in southern Africa confirms that management selection is critical to the Funds' success. As already outlined, the management of the proposed SAAEF should have specific experience with venture capital transactions and with financing small- and medium-sized businesses. Moreover, the SAAEF's management should be intimately familiar with the Region. This includes sufficient knowledge of the marketplace to access investment opportunities and to identify entrepreneurs. It also implies a demonstrated sensitivity to the social/economic environment envisioned in a post-apartheid southern Africa region. These qualifications, in turn, suggest the maximum possible participation of Africans on the Board and management of the Fund, consistent with the attainment of USG objectives.

Perhaps the best way to ensure Fund management that will have an optimal combination of venture capital experience and contacts in the U.S., as well as familiarity with the market and conditions in the Region, is to advertise for contracted management, both the Board of

Directors and corporate officers, through the Request- for-Proposal (RFP) process. The RFP process offers USAID the best opportunity to articulate the projects goals and objectives, and to stipulate the degree of oversight to be retained by USAID. While the RFP process can also be time consuming (three to six months) its benefits outweigh its drawbacks. Therefore, it is recommended that USAID consider the RFP method of selecting Fund management as an alternative to the EUR/NIS approach.

E. Investment Philosophy

Past experience with Enterprise Funds, both in EUR and in Africa, suggests that such funds may pursue two different investment philosophies:

- investing in intermediary financial institutions (IFIs) which in turn target groups of companies and firms ("wholesale" or "indirect" investment); and

- investing and co-investing directly into operating companies that meet the Fund's objectives and criteria ("direct" or "retail" investment).

This section describes the pros and cons of each of these approaches and concludes that the proposed SAAEF should have the flexibility, at the discretion of Fund Management, to pursue both investment strategies, depending on the conditions prevailing in particular countries in the southern Africa region.

1. Indirect or Wholesale Investment

In the venture capital business, it is widely accepted that investors should stay within their own community where they have high market familiarity or focus on a technical specialty where they have dominant knowledge. These strategies are viewed as "critical success factors" for making accurate assessments of the value of a business interest being purchased and the honesty of the owners of investee companies during investment selection.

The failure to adhere to these success factors partially accounts for USAID's difficulty in earlier venture capital endeavors. Continent-wide, region-wide and even country-wide funds may have neither local knowledge or a technical specialty. USAID-supported investment funds that have done best have been those that had a specialty focus (such as LAAD, which has focused on agribusiness production for sale in U.S. markets).

One of the primary types of approaches which the Fund will use is to wholesale its capital resources to Intermediary Financial Insititutions (IFIs) that either have market intimacy or a special focus, and allow them to make the direct investments. To meet USAID policy objectives of reaching indigenously owned, small and medium-size businesses, the Fund will select IFIs for whom such SMEs are their "natural markets."

The range of firms, and their particular "natural markets" include the following:

- PVOs, of whatever nationality, which specialize in SMEs development in Africa (e.g. Technoserve, KREP and SIDI);

- African institutions and individuals already engaged successfully in SME development (e.g. banks and investors), which are interested in expanding their operations to include a venture capital affiliate to operate within their community and/or field of expertise; and

- international investment companies or businesses already engaged in Africa with the target business group which may wish to expand operations (e.g. SIFIDA, AGF, Land O'Lakes).

Implicit in this approach is the assumption that the SAAEF will be able to identify IFIs with the experience and qualifications to provide investment financing to target African businesses.

Alternatively, there are also a number of international PVOs engaged in micro and small-enterprise development throughout Africa (e.g. Technoserve, KREP, SIDI). For many of them, the limiting factor in their growth is available investment capital. With appropriate price and terms on its funds, they too might negotiate IFI status with the SAAEF.

Finally, there are also a substantial number of more sophisticated clients engaged, or willing to become engaged, in business development in Africa, for whom availability of investment capital is a constraint to growth. Established venture capital firms such as EDESA and SIFIDA, USAID-sponsored undertakings such as the Africa Growth Fund, and international cooperatives such as Land-O-Lakes, all offer possibilities as IFIs for the SAAEF.

Indeed, should the SAAEF prove successful in attracting capital from other sources, each such source is likely to have its own particular priorities for investment. In the marketplace for money, it is critical to the SAAEF's long-term survival that it have the flexibility to deal with the widest possible range of investment objectives.

Another critical element to the SAAEF's relationship with the IFIs is that there be no interference with investment placement, management or liquidation. IFIs should be free to be as agile in the marketplace as if they were dealing with their own capital within the sole constraint of their negotiated agreement with the SAAEF.

The *disadvantages* of limiting the Fund's investment strategy to indirect investments may include:

- past experience indicates that while many IFIs may apply for financing, few will actually meet the criteria for funding;

- the better qualified, more experienced IFIs have become leery of applying for USG-sponsored financing, with its attendant conditions and reporting requirements;

- indirect/wholesale investing does not provide Fund management with the same "feel" for the conditions and obstacles to investing in a country, or suggested approaches to overcoming such constraints; and

- past experiences with the Development Banks is relevant, since many such institutions suffered from poor repayment of what was considered "easy" money, and a lack of close-up, on-the-ground management of their portfolios.

2. Direct Investment

There are several reasons why the proposed Fund should have the flexibility of making direct investments in operating companies in the southern Africa region.

- Such investments can have an important demonstration effect. A successful investment in a well-designed company invites imitation by other investors.

- Investments in co-financing with intermediate financial institutions can help strengthen the financial sector, thus contributing to a healthy private sector. An efficient competitive financial system becomes a model for the rest of the private sector to emulate and consequently sound investments in this area can have an influence well beyond the financial institution itself. Fund investments could be made in conjunction with a variety of financial institutions, such as commercial and savings banks, merchant banks, leasing companies, venture capital companies, etc.

- Direct investments by the Fund into operating companies will often require government assistance and approval. In the process, such investment proposals will help identify policy, institutional and regulatory obstacles which need to be addressed and overcome. In that sense, the Fund's "direct investment" approach can make a significant developmental contribution to improving the enabling environment.

- Direct investments imply somewhat larger investments in individual companies (e. g. from $1-3 million per investment). Because of their size, such companies often make a proportionately larger contribution to employment in the recipient country, investment stimulation, and economic development in general.

Direct investment activities by the Fund will include the following:

- small-and medium-size businesses in targeted industries (specified portfolio strategy);

- Co-investments with IFIs to strengthen targeted capital market development. These IFIs include venture capital firms, leasing companies, franchising companies, business credit agencies, commercial banks, brokers/investment banks;

- Privatizations, i.e. recently privatized companies or companies to be privatized;

- Joint Ventures with foreign (including U.S.) investors.

The *disadvantages* of the direct investment approach include:

- relatively larger-size deals ($1-3 million) entailing higher risk in a Fund of limited size and resources;

- the relatively greater staff intensity which will be required by the Fund to identify, evaluate, negotiate, monitor and exit from individual deals.

3. Building Linkage with U.S. Industry

The Funds can and should be managed so as to assist in the development goals of the host country and at the same time lead to increased trade and investment, and closer ties between the U.S. and those countries. U.S. companies have much of the technology and expertise needed by companies within host countries. Joint ventures involving U.S. firms should be assisted and encouraged through all available means.

The NIS and EUR grant agreements take somewhat different approaches on this and should be reviewed carefully to see which approach is best for southern Africa. Assisting the expansion of U.S. franchising is a good example of an area where the development needs of host countries and the desire for growth in international markets for U.S. firms run exactly parallel.

G. Technical Assistance

Two types of technical assistance (TA) and training were considered. The first is generally for activities that will over time be provided by the private sector and thus should be oriented toward building a private delivery capacity from the outset. The second is essential to and supportive of private sector development, but is inherently a government and donor role, thus should be managed and controlled by USAID directly.

- **"Transaction-specific" Technical Assistance**

Technical assistance will be required in most countries in the region to "prove-up" or develop specific potential investment opportunities provided by the Fund management. This TA is to help SME and individual entrepreneurs prepare applications and business plans for the Fund, as well as provide consulting advice on client operations. It will also support the Fund in conducting research activities needed to produce data essential for financial decision making and management. Such assistance will be provided as needed and paid from Fund capital. Within the Fund, such assistance could be administered by a separate TA Department, to be coordinated with the Investment Department at the CEO level.

- **Private Sector Development Technical Assistance**

Separately from the Fund TA, USAID should consider providing a range of technical assistance and training to the target segment of the business community (SMEs and individual black African entrepreneurs.) Although local institutions and donor-supported programs provide such training in several countries at the present time, the number of people trained does not come close to meeting the demand of the business and financial sectors. Therefore, USAID should, in the context of the Initiative for Southern Africa, consider supplementing existing programs with a program of technical assistance and training in entrepreneurship, business skills and financial management. Such a program should contain the following components:

- TA and financial support for the local business training institutes that are considered most effective and most relevant in reaching the target beneficiaries of the Fund, and for local financial and non-financial institutions which provide training in financial management and financial analysis skills and business management;

- TA in support of policy reform benefitting the private sector in countries of the region;

- USAID-funded exchange program to provide short-term training (up to one year) in the United States or third countries. Target recipients would include African SME owners who desire to rehabilitate or expand their businesses, university graduates, and the staff of public and private institutes who desire to enter the field of capital finance in their home country.

Although not part of the Fund, such a program should be closely coordinated with the Fund, so that fund staff and management can help identify the needs for TA and training in the financial markets in each country.

No attempt has been made to quantify the costs of the proposed technical assistance and training programs needed in the region, since the needs (demand) and availability (supply) of such assistance and training varies from country to country and, even in countries visited by the field assessment Team, would have to be appraised in detail in a full feasibility study.

F. USAID Oversight

Although the SAAEF will have its own full-time staff handling day-to-day operations, there is a need for broader oversight to ensure compliance with USAID's objectives as well as general U.S. Government policies, laws, and regulations.

Because the SAAEF is proposed to be established as a non-profit corporation, the indicated form of its directory body is a corporate Board of Directors. This is the model followed in similar USAID undertakings as wide-ranging as OPIC (a parastatal corporation), all of the

Enterprise Funds for Eastern Europe (non-profit corporations), and likewise in the USAID-supported Venture Capital Funds in Kenya, Ghana and Tanzania (for-profit corporations).

Examples of USAID involvement from recent experience include the following:

- OPIC, a USAID spin-off of the 1960's, where the Administrator of USAID served, until recently, as Chairman of the Board of Directors;

- Ghana and Tanzania Venture Capital Funds, where USAID enjoys some modicum of influence over operations during the period that the operating cost subsidy is being disbursed;

- Africa Growth Fund and Kenya Equity Capital Fund, where the USAID subsidy is given without specific reporting requirements or opportunity to influence policies; and

- East Europe Enterprise Funds, where enabling legislation literally precluded USAID involvement in Fund operations and policies and where practice, until recently, was one of actively limiting USAID's knowledge of Fund activities.

Recent experience with the EUR funds indicates that the option of severely restricting USAID involvement in Fund operations and policies is inappropriate. The USG has a need to: 1) know what the Funds are doing; and 2) have a presence (not necessarily a vote) at critical stages in the Fund's development along with regular performance reporting as to progress and status of both financial and development goals.

Therefore, an arrangement is recommended which assures USAID of the following knowledge of and access to routine Fund operations:

- knowledge of all Directors meeting and invitations to observe or participate in these meetings;

- receipt in timely fashion of all annual reports, minutes of Director meetings, audits and studies; and

- right to audit per normal and usual RFP guidelines.

Further, with respect to its basic developmental objectives of investment in the Fund, USAID should be entitled to the following:

- periodic reports as to Fund progress toward meeting performance targets established in the Fund's original charter and bylaws; and

- right to perform periodic evaluations of Fund performance from any and all perspectives.

V. NEXT STEPS

While the Field Assessment Team is satisfied, on the basis of this study, that the need for a venture capital fund exists in southern Africa, and that the conditions exist for its successful operation, a number of aspects need to be studied and developed further to establish full economic, financial, social and administrative feasibility. Consequently, the Team recommends that USAID consider undertaking a full feasibility study and the detailed design of such a Fund. Specifically, the feasibility study should:

- define USAID's and the Fund's objectives, define appropriate USAID oversight, monitoring and evaluation criteria.

- examine alternative structures for the Fund, including location of headquarters and regional office(s) of the Fund, as well as the relative emphasis to be given on direct and indirect investing of the Fund's resources.

- "prove" the market, viz. assess the SMEs' demand for venture capital in the Region; existing sources of such capital; and the existence of financial and other institutions that can act as intermediary institutions for the Fund;

- assess the availability of competent, experienced management for the Fund, maximizing African participation, and devising appropriate compensation/incentive schemes for them;

- perform a financial analysis for the Fund, including an assessment of start-up, initial operating expenses, as well as likely financial returns for the Fund's venture capital investment activities;

- do a social and economic analysis for the Fund, to assess its probable developmental impact in the Region; and

- appraise the nature and probable costs of the TA and training that is needed to ensure that the Fund will have maximum impact on the target beneficiaries.

ANNEX A
USAID EXPERIENCE
WITH
VENTURE CAPITAL ACTIVITIES

USAID EXPERIENCE
WITH
VENTURE CAPITAL ACTIVITIES

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

AFRICA BUREAU

OFFICE OF OPERATIONS AND NEW INITIATIVES

JANUARY 14, 1994

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The information contained in this section consists of data available through desk research. It is therefore "observational" in nature and does not provide a comprehensive analysis of the factors affecting the successes or failures of venture capital funds. In the next stage of preparation, actual field research could be undertaken to ascertain the current performance and remedies taken to solve performance problems. Many of the funds have not compiled information on several factors affecting economic impact. Two tables at the end of this report summarize the experience of several global venture capital funds and 18 venture capital proposals which USAID assessed in sub-Saharan Africa.

I. ENTERPRISE FUND EXPERIENCE IN EASTERN EUROPE

A. General Observations

The Enterprise Fund model, as it currently exists in Eastern Europe (EUR) and the New Independent States (NIS), is described in Section I.D. of the main report. The model is considered to be relatively successful, despite its short track record, in acting as a catalyst for bringing increased capital and technical assistance resources to the small and medium business sector in those countries. The USAID grant agreement developed and now in place for the Russian-American Enterprise Fund represents the current state of the art for structuring such a fund and could be considered as the model for Southern Africa, with possible modifications considered carefully to address differing economic, political and cultural realities in the Southern Africa region.

Independent exercise of investment decision making is critical to long term success and sustainability of a fund. Freedom to choose size, type and location of investments that make the best business sense must be maintained within the fund management, with general directions provided by USG in the initial grant agreement and through regular dialogue throughout the life of the project.

Balancing the right combination of business independence and freedom for a fund while recognizing the needs of the USG for financial and political accountability is a very delicate and difficult process. Both sides must be respectful and sensitive to the needs and internal pressures of the other.

Ability to act quickly without normal USG contracting requirements is important and necessary for a fund to react to changing business opportunities and conditions. Selection of appropriate members of the Board of Directors and their selection of the President/CEO is perhaps the single most important decision in the future success of a fund.

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B. Formation

1. Goals and Expectations

The goals and expectations of the Fund should be clear from the outset and stated explicitly in the Fund's corporate documents. For example, to be sustainable, the fund should be seen as a profit-oriented financial institution (notwithstanding its "non-profit" status for tax purposes) that will primarily make loans and/or equity investments, not grants, to new and growing businesses. USAID's development objectives and expectations should also be clear. Technical assistance is a separate matter and needs to be considered within the context of the Fund's primary role of providing investment capital for economic development.

2. Existing Grant Agreement for Russia

Much of the difficult start-up experience of the past three years in EUR is reflected and now built-into the Russia grant agreement. As such, that agreement provides an excellent starting point for a similar project in southern Africa. Even if significant changes are contemplated, the agreement also provides an excellent basis for focusing discussion, and a checklist of issues, along with indications of Congressional sensitivity to such issues as compensation and USG oversight.

3. USAID Coordinator

There is a need to have one person in USAID who is responsible for receiving questions and channeling information regarding the Fund and to coordinate with State and Hill counterparts, to ensure that direct lines of communication stay open and clear.

4. Sunset Provision

Venture capital is "patient" capital. Therefore, the establishment of a venture capital fund requires a long-term commitment (10 to 20 year timeframe) to complete the investment cycle. If successful the Fund could become a major factor in the economies of host countries. Therefore, the ground rules for the eventual wind-up of the Fund -- providing for graceful exit and disposition of fund assets -- should be considered at the beginning. This long-term issue was not focused on originally for the EUR funds.

5. Tax Status

Assurances should be obtained from the outset as to tax status, permits, etc. in the U.S. and host countries. Major delays and PR problems were met in EUR and some of these involved the U.S. Treasury as well as the host governments.

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6. Geographic Focus

Structuring a fund that can effectively cover a region as large and diverse as southern Africa will be difficult and costly. It is essential to understand that venture capital is a local activity. It is simply unrealistic to expect that Fund management sitting in any of the individual countries will utilize scarce staff travel, time and money to seek investments more than a few hours away. The need for frequent face-to-face meetings, due diligence and ongoing assistance and monitoring dictates that most investments be made close to home. The fact that there are eleven (11) separate political jurisdictions in the region makes it important that none are made to feel "unattended" -- even if the nature of delivered assistance (i.e.,TA versus capital) varies. Such inherent political decentralization requires a greater sensitivity to providing a corresponding operational structure that meets this need.

C. Successes

The Enterprise Funds have been successful in a number of respects:

- they have established small business lending programs in several countries, which are considered successful in terms of the number of loans made and their relatively low default rates;
- they have succeeded in attracting additional capital to investments they have made, for example, other organizations have copied the small business lending windows;
- in one or two instances, they have succeeded in attracting other investors to join the Funds, although such additional capital was organized into a separate fund;
- although it has not been quantified, some of the Funds have probably had a positive effect on job creation, by using employment generation as one criterion for the selection of their sectors of operation;
- the Funds have successfully created and supported new financial institutions in several countries, e.g. a mortgage bank, a merchant bank;
- the Funds have successfully created joint ventures between private businesses in their countries and the United States, though such ventures have not been many.

D. Regional Funds

An alternative to a large centralized Fund is the establishment of smaller, regionally-based funds in two or more locations utilizing a common Board. (The Czech and Slovak countries have separate funds but one board.) Locations should be selected based on their success in

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adopting policy reform and providing an atmosphere in which private business can flourish. Also, to the extent that there are existing USAID technical assistance projects for encouraging small business development, that is an important reason to consider co-locating. The regional structure would avoid concentrating resources in one area, and such a geographically diverse network if properly designed would:

- encourage regular communication, sharing of experience, data and ideas among the funds;

- provide a broader range of management expertise and permit specialization by each fund based on the competitive advantage of each region. While staffing costs would be somewhat higher, the desired development impact would be greater. The larger staff and closer proximity would allow significantly more actual assistance to be delivered to potential client enterprises;

- allow local management to be judged on their success in creating viable investment and development projects within their own region. Separate accounting and reporting for profit/loss and impact is important to this concept;

- allow initial capital to be allocated from the "central fund" with each regional fund competing for additional capital based on the success of their regional program; and

- leverage use of a core staff in the U.S. to provide linkage to USG and the U.S. business community. In this way, a relatively small local regional staff can capitalize on their local knowledge and contacts and their on-the-ground presence to identify and screen potential projects. Standardized input criteria can allow U.S. staff to provide investment analysis and review as well as ongoing technical support for the benefit of each regional fund.

E. Composition of Board and Operating Management

Experience in EUR has demonstrated that much of the Fund's investments will be with business enterprises considerably smaller and less sophisticated than those typically served by Wall Street firms. It is critical that the Board and Fund management have international experience working with these types of enterprises. The typical need is for capital infusions from $250,000 to $2.5 million. In Africa, the needs are probably for even smaller amounts per transaction, along with a relatively higher contribution of technical, financial and management assistance. It therefore seems desirable that Fund leadership have a venture capital background, preferably with experience in dealing with small and medium enterprises.

What is needed are experienced U.S. business people who are aware of the differences in

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dealing in the African markets, and are willing to go the extra mile to assist SMEs, while still demanding operational and financial discipline from their clients.

F. Survey/Interview of Management and Board - Existing Enterprise Fund

It would be very helpful to interview current Board members, as well as key management staff for each of the existing Funds, to hear their thoughts on their own experience. However, such work was considered to be outside the scope of work for this report.

G. Operational Issues - Development Impact and Economic Yield

It is critical that any investment fund have clear cut goals and objectives against which to measure its performance. The purpose of the EUR funds, generally, has been to assist in the development of an indigenous emerging market and to promote broad-based, grass roots private sector enterprises, particularly small and medium enterprises. They are not intended to compete with the private sector which is principally oriented to profits. Rather, they are designed to address a market imperfection, providing investment capital to commercially viable and developmentally beneficial enterprises that would otherwise be unable to secure adequate financing from the existing market. As such, they may take higher calculated risks than available market sources of capital, as long as the client enterprises are projected to be commercially sound.

To this end, developmental goals should be well-integrated into the Funds' overall objectives. The development impact of the Funds' portfolio should be periodically evaluated against the development objectives.

Goals for economic yield must be sufficient over the long run to allow the Funds to become sustainable, including coverage of operating costs and overhead. In the early stages, a greater emphasis toward loans versus equity may be helpful in providing higher reflows for re-investment. Also, it is considerably more difficult and inefficient to make "equity" investments in smaller companies and even more so in micro-enterprise situations. The Polish Fund worked through existing financial institutions to provide small loan programs and improved lending criteria, with good development results and notable success in reaching a broader range of entrepreneurs.

H. Building Linkage with U.S. Industry

The Funds can and should be managed so as to assist in the development goals of the host country and at the same time lead to increased trade, investment and closer ties between the U.S. and those countries. U.S. companies have much of the technology and expertise needed by companies within host countries. Joint ventures involving U.S. firms should be assisted and encouraged through all available means.

The NIS and EUR grant agreements take somewhat different approaches on this and should be reviewed carefully to see which approach is best for southern Africa. Assisting the expansion of U.S. franchising is a good example of an area where the development needs of host countries and the desire for growth in international markets for U.S. firms run exactly parallel.

I. Coordination with other USG programs/Resources

Consideration should be given to establishing a special office to coordinate the efforts of the key USG trade groups (Eximbank, OPIC, TDP, etc.) to assist U.S. firms and local businesses to maximize the assistance given.

J. Broadening Impact: Creating SBIC-Like Affiliates

Funds can channel their capital on a wholesale basis through existing financial institutions. This approach may be more feasible in this region than in EUR/NIS and would allow a faster start. Also, where needed, the Fund could establish a program similar to the Small Business Investment Companies (SBICs) program in the U.S. whereby it would supply a portion of the capital necessary to assist local businessmen start a new venture fund. Risk sharing by the local investors should be required. TA should be provided as needed to acquire deeper experience in analysis of small firms potential for financial success. Capital to new SBICs should be loans or equity, not grants.

K. Technical Assistance

The experience of the existing Enterprise Funds in EUR is that a greater amount of TA has been necessary at all stages of completing transactions than much was anticipated. The funds in Poland and Hungary have received high marks for their TA work. Many would say that technical assistance is, perhaps, the most significant contribution made by such Funds.

Coordination with existing USAID TA projects is important. However, Fund managers are often the ones who identify a need for a certain area of TA. They need the discretion to use their funds for TA to assist client companies. However, separate accounting for TA disbursements is important so the Fund's true performance can be determined.

Training is an important need. For example, working with small business development groups is a good way to stimulate entrepreneurs to improve the quality of their business plan submissions and to increase the deal flow that ultimately comes to the Fund.

L. Policy Reform

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Often the Fund managers' work on specific investment transactions make them aware of areas of the existing law or regulatory framework that need to be changed. In such cases, a regular dialogue between the Funds and U.S. Embassy/USAID is helpful to call the attention of host country government to address needed changes. In so doing, the Funds provides a practical barometer to the USG as to which specific reforms are needed and the extent to which the host government is willing and able to effect such changes.

II. AFRICA VENTURE CAPITAL FUNDS

USAID has developed considerable experience with venture capital in Africa over the last seven years. We gathered available reports and conducted interviews covering four operating venture capital funds and summarized prior field work on 16 other venture capital initiatives which were evaluated under the AVCP. The summaries follow:

A. The Africa Growth Fund (AGF)

The Africa Growth Fund is a 15-year limited partnership, which is a privately owned, funded, and managed investment company that takes positions in highly profitable new and expanding business enterprises in sub-Saharan Africa. The AGF is owned by five major U.S. corporations, which invested $1 million each, and was developed and is managed by Equator Investment Services Limited, an affiliate of Equator Bank.

- **Management** - Although Equator did not have venture capital experience prior to the AGF, they did have African environment experience. None of their investments has been in trouble, indicative of their strong due diligence procedures, and "cherry-picking" philosophy of selecting only the best deals. They have put effort into creating the local partnerships and relationships needed for success, and have shown concern for USAID developmental objectives. They have been flexible and shrewd in structuring deals, and built synergies with other markets and firms. Every project chosen has involved local investors as part of an exit strategy.

- **Deal Flow** - The value of long due diligence periods can be seen in management's success in finding quality deals, weighing risks, and for structuring advantageous deals and terms.

- **Raising Capital** - The AGF's high debt-equity ratio has put serious constraints on cash flow. This creates a need for deals with cash flow in the short term. Being a relatively small fund, AGF must carry a high fixed cost burden from its debt capital over a small number of investments.

- **Exits** - Divestment may prove difficult. By way of comparison, less than 5% of U.S. Venture Capital funds have been able to fully divest over the past 15 years, and the

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African environment is far less conducive to seccndary equity transactions. However, the commercial rather than developmental focus has brought financial and market-driven discipline to the investment process and increases the chance of successful divestment in the future.

- **Applicability** - The AGF model is limited in terms of broad applicability. The dominant structural issue for the AGF is the ext^nt to which a high debt burden will compromise the Fund's mission.

B. Kenya Equity Capital Corporation (KECC)

- **Structure** - Kenya Equity Capital Corporation began in 1988-1989 under the sponsorship of USAID. KECC has had a mixed investment record and was refocused in 1993 for greater long term profitability. Fund management is provided by Equator Bank. The diverse shareholder structure and need for operating cash flow diverted management focus from deal generation.

- **Performance** - The uncertain and sometimes negative enabling government regulatory and tax environment have created difficulties in the area of identifying and structuring deals. While it seems that KECC has failed to maintain itself as a venture capital company, it appears to have identified a potentially viable niche for services within the Kenyan financial community as a facilitator of commercial projects relying largely on capital from other private and donor sources.

- **Investments** - KECC has made seven investments. An investment in a computer supply company was successfully exited in 1991. The largest single project, a resort development company of about $6 million of which USAID has 9%, has good prospects. A small restaurant investment, some $217,000 of which USAID provided 27%, is being written off. USAID has provided investment funds for all the investments, with KS27,900 being loan funds through KECC and KS60,400 as direct USAID loans to four projects. In addition, USAID provided a KS200,000 guarantee for one investment's bank loan.

- **Applicability** - There is no conclusive evidence that KECC has stimulated other private sector venture capital investment activities in Kenya nor that its investments will prove profitable over the long term. We have no information as to the size of the investee companies compared to the SME target other USAID projects have established.

C. Ghana Venture Capital Fund (GVCF)

- **Structure** - Ghana Venture Capital Fund (GVCF) LTD was formed November 1992 as a Ghanaian private limited liability company with a minimum of $2 million and up to a maximum of $5 million of committed capital equivalent in cedis.

- **Start-up** - Activities began in January 1992, following the December 1991 signing of an USAID grant for start-up expenses, with Commonwealth Development Corporation (CDC). By June 1992, all government "in principle" approvals and exemptions from restrictive regulations had been obtained. Work continued on raising capital from five local investors, legal work to incorporate the Fund and the management company, and identifying potential staff. Efforts to generate deal flow were not commenced until early 1993, after the fund had been legally established. This timing was prudent as there were many uncertainties as to structure and capitalization which required resolution before opening the doors. However, this step by step start-up process, rather than recruiting staff and filling the deal pipeline has delayed getting investments done, which has resulted in lost momentum.

- **Management** - GVCF has its own Board of Directors, but delegates day-to-day management and the responsibility for making investments to Venture Fund Management Company (VFMC), for a fixed annual 3% fee and a share of the profits. VFMC is formed as an independent management company, incorporated in Ghana, to manage GVCF and potentially a series of other fund companies.

  The staff of VFMC consist of a manager seconded from Commonwealth Development Corporation (CDC), an investment manager, a controller, an administrative assistant, a receptionist and a driver. In general, the original assumption that competent local financial professionals are available has been supported. However, the number of qualified candidates at the desired top level is very limited and significant incentives will have to be provided to attract and retain senior managers. The firm intent remains to replace the CDC-seconded manager with local management in 1994.

- **Policy** - Investments will not exceed U.S. $500,000 in any one company, and will be spread so that no more than 25% of GVCF's committed capital is invested in any one group of companies nor more than 35% in any one sector. Investment will be balanced between expansions and new business start-ups.

- **Deal Flow** - The original assumption was that a well publicized supply of equity would reveal demand. In terms of deal flow, that has proven to be true. The potential for successful investment seems to exist and will be aided by a continuing reduction in the rate of inflation and a corresponding drop in short term interest rates, thus lowering the nominal IRR required on GVCF investments. Investment has been approved in three deals and several more are in the approval process. GVCF makes equity and quasi-equity investments in Ghanaian SME companies which have clear potential for achieving above average growth and profitability, as well as proven, successful management.

- **Exits** - GVCF aims to realize its investments and to distribute the proceeds to its investors within 10 years of starting business. GVCF aims to achieve returns for its investors commensurate with the risks involved in equity investments, i.e. 20% or more per annum. Options for disinvestment can not be evaluated at this time. Once several investments have been structured and accepted, it will be possible to evaluate the potential for achieving the attractive returns on investments necessary to attract additional investment funds from local investors.

D. Tanzania Venture Capital Fund (TVCF)

- **Structure** - USAID began prefeasibility work in February 1992. By October, CDC had agreed to provide initial management and up to $2.5 million in capital. CDC start-up management began at the same time. In December 1992, USAID signed a multi-year start-up grant to CDC. With concerted USAID and CDC effort, Tanzanian government "in principal" approvals were received in just four months.

  The management company, Tanzania Equity Investment Management (EIM) was operational in early June 1993. Office staff was hired and the new premises were occupied in October 1993. Legal incorporation of TVCF as a non-bank financial institution was completed and the fund was officially launched on October 18, 1993, at which time the first investment was announced. An investment manager and an accountant have been hired.

- **Target Market** - The TVCF is the first venture capital fund in Tanzania. Managed EIM, it will make equity and quasi-equity investments in local business as partners with Tanzanian entrepreneurs. The goal of the TVCF is to provide opportunities for Tanzanian business people by giving them access to the capital and management skills which they require if their businesses are to develop. More than five SME investment have received Board approved as of December 1993.

- **Investment Philosophy** - Most of TVCF investments will be to existing businesses seeking second-stage expansion capital, though it will also consider start-ups if they are attractive. The fund's minimum investment limit will be U.S.$ 50,000 and its maximum investment will be U.S.$500,000. TVCF may buy up to 50 % of the ordinary equity in each investment.

- **Capital** - The current investors in TVCF are CDC, Deutsche Investitions-und Entwicklungsgesellschaft (DEG), Swedefund, PROPARCO, Tanzania Development Finance Ltd. (TDFL), and National Provident Fund. The fund is presently capitalized at $6,750,000. In order for the fund to be sustainable over the long term, capitalization of $15 million is required to support overhead and achieve self-sufficiency.

- **Key Issues** - The key strategic issues facing the fund are the need for a parallel mezzanine fund to supplement equity financing-due to the undeveloped nature of the banking sector and its inability to provide adequate working capital financing to the marketplace; and, for the management of EIM to be separate from the supporting donor agency and work directly for EIM. Selection of an operating approach that supports fund raising objectives must be established.

  Completion of an incentive compensation plan for the carried interest to be held by the investment manager is an important operating challenge. Additionally, establishing portfolio valuation guidelines, and timeliness for accounting review and determination of portfolio allocation between seed capital, expansion financing and buyout financing for privatization projects need to be formalized, along with follow on capital and exit strategies.

E. African Venture Capital Project (AVCP)

The experience as presented in the following table indicated the difficulty in starting up venture capital funds in Africa and the need for high quality management and technical support. The essence of venture capital investing is a patience long-term approach. Ten years or more may be needed to complete a round of investing and evaluate results.

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F. SIFIDA

SIFIDA is an international financial institution, established in 1970, to foster the growth of developing independent countries in Africa and to act as a catalyst by providing merchant banking services.

SIFIDA consist of 125 shareholders which are financial institutions and industrial or commercial groups from 23 industrialized countries worldwide. The authorized share capital is $50 million. Over the past 20 years, SIFIDA has provided and organized equity and loan finance for over 100 projects in more than 30 African countries. The sectors covered are principally mining, agri-food processing, manufacturing, tourism, and other productive industries or service, with a preference for export oriented projects.

The Board of Directors is composed of 26 members designated by the shareholders and reflecting the international structure of the share capital. These individuals have significant trade, industrial and financial experience and African expertise and form a valual 'e part of the overall capabilities.

In addition to investing directly from its own funds, SIFIDA raises equity through mechanisms such as debt conversion and private placements, and arranges loan finance through syndications, co-financing and export credits. SIFIDA also provides and arranges guarantees including cover for non-commercial risks.

The criteria for investment by SIFIDA is potential profitability with good growth prospects, technical and economical feasibility, commercial viability, sponsorship by reputable partners and investors of good standing. Management by experienced and competent technical partners that are able to contribute to the development of the perspective country's economy is also a critical criterion for investment by SIFIDA.

SIFIDA has developed considerable experience in setting up retention schemes that have enabled projects to attract foreign investors. Emphasis has been placed on consolidating the existing portfolio through measures that include the conversion of debt into equity. SIFIDA continues to show a positive operating profit and the net losses after allowing for provisions have been constantly reduced over the past three years, evidencing the steady progress being achieved in improving the investment portfolio, with particular reference to sovereign risks.

G. Economic Development for Equatorial and Southern Africa (EDESA)

- **Organization** - EDESA is a development financing institution based in Switzerland and operating primarily in sub-Saharan Africa. EDESA is financed by a small number of blue-chip investors, which has been able to remain consistently profitable for the 20 years of its existence.

- **Investments** - For the first 15 years, EDESA was primarily in the business of medium-term lending to governmental institutions for export promotion activities, with only a small amount of direct equity investment, but that has changed due to the debt crisis and changes in developmental economic theory, and now EDESA's management characterizes themselves as venture capitalists, with 47% of invested assets in equity holdings, and an additional 15.5% in project loans. $27.38 million of $44.24 million in total assets is taken up by either loans or equity investments.

  The management, which takes a pro-active role in locating and developing investment opportunities particularly in the financial sector, has also been effective at locating joint partners for deals. A new focus is being taken on consulting as a way to generate higher off-balance sheet income; revenues generated in this way were above $1.5 million.

- **Operations** - Cash flow generated by loans is used to maintain profitability and underwrite the riskier equity investments. Liabilities are maintained at 76% of stockholder equity, as the management prefers a low level of leverage due to the unstable environment EDESA operates in. A profit motive is maintained as an integral part of operations, but due to the tempering influence of EDESA's developmental functions, earnings at times have been nominal.

- **Management** - The management team has extensive experience in Africa, while the Board of Directors is composed of individuals with banking/corporate experience in major multinational institutions. The Managing Director has retained his post for the entire time of EDESA's existence.

- **Raising Capital** - EDESA has found a niche in venture capital and as a sponsor of financial institutions, which has the added benefit of multiplying the limited resources EDESA can provide. Over $200 million has been leveraged by African financial institutions from EDESA's $7 million investment in the form of loans and foreign exchange.

- **Investments** - The majority of EDESA's portfolio is in minority holdings of a wide range of manufacturing, financial and service companies, and majority ownership of a number of leasing companies. EDESA estimates that over 10,000 entrepreneurs, most at the micro-enterprise level, have been able to benefit from the increased availability of funds through EDESA's investments in financial institutions. However, the number of jobs created is unknown.

- **Exits** - EDESA has had problems in the exit phase due to the low demand for shares and the absence of sophisticated capital markets, and so has had to retain holdings rather than turning them over for new investments.

- **Operations** - EDESA has never shown a year-end loss, although at times earnings have been nominal, as in 1992, when net income after provision for future losses was less than $36,000.

  The main constraint EDESA operates under is low capitalization of $44.24 million in total liabilities and shareholder equity, compounded by the management philosophy of maintaining low debt-equity ratios. Coupled with the difficulty of exiting from investments, this has limited the developmental impact EDESA has had in the region.

III. OTHER EXPERIENCE WITH VENTURE CAPITAL

A. Latin America Agribusiness Development Corporation S.A. (LAAD)

- **Structure** - The LAAD is a private investment and development company. Its shareholders are thirteen leading agribusiness and financial corporations. LAAD finances and develops private agribusiness projects in Latin America and the Caribbean.

- **Raising Capital** - The original intent of LAAD was to establish a continent-wide fund and take minority equity positions in small and medium sized companies. However, this has not materialized. LAAD could not sell minority equity positions in small and medium size companies and the concentration has shifted to long term lending.

- **Investments** - To be profitable, LAAD could not concentrate on a large region, hence their concentration in Latin America and the Caribbean. Additionally, they must focus tightly in the agribusiness area on all phases of production, processing, storage, services, technology and marketing in the fields of agriculture, livestock, forestry and fishing; and specifically within these areas, on products for sale in the U.S. market.

- **Operations** - Net earnings improved by 30% in 1992 rising to $1.75 million, yielding a 9.4% return on average net worth. These were record high earnings in absolute terms, although the return on equity was lower than the average for the past ten years. Earnings per share rose to $3,381, which is 25% above the previous high two years ago. Gross revenue increased by 12% over the previous year to $6.6 million. Interest charges rose by 10% because of the higher cost of new medium term borrowing. Operating expenses rose by 8% but fell as a percentage of gross profits and total assets. The equity portfolio generated a loss of $154,000 related primarily to the Corporation's investment in Southern Sun Trading which was sold during the year.

  Operating income went up by 18% to $2.6 million, a record high. Total assets increased 11% to $62.9 million, mainly due to expanded lending operations and a higher cash position. Cash flow from operations improved substantially with total repayment of $13.8 million. The total holdings by the Corporation of sovereign debt is now down to about 1.5% of its assets.

B. The U. S. Experience with Small Business Investment Companies

1. Small Business Investment Companies (SBICs)

The SBICs are privately operated investment companies and may be owned by a) individuals, b) banks, with certain limitations, and c) corporations. SBICs are authorized to make equity investments in small business concerns which are owned or controlled by persons deemed to be socially or economically disadvantaged. A SBIC may not ordinarily assume control of a business. Ownership must be less than fifty percent (50%) of the business' outstanding voting securities, except under circumstances where temporary control is reasonably necessary for the protection of the SBICs' investment. SBICs may also make long-term loans for periods up to 20 years at interest rates not to exceed 15 percent or the maximum rates permitted by the laws of the States in which they operate, whichever is lower.

There are currently 275 licensed SBICs with private capital of $1.7 billion and almost $800 million in funds borrowed through the Federal system. SBICs have invested almost $8 billion in more than 66,000 small business during the past three decades. The SBIC program has a track record of outstanding investments in companies such as Federal Express, Apple Computer, Pandick Press, Cray Research, Intel and Rolm Corporation.

2. Minority Enterprise Small Business Investment Company (MESBIC)

The minority-focused venture capital industry has encouraged the development of a generation of successful minority venture capitalists and entrepreneurs. Over the past 10 years, close to $ 1 billion has been provided to over 12,000 minority-owned companies. The MESBIC industry is currently represented by 132 different companies, in all parts of the U.S. The National Association of Investment Companies (NAIC), the successor to the American Association of MESBICs, asserts that by the late 1970's, MESBICs were principals in the financing of a large portion of minority-owned radio, television, and other telecommunications properties. The trade association has been in the vanguard of minority investments in franchises, health care, environmental services, transportation, high technology ventures, wholesale and retail distribution and manufacturing enterprises.

In addition, because of the relative success of MESBICs, purely private venture firms have been capitalized in the $30 to $50 million range. The NAIC has undertaken an effort to raise $200 million from pension funds and other sources to be used to invest in venture capital limited partnerships or other venture capital investment vehicles which provide funds to minority firms.

The unique feature of the MESBIC model which gives it direct applicability to conditions in Southern Africa is that the Federal government, with the creative efforts of the private sector, developed this intermediary to overcome obstacles in the marketplace which hampered access to credit on the part of blacks and other minorities, throughout the United States. Some of the conditions of underdevelopment in Africa are similar to aspects of life one would have found in the U.S. in 1969. Through the use of lower than market rate money, and other government subsidies in the form of loans, the purchase of preferred stock, grants, etc., the innovative MESBIC was fashioned to act as a catalyst for business development in areas of the country that needed the stimulus.

IV. SUMMARY OF LESSONS LEARNED

Lessons learned from past experience with venture capital funds in Africa and other funds include the following:

1. venture capital (vc) investing is an innovative, creative process which requires maximum flexibility in management and structure; this requires a new way of doing business for USAID;

2. it takes a long and persistent effort to organize a fund and make investments and even longer to realize financial returns;

3. the long-term investment risks inherent in an emerging or transitional economy in Africa are manifold and go far beyond the business, technology and market risks in the West, i.e. the additional political, economic, legal, social and other risks;

4. a clear statement in a fund's mandate of its investment and development objectives is essential to the identification and assessment of investments.

5. significant local participation by investors, management and/or entrepreneurs is critical to success. Local investment managers, with a "feel" for the market are essential to "smelling out" attractive transactions; it is management, not structure, that does deals;

6. the pool of potential VC managers and investors is very small in Africa due to the unusual qualifications and requirements involved;

7. government or public agency involvement in VC fund management and economic subsidy dilutes and undermines the private sector discipline and commitment required for success;

8. a poor enabling environment, and a short term investment climate, was responsible for failure to attract investors in several cases;

9. all other considerations being equal, country-specific funds tended to be more attractive to investors than regional funds;

10. the initial capitalization of VC funds deserves special attention. High debt-equity ratios can be problematic in the undue burden they can impose on cash flow;

11. exit strategies can be difficult to design and implement in the Southern Africa context. Minority positions in SMEs are especially hard to divest;

12. raising (leveraging) additional capital proved to be difficult in several instances;

13. the demonstration and catalytic effect that results from actually doing deals is crucial to the objective of generating sustainable investment activity; and

14. USAID grants can be difficult, time consuming and costly to structure and monitor. Care is also needed to avoid imposing too great a reporting burden on the funds.

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ANNEX B
COMPARATIVE MACROECONOMIC INDICATORS FOR COUNTRIES CURRENTLY RECEIVING USAID ENTERPRISE FUNDS AND COUNTRIES IN SOUTHERN AFRICA

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KEY MACROECONOMIC INDICATORS: COUNTRIES WITH AID ENTERPRISE FUNDS

	population (1000s, 1991)	GDP (bil $, 1991)	area (1000s of km²)	external debt (mil $, 1991)	life expectancy	AID Enter-prise Funds
Southern Africa Region	122,275	132.94	6,930	24,515 (total shown)	...	...
Sub-Saharan Africa	488,900	164.34	23,066	...	51	...
Africa (total)	643,072	349.384'	30,030	...	...	...
World	5,351,000	21,639.12	111,306	...	66	...
Russia	148,700	...	17,075	...	69	300
Czech Rep/ Slovakia	15,700	33.17	128	9,793	72	45
Poland	38,200	78.03	313	52,481	71	240
Hungary	10,300	30.79	93	22,658	70	65
Bulgaria	9,000	7.91	111	11,923	72	55

Source: World Bank, "World Development Report 1993"

KEY MACROECONOMIC INDICATORS: SOUTHERN AFRICA REGION

	population (1000s, 1991)	GDP (bil $, 1991)	area (1000s of km²)	external debt (mil $, 1991)	life expectancy	AID Enter- prise Funds
Angola	9,465	9.07 (est.)	1,247	...	46	...
Botswana	1,330	3.644	582	543	68	...
Lesotho	1,800	0.578	30	428	56	...
Malawi	8,800	1.986	118	1,676	45	...
Mozambique	16,100	1.3	802	4,700	47	...
Namibia	1,500	1.961	824	...	58	...
RSA	38,900	102.1	1,221	...	63	...
Swaziland	780	0.704	17	...	57	...
Tanzania	25,200	2.223	945	6,460	51	...
Zambia	8,300	3.831	753	7,279	49	...
Zimbabwe	10,100	5.543	391	3,429	60	...
Southern Africa Region	122,275	132.94	6,930	24,515	...	...
Sub-Saharan Africa	488,900	164.34	23,066	...	51	...
Africa (total)	643,072	349.384[1]	30,030	...	...	...
World	5,351,000	21,639.12	111,306	...	66	...

Source: World Bank, "World Development Report 1993"

[1]Does not include Djibouti, Equatorial Guinea, The Gambia, Liberia, Libya, Somalia, Sudan, and Zaire.

ANNEX C
SELECTED MACROECONOMIC INDICATORS FOR 11 COUNTRIES IN SOUTHERN AFRICA REGION

Note on statistical tables

The statistical information presented has been gathered from a variety of sources. While every effort has been made to select the most reliable figures, there are a number of discrepancies and gaps in the tables due to the use of different sources (or in some cases the absence of sources) for certain countries. Preference has been given first to US government documents, and second to World Bank/IMF reports; where these have been unavailable or incomplete, data generated by other international organizations, or the nations being examined, or privately gathered data has bee presented. Information on GDP contributions by sector was not available for all economies.

STATISTICAL SUMMARY: ANGOLA

YEAR	1992	1991	1990	1989
population[1]	9,890,000	9,520,000	9,190,000	8,900,000
nominal GDP (bil $)	n/a	n/a	9.07	7.72
real GDP growth rate	n/a	n/a	2.8%	1.8%
inflation (CPI)	n/a	n/a	6.1%	n/a
official Kz/$ exchange rate	n/a	180	90	29.92
black market Kz/$ exchange rate	n/a	n/a	n/a	3,500
per capita GDP	n/a	n/a	907.3	796.3
merchandise trade balance (bil $)	(0.75)	(1.69)	(0.87)	0.36
exports (bil $)[1]	3.77	3.83	3.52	3.57
imports (bil $)[1]	4.52	5.52	4.39	3.21
foreign exchange reserves	n/a	n/a	137.6	174.5
total debt (bil $)[1]	n/a	8.78	8.19	6.77
debt service/ total exports	n/a	n/a	182.4%	207.8%
literacy rate[2]	n/a	n/a	42%	41% (1985)
life expectancy male/female[2]	n/a	46	46	46

Source: "Angola - Economic and Trade Policy", US Department of State, Washington, DC, 1992, except as noted

[1]African Development Bank, "African Development Report 1993"
[2]World Bank, "World Development Report", 1991, 1992, 1993

STATISTICAL SUMMARY: BOTSWANA

YEAR	1992	1991	1990	1989
population	1,567,000 (est.)	1,325,000	1,281,000	1,237,000
population growth	3.4% (est.)	3.4%	3.6%	3.4%
GDP (bil $)	3.55 (est.)	3.15	3.21	2.88
real GDP growth rate	8.0% (est.)	8.7%	5.3%	13.3%
inflation (CPI)	15.0% (est)	11.8%	11.4%	11.6%
Average Pula/$ exchange rate	2.10	2.20	1.88	1.87
Per Capita GDP	$2300	$2400	$2500	$2300
investment/GDP[1]	36% (est.)	35% (est.)	37% (est)	32% (est.)
savings/GDP[1]	26% (est.)	34% (est.)	41% (est.)	47%
merchandise trade balance ($)	n/a	83.3	174.7	633.6
exports (bil $)	n/a	1.673	1.765	1.995
imports (bil $)	n/a	1.589	1.590	1.361
foreign exchange reserves (bil $)	4.100 (est.)	3.510	3.317	2.803
total debt (mil $)	614 (est.)	358.9	400.1	394.8
debt service/total exports	n/a	2.3%	1.6%	1.4%
money supply growth[1]	12.5% (est)	18.1% (est.)	36.5%	(14.1%)
# of private banks[2]	9	6	n/a	n/a
capitalization of private banks[2] (mil $)	$81.5	n/a	n/a	n/a
assets of private banks (mil $)[2]	$872.6	n/a	n/a	n/a
total loans (bank, non-bank sources, mil $)[3]	n/a	789.5	637.8	432.1
number of firms traded on exchange[4]	11	9	8	5
volume traded (1000s of shares)[4]	9,893.9	5,207.5	2,240.9	650.6
literacy rate[5]	n/a	74%	n/a	71%
life expectancy[5]	n/a	68	67	67

Source: "Foreign Economic Trends", Sept. 1992, by the US Embassy, Gaborone, Botswana, except as noted

[1]Bank of Botswana
[2]KPMG Peat Marwick, "Banking Survey: South Africa including Southern and Central Africa, 1992"
[3]World Bank, "Opportunities for Industrial Development in Botswana", April 28, 1993
[4]Stockbrokers Botswana Ltd., "Stockbrokers Botswana Ltd. and the Botswana Share Market", 1992
[5]World Bank, "World Development Report", 1991, 1992, 1993

STATISTICAL SUMMARY:BOTSWANA

GDP Contribution by Sector

Sector	1991 estimates
Agriculture	5.0%
Mining	41.4%
Manufacturing	4.0%
Water & Electricity	2.1%
Construction	5.5%
Trade, hotels, tourism	14.1%
Transport & Communications	2.3%
Financial Institutions	5.0%
Government & Services	20.7%

from Ministry of Finance and Development Planning, Government of Botswana

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STATISTICAL SUMMARY: LESOTHO

YEAR	1992	1991	1990	1989
population	1,880,000	1,800,000	1,750,000	1,700,000
population growth	n/a	2.8%	2.8%	2.8%
GDP (mil $)	n/a	605	583	496
real GDP growth rate	0% (est.)	1.9%	5.0%	11.9%
inflation	n/a	17.9%	11.6%	14.7%
average M/$ exchange rate	2.73	2.76	2.59	2.62
per capita GDP	n/a	336	333	289
investment/GDP[1]	n/a	93%	71%	66%
savings/GDP[1]	n/a	(13%)	(41%)	(55%)
merchandise trade balance (mil $)	n/a	(718.4)	(613.1)	(526.2)
exports (mil $)	n/a	57.3	59.5	66.4
imports (mil $)	n/a	887.6	769.8	672.9
foreign exchange reserves (mil $)	n/a	110.1	72.6	48.6
total debt	n/a	374	360	306
debt service/ total exports	n/a	4.2%	3.8%	4.7%
# of private banks[2]	4	n/a	n/a	n/a
capitalization of private banks (mil $)[2]	10.9	n/a	n/a	n/a
assets of private banks (mil $)[2]	283.9	n/a	n/a	n/a
literacy rate[1]	n/a	n/a	n/a	74% (1985)
life expectancy[1]	n/a	56	56	56

Source: "Foreign Economic Trends - Lesotho", 1993, US Embassy, Maseru, except as noted

[1]World Bank, "World Development Report", 1991, 1992, 1993
[2]KPMG Peat Marwick, "Banking Survey: South Africa including Southern and Central Africa, 1992"

STATISTICAL SUMMARY: MALAWI

YEAR	1992	1991	1990	1989
population	9,090,000	8,800,000	8,550,000	8,200,000
population growth	n/a	3.3%	3.3%	3.4%
GDP (bil $)	n/a	1.99	1.66	1.41
real GDP growth rate[1]	n/a	7.8%	4.8%	n/a
inflation[2]	11.9%	11.6%	n/a	n/a
average K/$ exchange rate	2.62	2.72	2.70	2.75
per capita GNP ($)	n/a	230	200	170
investment/GDP[1]	19.8	20.2	19.1	20.2
national savings/GDP[1]	4.0	9.6	10.4	6.9
merchandise trade balance (mil $)	n/a	249	(164)	(238)
exports (mil $)	n/a	470	412	267
imports (mil $)	n/a	719	576	505
foreign exchange reserves[3]	n/a	157.7	142.1	105.5
total debt (bil $)	n/a	1.68	1.58	1.39
debt service/total exports[4]	27.3%	21.3%	27.3%	28.0%
money supply growth	n/a	21.6%	12.3%	n/a
# of private banks[5]	2	2	2	2
capitalization of private banks (mil $)[5]	n/a	53.8	21.1	18.1
assets of private banks (mil $)[5]	n/a	301.5	238.3	180.5
literacy rate	n/a	n/a	n/a	41% (1985)
life expectancy	n/a	45	45	47

Source: World Bank, "World Development Report", 1991, 1992, 1993, except as noted

[1]"Economic Report: 1992", Department of Economic Planning and Development, Malawi
[2]Southern Africa Development Coordination Conference Annual Report, 1992
[3]World Bank, "World Tables", 1993
[4]"Malawi - Commercial Activity Report 1993", US Embassy, Lilongwe
[5]KPMG Peat Marwick, "Banking Survey: South Africa including Southern and Central Africa, 1992"

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STATISTICAL SUMMARY: MALAWI

GDP Contribution by Sector

Sector	1992
Agriculture	30.9%
Manufacturing	13.9%
Electricity and Water	2.5%
Distribution	13.0%
Transport and Communications	5.9%
Financial/ Professional Services	7.3%
Government and other Services	24.1%
Construction	4.5%

derived from statistics in "Economic Report: 1992", Department of Economic Planning and Development, Malawi

STATISTICAL SUMMARY:MOZAMBIQUE

YEAR	1992	1991	1990	1989
population	16,617,000	16,200,000	15,700,000	15,300,000
population growth	2.1%	2.1%	n/a	n/a
GDP (bil $)	n/a	1.9	1.32	1.1
real GDP growth rate	(2.7)	2.4	1.3	5.4
inflation (CPI)	45%	33%	49%	42%
average MT/US$ exchange rate	2000.0	1845.0	1038.0	747.1
per capita GDP ($)	n/a	80	80	90
investment/GDP[2]	47.1%	42.1%	38.1%	35.5%
savings/GDP[1]	n/a	n/a	(11.7)	(16.6%)
merchandise trade balance (mil $)[1]	n/a	n/a	(737.8)	(702.9)
exports (mil $)[1]	n/a	n/a	126.4	104.8
imports (mil $)[1]	n/a	n/a	864.2	807.7
total debt (bil $)	4.39	4.7	4.9	4.74
debt service/total exports	n/a	10.6	n/a	23.1%
money supply growth[3]	n/a	33.4%	31.9%	45.7%
# of private banks	3	1	1	1
literacy rate	32.9%	33%	33%	38%
life expectancy	n/a	47	47	48

Sources: "World Bank Development Reports" 1991, 1992, 1993 and World Bank, "Mozambique: Issues for the Transition from Emergency to Sustainable Growth" except as noted

[1]World Bank, "Mozambique: Financial Sector Study", 1992
[2]Plano Economico y Social 1993, provided by USAID Mission, Maputo
[3]Mozambique Office for Investment Promotion, "Investor's Guide: Investing in Mozambique", from Bank of Mozambique statistics

GNP Contribution by Sector

Sector	1990	1991
Agriculture & Cattle	40.2%	37.4%
Industry & Fishing	23.1%	22.9%
Construction	11.9%	13.2%
Transport & Communication	8.5%	9.4%
Commerce & other	16.2%	17.2%

from Mozambique Office for Foreign Investment Promotion statistics

STATISTICAL SUMMARY: NAMIBIA

YEAR	1992	1991	1990	1989
population	1,440,000	1,400,000	1,370,000	1,330,000
population growth	3.0%	3.0%	3.0%	3.0%
GDP (bil $)	1.54 (est.)	1.42	1.36	1.28
real GDP growth rate	2.0% (est.)	5.1%	3.0%	(1.5%)
inflation (CPI)	15.0% (est.)	16.8%	9.7%	13.9%
average R/$ exchange rate	2.73	2.76	2.59	2.62
per capita GDP	1,541 (est.)	1,423	1,359	1,275
merchandise trade balance (mil $)[1]	n/a	(53)	(152)	(135)
exports (bil $)[1]	n/a	1.182	1.069	1.121
imports (bil $)[1]	n/a	1.235	1.221	1.256
total debt (mil $)	n/a	295	299	281
# of private banks[2]	5	5	5	5
capitalization of private banks (mil $)[2]	47.2	n/a	n/a	n/a
assets of private banks (mil $)[2]	989.7	n/a	n/a	n/a
life expectancy[3]	n/a	58	57	57

Source: "Commercial Activity Report '93 - Namibia" and "Foreign Economic Trends - Namibia", 1992, by the US Embassy, Windhoek, except as noted

[1]World Bank, "World Tables", 1993
[2]KMPG Peat Marwick, "Banking Survey: South Africa including Southern and Central Africa", 1992
[3]World Bank, "World Development Report", 1991, 1992, 1993

N.B.: Namibia became independent from South Africa in 1990, so statistics prior to 1991 are derived from South African regional estimates

STATISTICAL SUMMARY: REPUBLIC OF SOUTH AFRICA

YEAR	1992	1991	1990	1989
population	39,800,000	38,900,000	38,000,000	37,100,000
population growth	2.4%	2.4%	2.4%	2.3%
GDP (bil $)	114.8	107.9	102.1	88.9
real GDP growth rate	(2.1%)	(0.6%)	(0.5%)	2.3%
inflation (CPI)	13.9%	15.3%	14.4%	14.7%
average R/US$ exchange rate	2.86	2.78	2.56	2.63
per capita GDP ($)	2884	2774	2687	2396
investment/GDP[1]	n/a	16%	19%	21%
savings/GDP[1]	n/a	21%	25%	26%
merchandise trade balance (bil $)	6.5	6.3	5.2	5.3
exports (bil $)	23.5	23.7	23.4	22.2
imports (bil $)	17.0	17.4	18.2	16.9
foreign exchange reserves (bil $)	3.2	3.0	2.4	2.0
total debt	17.3	18.1	19.4	20.6
debt service/totaln exports	6.7%	7.5%	7.1%	n/a
# of private banks	47 (4 main)	n/a	n/a	n/a
assets of 4 main private banks (bil $)[2]	25.19	n/a	n/a	n/a
value of daily turnover on stock exchange (bil $)[2]	n/a	8.25	n/a	n/a
unemployment rate	43%	40%	37%	35%
life expectancy[1]	n/a	63	62	61.5

Source: "Foreign Economic Trends" from 1993 and 1992, US Embassy, Pretoria, except as noted.

[1]World Bank, "World Development Reports", 1991, 1992, 1993
[2]Arie Beenhakker, "South African Financial Sector Profile", November 1993

GDP Contribution by Sector

Sector	1991
Agriculture	6%
Mining and mining input industries	33%
Manufacturing	26%
Trade & Tourism	14%
Finance & Business Services	15%
Government & other services	6%

from "Investment Climate Statement - South Africa" by the US Embassy, Pretoria

STATISTICAL SUMMARY: SWAZILAND

YEAR	1992	1991	1990	1989
Population	825,000	780,000	750,000	720,000
population growth	4.1%	3.4%	3.4%	3.4%
GDP (mil $)	722.9 (est.)[1]	736.9 (est.)[1]	703.9	600.8
real GDP growth rate	(1.9%)[1] (est.)	4.7% (est.)[1]	9.8%	2.5%
inflation	8.8% (through July 1992)	14.7%	13.5%	8.2%
average Em/US$ exchange rate	2.74	2.76	2.59	2.62
per capita GDP ($)	880 (est.)	940 (est.)	902	801
investment/GDP[2]	23.8%	26.5%	23.7%	n/a
merchandise trade balance (mil $)[1]	(93.1)	(61.6)	(12.1)	(21.7)
exports (mil $)[1]	628.4	575.2	563.7	494.3
imports (mil $)[1]	721.5	636.8	575.8	516.0
foreign exchange reserves (mil $)	n/a	221.5	205.2	176.4
total debt (mil $)	213.4	208.6	213.7	215.9
debt service/total exports	n/a	3.0%	8.5%	7.7%
# of private banks[3]	4	4	4	4
capitalization of private banks (mil $)[3]	18.6	n/a	n/a	n/a
assets of private banks (mil $)[3]	304.3	n/a	n/a	n/a
literacy rate[4]	n/a	n/a	n/a	68%
life expectancy[4]	n/a	57	56.5	56

Source: "Foreign Economic Trends, 1993 - Swaziland", by the US Embassy, Mbabane, except as noted

[1]Central Bank of Swaziland, "Annual Report, 1992-93"
[2]Union Bank of Swaziland, "Swaziland in Figures", 1993/94
[3]KMPG Peat Marwick, "Banking Survey: South Africa including Southern and Central Africa", 1992
[4]World Bank, "World Development Report", 1991, 1992, 1993

STATISTICAL SUMMARY: SWAZILAND

GDP Contribution by Sector

Sector	1992 estimates
Agriculture & Forestry	20%
Manufacturing	41%
Mining	3%
Trade & Tourism	5.5%
Transport & Communications	4.5%
Finance	5%
Government	21%

from "Swaziland Business Yearbook: A Commercial Guide", 2nd ed., 1993

STATISTICAL SUMMARY: TANZANIA

YEAR	1992	1991	1990	1989
population	27,200,000	26,400,000	25,600,00	24,800,000
population growth	3.1%	3.1%	3.2%	3.4%
GDP (bil $)	3.64	3.53	3.42	3.29
real GDP growth rate	2.9%	3.2%	4.2%	4.8%
inflation	20%	24%	26%	28.9%
average shilling/$ exchange rate	300	234	200	243.4
per capita GDP ($)	133.7	133.9	133.8	1[illegible].6
investment/GDP[1]	n/a	22%	25%	21%
savings/GDP[1]	n/a	(11%)	(6%)	(5%)
merchandise trade balance (mil $)	(980)	(968)	(964)	(897)
exports (mil $)	440	428	422	407
imports (mil $)	1420	1396	1386	1307
foreign exchange reserves (mil $)	220	106.4	90.6	54.2
total debt (bil $)	5.722	6.012	6.097	5.090
debt service/total exports	43.2%	44.8%	46.7%	48.9%
# of private banks[1]	2[3]	2	2	2
life expectancy[2]	n/a	51	51	49

Source: "Foreign Economic Trends - Tanzania", 1993, US Embassy, Dar es Salaam, except as noted

[1] World Bank, "World Development Report", 1991, 1992, 1993
[2] "Country Program Strategic Plan, USAID Tanzania, 1992-1997", August 1992
[3] Two other banks have applied for charters, which are expected to be granted in the near future.

STATISTICAL SUMMARY: ZAMBIA

YEAR	1992	1991	1990	1989
population	8,640,000	8,390,000	8,140,000	7,880,000
population growth	3.4%	3.2%	3.2%	n/a
real GDP (bil $ in 1977 prices)	2.84	2.91	2.97	n/a
real GDP growth rate[1]	(2.8%)	(1.8%)	(0.5%)	n/a
inflation (CPI)[1]	207%	118.4%	105.3%	n/a
average ZK/$ exchange rate	175	64.9	31	n/a
per capita GDP ($)	348	364	381	n/a
investment/GDP[2]	15.5%	15.0%	13.9%	n/a
savings/GDP[2]	12.6%	12.0%	16.6%	n/a
merchandise trade balance (mil $)	(177)	314	137	470
exports (bil $)	1.10	1.13	1.25	1.34
imports (bil $)	1.28	0.81	1.11	0.87
foreign exchange reserves (mil $)	184	211	176	n/a
total debt (bil $)	6.99	7.20	6.65	n/a
money supply growth[1]	99%	98.2%	65%	n/a
debt service/total exports	70%	65%	65.8%	n/a
# of private banks	13	n/a	n/a	n/a
assets of private banks (mil $)[3]	645.6 (est.)	n/a	n/a	n/a
literacy rate[4]	n/a	80%	73%	77% (1985)
life expectancy[5]	n/a	49	50	51

Source: "Foreign Economic Trends - Zambia", August 1993 by the US Embassy, Lusaka, Zambia, except as noted

[1] Bank of Zambia
[2] Price Waterhouse, "Investor's Guide to Zambia", 1992
[3] KMPG Peat Marwick, "Banking Survey: Southern and Central African Banks", 1992
[4] USAID, "Country Program Strategic Plan, 1993-1997 - Zambia", June 1993.
[5] World Bank, "World Development Report" 1991, 1992, 1993

GDP Contribution by Sector

Sector	1991
Mining	7.3%
Agriculture	15.7%
Manufacturing	36.3%
Services	10.0%
Construction	3.1%
Government & other services	15.8%

from Price Waterhouse, "Investors Guide to Zambia", 1992

STATISTICAL SUMMARY: ZIMBABWE

YEAR	1992	1991	1990	1989
population	10,390,000 (est.)	10,080,000	9,800,000	9,500,000
population growth	3.8% (est.)	3.1%	n/a	n/a
GDP (bil US$)	n/a	6.19	6.77	6.43
GDP growth rate	(9.0%) (est.)	3.6%	2.1%	4.7%
inflation	40.4% (est.)	23.7%	15.7%	11.6%
average Z$/US$ exchange rate	5.1	3.4	2.4	2.1
per capita GDP (US$)'	n/a	660	690	650
investment/GDP	12.0% (est.)	12.6%	17.3%	19.0%
savings/GDP	25.0% (est.)	22.0%	20.1%	19.0%
merchandise trade balance (mil US$)	n/a	(550)	(100)	150
exports (bil US$)	n/a	1.65	1.7	1.65
imports (bil US$)	n/a	2.2	1.8	1.5
foreign exchange reserves (mil US$)'	n/a	149.7	149.2	94.6
total debt (bil US$)'	n/a	3.43	3.25	2.79
debt service/total exports	25.1% (est.)	21.6%	22.0%	24.0%
money supply growth	25.1% (est.)	30.0%	22.4%	19.8%
# of private banks'	6	n/a	n/a	n/a
capitalization of private banks' (mil US$)	121.9 (est.)	n/a	n/a	n/a
assets of private banks (bil US$)'	1.615 (est.)	n/a	n/a	n/a
avg. daily volume traded on stock exchange'	450,000 shares	n/a	n/a	n/a
literacy rate'	67%	67%	67%	74% (1985)
life expectancy'	56	60	61	64

Source: USAID, 'Country Program Strategic Plan, FY 1994-1998 - Zimbabwe', 1993, except as noted

'World Bank, "World Development Report", 1991, 1992, 1993
'African Development Bank, "African Development Report 1993"
'"Commercial Activity Report, 1993", US Embassy, Harare
'KMPG Peat Marwick, "Banking Survey: South Africa including Southern and Central Africa", 1992
'Equinox Investment Advisors, "Proposal for an Africa Equity Fund", 1993

STATISTICAL SUMMARY: ZIMBABWE

GDP Contribution by Sector

Sector	1991
Agriculture	13%
Manufacturing	26.5%
Minerals	7.5%
Construction	1%
Finance & Insurance	6.5%
Transport & Hotels	18%
Government & Other Services	27.5%

from USAID Country Program Strategic Plan, FY 1994-1998 - Zimbabwe", 1992

ANNEX D
INVESTMENT CLIMATE ANALYSIS FOR 10 COUNTRIES IN REGION

Note on country profiles

These are taken from US government reports (Foreign Economic Trends, etc.) on ten of the eleven countries in the southern Africa region (Angola has been excluded as our research indicates that there is no potential in the current state of turmoil there for venture capital to be a useful tool for development at present). They are intended to provide background information on the economic environments, sectoral strengths and weaknesses, policies, infrastructure and opportunities in the various countries, but not to be exhaustive studies.

BOTSWANA

At independence in 1966, Botswana was one of the 20 poorest countries in the world with minimal infrastructural development and a predominately subsistence economy. Government revenues were critically dependent on foreign aid and the remittances of the Batawana males employed in South Africa. Moreover, there were no obvious prospects for economic development outside the beef sector. During the 1980's, however, Botswana's economic performance exceeded that of all other non-petroleum producing countries in Africa. Gross domestic product (GDP) rose, in real terms, by an annual average of 11.3% in 1980-89, giving Botswana one of the world's highest growth rates. This exceptional record was partly due to the rapid expansion of the beef industry, but the predominant cause was the discovery and development of valuable mineral resources, especially diamonds. Apart from transforming Botswana's export base, the development of the mining sector has also helped to stimulate and finance the development of the infrastructure, the manufacturing and the social services.

Faced with a high population growth rate and growing unemployment, Botswana is placing heavy emphasis on private sector growth and job creation, especially in manufacturing and agriculture. Areas of increased government expenditure include education, housing, primary health care, and commercial and trade development. The budget for educational, commercial, and local development programs has increased considerably over the last few years. School fees for secondary education were abolished in 1988, with the result that all education through university level is now free.

Import and Tariff Regulations: Botswana, Lesotho, Swaziland, Namibia, and South Africa form the Southern African Customs Union (SAC). Goods are freely traded between members of SAC, and imports into the union face a common external tariff. Botswana's membership in SAC effectively expands its market substantially.

Botswana, Lesotho, and Swaziland are members of the British Commonwealth and signatories to the Lome III Convention. As a result, their exports receive special tariff preferences with other Commonwealth members and with the European Economic Community. In addition, by virtue of Title V of the U.S. Trade Act of 1974, and the Trade Act of 1984, these nations participate in the U.S. Generalized System of Preferences (GSP), which grants beneficiary developing countries duty-free treatment into the United States on a wide range of manufactured and semi- manufactured goods.

Manufacturing: The country's economic development plans call for diversification, including expanded investment in manufacturing. Since 1987, Botswana's light industrial sector has grown at a rate of about 5 percent annually. Textile products represent an important segment of this sector and one which is expected to expand over the next few years and to exceed the rate of growth in other segments. Botswana's major textile markets are the countries of the European Economic Community, South Africa, and Zimbabwe.

Botswana's small size, (1.3 million population), requires extensive development of export markets to produce lasting growth. Because of the competition it faces from South African products, (which enter duty free under the Southern African Customs Union agreement), the manufacturing sector in Botswana has developed slowly. Botswana's membership in the Customs Union, however, provides Botswana-based exporters duty-free access to a market of about 35 million people.

Tourism: Tourism earns the country some foreign exchange, but it has yet to make a major contribution to the country's total output. In 1988, about 61,000 holiday visitors came to Botswana and spent approximately $32 million. The development of the country's unique tourist areas -- the Kalahari desert, the Okavvango delta, and the Chobe game reserve -- could make tourism one of the country's foremost growth sectors. Botswana is presently formulating a national tourism policy, including policy guidelines on promotion and investment in tourism areas and preservation of the country's natural habitats.

Investment and Tax Incentives: In an effort to encourage new industrial/manufacturing firms to establish themselves in Botswana, the government has adopted several new programs, one of the more attractive being the Financial Assistance Policy which
is available to foreign investors. Some of the major terms of the policy are: a) firms will be reimbursed 50 percent of cost of training Botswana employees; b) the government will give an outright grant for each unskilled laborer employed; c) in addition, new firms receive a tax holiday for five years, ranging from no taxes for years 1 and 2, and graduated taxes for the following three years.

LESOTHO

The Kingdom of Lesotho is a small, independent nation totally surrounded by the Republic of South Africa. It is, economically, one of the world's least developed countries, with few natural resources apart from modest diamond deposits and the hydroelectric power potential of its swift-running rivers. Only about 13 percent of the land area is arable, and large areas suffer from soil erosion, population pressures and overgrazing. Of the economically active population, up to one-quarter are employed as migrant workers in South Africa, reflecting a continuing lack of opportunities in the domestic formal sector, despite government attempts to develop manufacturing and services. The country's GDP increased by an annual average of 6.8% in 1965-80. From 1981 the economy had to contend with the impact of the cessation of diamond exports, drought and the problems of the intimately linked South African economy, particularly in terms of the depreciation in the value of the South African rand, which is at par with the Lesotho currency unit, the loti (plural: maloti).

Agriculture: Agriculture is the largest component of GDP, accounting for about 21 percent in 1988. Although agricultural growth has been low for much of the decade of the 80s, the agricultural sector was estimated to have expanded by 9.3 percent in 1988. The sector is dominated by the production of livestock and livestock products, of which wool and mohair are the principal exports. Improvements to crop and livestock productivity, as well as improved resource management, are major elements of U.S. economic assistance to the Kingdom. Lesotho is currently involved in a gigantic Highlands Water Project. When completed, the water transfer scheme will reroute massive quantities of surplus water from Lesotho to South Africa's water- starved industrial Transvaal Province while generating enough power to make Lesotho self-sufficient in electricity. The Highland Water Project offers huge potential commercial opportunities.

Manufacturing: Lesotho's manufacturing activities are a small but increasingly important sector of the economy. Manufacturing grew by an average of 12.7 percent from 1968-88, and increased its share of GDP from 8 percent in 1984 to almost 11 percent in 1988. The production of clothing and textile products is the fastest growing area in the industrial sector. Manufactured export products include footwear, sportswear, and umbrellas. Many investors from the Far East and South Africa are taking advantage of Lesotho's investment incentives and nearly global preferential market access to set up manufacturing operations in the country. There is also a growing focus on handicraft production, particularly wool and mohair tapestries, rugs, hand knits, pottery and grass-woven products. Agro-industries continue to be an important component of the manufacturing sector. These include flour milling, fruit and vegetable processing, leather tanning, and brewing. Future enterprises are expected to produce disease free seeds for export to the continental African market.

Tourism: Although the number of tourists, mostly from South Africa, increased 43 percent from 1983 to 1987, Lesotho's tourist industry is small and largely underdeveloped. Maseur, the capital city, has several excellent hotels with both conference and casino facilities, but quality accommodations elsewhere in the country are presently limited. The Lesotho

Government has placed high priority on expanding the tourist industry and hopes that the construction of lakes and access roads in connection with the Highlands Water Project will stimulate tourism and attract potential investors. Tourist attractions to be developed include water sports, lodge construction, mountain climbing, skiing and fishing.

Investment Climate: There is no discrimination between local and foreign investors nor is there a mandatory local shareholding requirement. Full foreign ownership in a locally established company is permitted. No investment disputes are under way, nor have any ever been known to have occurred. There have been no cases of nationalization or expropriation. Foreign investors are free to repatriate profits, capital, and royalties. The same tax laws apply to both foreign-owned and local firms, although foreign firms may receive various tax concessions, including a possible 15-year tax holiday. Any company starting a new manufacturing plant in Lesotho, or substantially expanding an existing one, may apply to the Lesotho National Development Company for a non-repayable cash grant to cover 75 percent of employee training costs.

MALAWI

Malawi is a landlocked country in southeastern Africa of 37,000 square miles--about the size of Pennsylvania. With an estimated 1990 per capita GDP of $231 and a population of 8.9 million, Malawi ranks among the world's least developed countries. Approximately 85 percent of Malawi's work force is engaged in agriculture, which accounted for 36 percent of GDP and 90 percent of export earnings in 1989. Malawi has relied upon a successful agricultural sector as the primary engine for development since independence in 1964. Normally self-sufficient in staple food production given favorable climatic conditions, Malawi also produces tobacco, tea, sugar, groundnuts, coffee, and cotton. However, drought and mealy bug infestation in 1987, another long dry spell in 1989, and a burgeoning refugee population (900,000 by December 1990) combined to disrupt the performance of the economy.

Over the next several years, Malawi's ability to import will depend largely upon hard currency earnings from its major exports (tobacco, tea, sugar, and coffee), external aid flows, and success in maintaining reliable and cheaper transportation routes. Transport routes still face continuing security problems as a result of the civil war in Mozambique.

Investment opportunities have been emerging within the parastatal sector (governmental controlled, commercial enterprises) as the government seeks to privatize several holdings. Several industrial projects are under consideration, including a fertilizer plant, and a $150 million hydroelectric project. The expanding tourist industry offers potential for investment in hotels and recreational areas. The United States has an Overseas Private Investment Corporation agreement with Malawi, and several U.S. companies use OPIC coverage. In May 1990, a USAID-sponsored trade/investment mission visited Malawi to explore opportunities. The response by the Malawian Government and business community was enthusiastic and encouraging.

There were an estimated 1.9 million radio receivers in use in Malawi in 1988. There is no television service in Malawi.

MOZAMBIQUE

Mozambique remains the poorest country in the world, according to 1992 World Bank statistics, with GDP per capita at $80 per year. Severe drought and the displacement and destruction caused by the civil war slowed economic growth to only 1.2 Percent in 1992. However, a good rainy season and the end of hostilities, following the October 1992 signing of the general peace agreement between the government (GRM) and RENAMO, significantly improve Mozambique's prospects for economic growth for the rest of the decade. However, Mozambique's economy remains very vulnerable to another drought or a return to civil war.

The World Bank forecasts annual GDP growth rates of 5 percent for Mozambique over the next four years, provided the government adheres to its economic and social rehabilitation program (ESRP). The ESRP aims to foster economic growth and reduce poverty through reforms in exchange rate, tariff, pricing and public expenditure policies. Privatizations of state owned or operated enterprises, mostly through joint ventures, is a major component of the ESRP.

On April 1, 1992 all foreign exchange transactions were shifted to the secondary market, and the export retention scheme was eliminated. At that time the official exchange rate was also abolished. The metical devalued further in 1992 and is near its market clearing rate. Merchandise exports have responded positively to the weakening of the metical and the reform of the system of foreign exchange allocation. Imports have fallen slightly with the higher price of foreign exchange.

Foreign exchange imported into Mozambique may be fully repatriated. Dividends may be remitted according to the percentages negotiated at the time a company receives its operating permit from the ministry of finance.

Mozambique's economy remains aid driven. It currently depends on grant and concessional donor financing for almost all of its domestic investment, as well as a substantial amount of recurrent expenditures. Net disbursement of overseas aid from all sources was US$49 per capita in 1990, the most recent year available.

NAMIBIA

Namibia, the world community's newest independent member, becoming independent on March 21, 1990, covers an area of 320,000 square miles, about twice the size of California. With a GDP officially estimated at US$1,022 per capita in 1989, and unofficially estimated to be higher, Namibia appears to be relatively prosperous in the African context. This reflects a large and relatively diversified mining sector, producing diamonds, uranium and base metals. Large ranches also provide significant exports of beef and sheepskins in normal years. Yet the economy is badly integrated. About 90% of the goods that Namibia produces are exported, and about 90% of the goods that are used in the territory, including about one-half of the food, are imported. Furthermore, the figure for GDP per capita disguises an extreme inequality in income distribution-the average income for the white minority is significantly higher than that for the mass of the black population.

Inflation averaged 14 percent during 1989. The South African economy greatly influences Namibia's inflation rate as Namibia continues to be a part of the Rand Monetary Area (South Africa, Lesotho, and Swaziland) using the South African Rand as currency. Monetary policy is therefore determined by Pretoria. In addition, foreign exchange transactions are subject to the controls of the South African Reserve Bank, which acts as the central bank of Namibia. The Namibian government is setting up a central bank and expects to leave the Rand Monetary Area soon. At independence Namibia became a member of the Southern African Development Co-ordination Conference (SADCC), which aims to reduce the region's economic dependence on South Africa. In September 1990 Namibia joined the International Monetary Fund.

Namibia is the world's leading producer of gem-quality diamonds, accounting for some 30% of total world output. In addition, Namibia has the world's largest uranium mine, and some of the world's largest known reserves of tin and lithium. Namibia is Africa's second largest producer of lead, its third largest producer of cadmium and fourth largest source of zinc and copper. Other important minerals include hydrocarbons, tungsten, vanadium, silver, gold, columbite/tantalite, germanium and beryl.

Agriculture and Fishing: War, drought (which affected some areas continuously from 1978 to 1985), overgrazing and unscientific farming methods have had an adverse effect on the agricultural sector. The contribution of agriculture and fisheries to GDP, however, increased from 7.3% in 1986 to 11.3% in 1989. Namibia has a fragile ecology, and most of the territory can support only livestock.

Colonial history bequeathed Namibia three different agricultural sectors: about 4,000 large commercial ranches, almost all white-owned; 20,000 African stock-raising households, compressed into central and southern reserves; and 120,000 black families practicing mixed farming on just 5% of the viable farmland in the far north. At the time of Namibia's independence about 50% of the country's commercial farms were owned by absentee landlords; the possible re-distribution of such land was an important political issue. In

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mid-1991 a national land reform conference resolved that abandoned and under-utilized land would be re-allocated and that ownership of several farms by one person would not be permitted. In 1990, following independence, Namibia signed the Lome Convention, agreeing to supply an EC quota of 10,500 tons of beef in 1991 and 1992, rising to 13,000 tons in 1993. Some 84% of commercial beef production had previously been exported to South Africa. The Lame Convention agreement gives Africa, Caribbean, and Pacific countries preferential access to European Community markets. Potentially, Namibia has one of the richest fisheries in the world and the fishing industry was formerly second in exporting to mining, which plays a dominant role in Namibia's economy.

Manufacturing: Manufacturing employs 5.1 percent of the formal sector work force and contributes 7 percent of Namibia's GDP. About 400 industrial enterprises operate in Namibia, more than half of which are located in Windhoek, the capital. Food processing businesses (primarily fish and meat) constitute the largest share of the sector. Other significant industries include textiles, wood working, furniture manufacturing, transportation equipment, metal products, chemical products, printing and publishing.

While the sector enjoys a well-developed infrastructure and financial institutions, the domestic market for manufactured goods is small, and the labor is largely unskilled. Potential for development exists in industries linked to Namibia's primary sector activities (mining, agriculture, and fishing). These may include processing of minerals, transportation of minerals, manufacture of mining and agricultural equipment, and processing of beef for export. The First National Development Corporation, run by the Namibian Government, will aid private investment in manufacturing activities.

Services: South African companies dominate Namibia's banking and real estate industries. The two biggest commercial banks are First National Bank (formerly Barclays Bank) and Standard Bank. The SWA Building Society (SWABS), established by seven South African building societies, finances upper and middle income housing projects. The National Building and Investment Corporation (NBIC) finances low-income housing. Both SWABS and NBIC operate predominantly in the main urban centers.

Namibia is home to some of Africa's most spectacular landscapes, yet its tourist sector is relatively underdeveloped. Conservation areas and recreation resorts cover 12 percent of the country's total surface area. The government is eager to develop the sector with private sector cooperation and investment. Preserving the fragile ecology will be an important component of tourism policy. Development of the sector will require creation of hotels and small safari camps, and investment in local air transport. High-cost, low-volume tours, with minimum disturbance, are likely to be favored.

Trade and Investment Climate: The government's development priorities are: expand smallholder farming with a view towards national self-sufficiency in food production; develop infrastructure and related services (electricity, water, and communications) throughout the country; and improve public services in health and education. The government expects to execute these programs through grant aid from bilateral and multilateral donors. The United Nations Development Program is coordinating most aid flows to Namibia.

Investment possibilities are in agriculture, mining and processing industries. The First National Development Corporation (FNDC) assists in the identification of investor projects and in the coordination of local and foreign investors, development agencies, and financing. The FNDC has compiled a significant list of projects seeking investor participation, most of which are in the area of processing industries for primary commodities.

REPUBLIC OF SOUTH AFRICA

South Africa's diverse climate permits the cultivation of a wide range of crops but, largely because of inadequate and erratic rainfall, only about 15% of the land surface is suitable for arable farming. It is in mineral deposits that South Africa's greatest wealth lies. There are abundant deposits of nearly every mineral in the country. South Africa, in 1980, was the largest producer in the Western world of chromium, manganese and vanadium; the second largest producer of platinum, diamonds, vermiculite, antimony, asbestos and fluorspar; and the third largest producer of uranium. The country's reserves of manganese, platinum, vanadium, fluorspar and sillimanite are estimated to be the largest in the Western world. In addition, it is a major producer of copper, lead and zinc.

Only two major mineral products - petroleum and bauxite - have not been found in economic quantities. However, in February 1985 the Southern Oil Exploration Corp. (SOEKOR), a government-owned company which had been involved since 1965 in an intensive search for petroleum deposits, announced that a discovery offshore at Mossel Bay, off the south coast of Cape Province, had yielded a daily output of 2,600 barrels of light crude and 1 million cubic meters of natural gas.

The chief characteristic of South Africa's population, and the one that dominates its society, is the great racial, linguistic and cultural heterogeneity of its people. The four broad groups making up the population are: i) Africans, who are member of the Bantu-speaking group of African tribes; ii) whites who are of European descent; iii) Coloreds, who are of no distinct racial origin; and iv) Asians, mainly Indians.

The total population of the Republic of South Africa as of the March 1985 census was 23.4 million. The population of the region, including the independent homelands, is estimated to be growing at the rate of 2.5% per year, and the population of the region is estimated to be 38.9 million in 1991.

Economic Overview: The South African economy, once based almost entirely on agriculture, was transformed rapidly by the discovery of diamonds in 1867. For the next 60 years, mining was the greatest single source of national income. The Second World War, which had cut off traditional sources of supply, boosted local manufacturing to such an extent that secondary industry soon emerged as the major contributor to the gross GDP, a position it still holds. In spite of this transformation of the economy, mining exports are still 49 percen' .xports of goods and services. In 1989 GDP amounted to R237 billion with the most important contributions made by manufacturing with 23 percent, mining 13 percent, commerce 11 percent, transportation and communications 9 percent, and agriculture 7 percent.

In recent years, government economic policy makers have conceded that past policies contributed to structural problems that have hampered South Africa's economic performance in the last decade. Chief among these are persistent inflation (estimated to be in the range of

15 percent in 1990), low domestic savings rates, the use of scarce capital to replace labor, and stagnation of production, employment and productivity.

The overriding economic policy consideration remains the need to suppress domestic spending and hence the demand for imports in order to maintain a sufficient current account surplus to cover South Africa's debt obligations. Since 1985, South Africa has been denied access to foreign capital and has been unable to refinance any significant portions of its debt. The resulting balance of payments pressures have forced the government to constrain the economy below its historic growth potential.

Nevertheless, South Africa is the economic powerhouse of southern Africa and outproduces by far any other economy on the entire continent. With less than a third of the population of southern Africa, South Africa contributes about three-fourths of the region's GDP and two-thirds of its exports. South Africa's
infrastructure is far more advanced than its neighbors. Its financial and transportation sectors, for example, are fully developed and can easily dominate the rest of the region.

The country's economy is best described by the term "partially free enterprise," a phrase used by a major bank to explain the extensive state involvement in the economy. The bulk of manufacturing, mining, agriculture, commerce and finance is privately held. However, state owned firms have near monopolies--telecommunications, postal services, water supply, television, railways and harbors -- and dominant market positions -- commercial radio broadcasting, pipelines, electricity generation, diesel engines, freight haulage, internal and external air services, phosphate production and armaments manufacture -- that permeate the economy. At present there is a national debate about reducing the state's control of and direct participation in the economy.

South Africa's economic future is uncertain as the country enters the transition from the apartheid era to majority rule. While South Africa faces an uncertain economic future, it does offer substantial inducements for foreign investors, among other things: a substantial market with significant growth potential, a free market tradition, little distinction between foreign and local firms, investment incentives, access to many of the other markets in Africa, good communication and transportation links with the rest of the world, liberal repatriation of profits and other earnings, lower labor costs than in Western industrialized countries (although productivity is also lower), and availability of cheap power and many raw materials.

The Financial Rand Incentive: South Africa place no restrictions on the reinvestment of profits and earnings of U.S. corporations and individuals. The only regulations affecting repatriation of earnings and capital are those contained in the foreign exchange control system. Equity investments from abroad usually enter via the financial rand which give a favorable rate in rand per dollar, at present about 37 percent, over the commercial rand. Dividends and profits are repatriated at the commercial rand rate. However, capital gains and proceeds from the sale of equity are repatriated at the financial rand rate. Loans usually enter through the commercial rand and proceeds as well as payment of loans are via the commercial rand.

Tax Treatment: The general principle is that taxes are levied only on income derived from a source within or deemed to be within the Republic of South Africa. This principle applies to resident and non-resident individuals and companies. Income taxpayers are divided into two basic categories: individuals, who are taxed at progressive rates, and companies, taxed at 50 percent of taxable income (mining companies excepted). Withholding taxes are imposed on interest and royalties remitted to non-residents. Capital gains are tax free. Undistributed profits are taxed at 33.3 percent, but companies owned 50 percent or more by non-residents are usually exempt from this tax. Companies make provisional tax payments at six months after the beginning of the financial year, at the end of the financial year, and six months after the end of the financial year.

Access to Credit Markets: Foreign owned firms do not have unlimited access to local credit. As a rule, domestic borrowing by South African subsidiaries is limited to about 50 percent of the effective foreign capital invested in the local concern. There is a measure of flexibility, however, and applications are considered in the light of the domestic situation and the national importance of the project. In instances where South African residents participate in the equity of the company, the limit of 50 percent is increased in the ratio of the local to foreign participation.

Foreign investors may freely transfer current earnings on any capital investments made in the country, subject to non- resident shareholders' tax and tax on interest payable to non-residents. However, where local borrowing by non-resident controlled locally incorporated subsidiary companies is out of all proportion to the amount of foreign funds invested therein, restrictions may be imposed on the transfer of dividends. Interest payments are also freely transferable provided the rate is reasonable for the type of loan involved. Royalty payments and technical service fees are permissible transfers, but the underlying agreements require the prior approval of the Department of Trade and Industry and Exchange Control.

Investment Incentives and Performance Requirements: To develop industry in outlying areas, the government in 1960 launched a program aimed at the decentralization of economic activity and, in 1982, revamped the regional industrial development incentives, which were aimed, first, at decentralization and, second, at employment creation. The main objective of this regional development program was to encourage new and existing labor-intensive industries to establish themselves in the less developed areas of the country where there normally is a surplus of labor, without any undue disruption on industry in the developed areas.

These incentives are divided into two-categories, namely, long-term incentives which are intended for existing industries and short-term incentives which are intended to assist short-term financing problems experienced by industries relating to new projects or the relocation of industries.

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The long-term incentives include: transportation rebates, electricity concessions, housing subsidies for key personnel, training allowances or grants, and price preferences in connection with purchases by the public sector.

The short-term incentives include: wage subsidies for periods of up to 7 years, interest subsidies on investments in land and buildings for periods up to 10 years, rental subsidies, and cash grants for relocations of on-going business concerns.

Labor: South African labor is characterized by the anomaly of massive unemployment coupled with a critical shortage of skilled labor. The government released figures in January 1990 showing Black unemployment in September 1989 was 13 percent, continuing a steady decline since 1986. Most observers, however, consider that statistic to be unreliable. It excludes, for example, unemployment in the homelands. More generally accepted estimates put Black unemployment at more than 20 percent overall, and as high as 35 percent in urban areas.

The forecast for unemployment in the future looks even grimmer. A South African Chamber of Business spokesperson recently predicted that increased urbanization, capital intensification in industry and a slack economy will all contribute to continuing growth in unemployment. The economy, which averaged annual growth of only 1.5 percent during the 1980's, seems unlikely to expand fast enough to absorb a significant percentage of new job seekers with a population growth rate of 2.5 percent.

The Chairman of South Africa's Parliamentary Standing Committee on Manpower has estimated that by the year 2000 there will be almost four times the number of unskilled workers as job opportunities, but twice as many skilled job openings as skilled workers. Apartheid can account for most of that incongruity, with the country's Bantu education system the most often cited villain. School boycotts have only exacerbated the problem. Decrying an inferior education system that robs them of skills while good jobs go begging, Black workers have demonstrated against and struck firms that have brought in foreign workers to fill skilled positions.

Black consumer markets are growing faster than those of the white population. Black consumers have historically preferred American design, style and quality. Clothing, toiletries, hair care products, children's toys and accessories plus other products targeted to Black consumers offer business opportunities to U.S. companies. In addition, franchising of Black entrepreneurs is an excellent opportunity for U.S. franchisors. Franchising opportunities exist in printing, hair dressing and beauty treatment, office and industrial cleaning, home carpet cleaning, industrial catering, auto parts and servicing and plant maintenance.

Doing Business with Black South Africans: According to South African marketing organizations, Black South Africans accounted for $7.6 billion or close to 50 percent of all consumer spending in that country during 1985. This consumption ranges from the highs of 66 and 64 percent respectively for food and clothing to 30 and 22 percent for transportation and insurance. By the year 2000, Black South African consumer spending for food and clothing should grow to 75 percent. The value of the consumer market in Black urban areas is especially seen in Soweto, a sprawling urban area south of Johannesburg with a population approaching 2 million. Average household income was up to $4,812 in 1985. The percentage of households in the higher income groups of $6,000 plus rose from 15 percent to 25 percent in real terms between 1975 and 1985.

SWAZILAND

Although it is the second smallest sovereign state in mainland Africa, Swaziland has one of the continent's highest per capita income levels. In 1988, according to estimates by the World Bank, the kingdom's gross national product (GNP), measured at average 1986-88 prices, represented US$810 per capita, the sixth highest of any country in sub-Saharan Africa and enough to rank Swaziland as a "middle income" economy.

Given the small size of the Swazi market, (approximately 800,000 people), export-led growth is the key to the country's economic development. Swaziland has a fairly diversified export sector, led by sugar, wood pulp, soft drink concentrate, citrus, and minerals. Although agriculture continues to dominate the economy, the country's industrial base has expanded steadily over the last five years thanks to new investments in textiles, paper production, and food processing.

Agriculture and Forestry: Sugar is the most important crop, with three large estates in the eastern lowveld supplying most of the cane. Most of Swaziland's sugar is exported to Western Europe and North America. Swaziland's forests (pine and eucalyptus) are among the world's largest planted forests, and its pulp mill produces roughly 10 percent of the world's unbleached kraft pulp. Pineapples are grown and canned, as are grapefruits and oranges. Fresh fruit is also shipped overseas by air cargo. Cotton is one of the main cash crops in the country. A majority of the population of Swaziland still practices subsistence agriculture, however, with maize as the standard crop for the small plot farmer. The beef industry, which targets the European Community, was revived in 1989 with rehabilitation of Swaziland's principal slaughterhouse.

Manufacturing: Swaziland has experienced major advances in manufacturing in recent years, and a number of new industries have been launched. Manufacturing, at roughly 20 percent of GDP in 1990, constituted the largest sector of the formal economy, and at 8.2 percent average annual growth since 1984, it is by far the fastest growing sector. The year 1990 saw a number of important new manufacturing ventures in home appliances, knitwear, auto parts, and textiles, all of which point towards a continued diversification of the manufacturing sector away from export-based industries processing agricultural or forestry products.

Tourism: Tourism is an important source of revenue. South Africans constitute the majority of the visitors to Swaziland. The country's main attractions are its natural beauty and game parks, its casinos, and golf. The total number of arrivals has been raised by growth in the number of business visitors as well as renewed tourist interest in the kingdom. The former trend reflects increased investment interest in the kingdom. The latter is the result of economic and political factors; South African arrivals rose in response to political unrest in the republic.

Facilities in the central Ezulwini valley (the heart of the Swazi tourism industry) are dominated by the South African Sun International chain. A new hotel complex, owned by the government but managed by Protea of South Africa, was opened in Piggs Peak in 1986, and in 1990 plans were announced for the development of two Sheraton managed hotel complexes. By mid- 1991, however, the developers had still had failed to secure the necessary backing to execute the project.

Labor: In general, labor in Swaziland, Botswana, and Lesotho has several factors in common: a) lack of sufficient local employment opportunities for rapidly expanding labor forces; b) shortage of trained manpower and heavy reliance on skilled expatriate technicians; c) high levels of subsistence farming and domestic underemployment; and, dependence upon remittances from migrant worker, primarily employed in South Africa.

Investment and Tax Incentives: The Government of Swaziland believes in a free market economy and therefore actively encourages foreign private investment. Tax allowances and investment incentives are detailed in the Income Tax Order of 1975, amended and considerably expanded in the Income Tax Amendment Act of 1985, which provides for the following: a) a 5- year tax holiday for new firms engaged in manufacturing under certain conditions; b) generous tax deductions for expenditures on fixed assets; and, c) indefinite carry forwards or accumulated losses to set off against income.

TANZANIA

Tanzania is improving as a potential customer for U.S. goods and investment, but it remains a difficult environment for the unwary. In recent years progress has been made in rehabilitating the country's infrastructure, in providing a more conducive market-based policy environment and in dismantling bureaucratic delays. Despite this progress, trained personnel are scarce, infrastructure is inadequate, and frustrating bureaucratic delays persist, all adding to the cost of doing business. Nonetheless, the persevering investor or trader can reap substantial rewards.

As in previous years, accurate economic growth figures are not available for 1992 and projected figures do not take into account the robust growth in the informal sector. Growth rates in this sector have likely outstripped the rate in the formal sector and have been a major force in Tanzania's sustained growth. That said, Tanzania has enjoyed seven years of positive growth in GDP since 1986 as a result of various factors, including favorable weather conditions and steady donor assistance. Economic growth has been further encouraged by a series of successful reform measures which have included trade liberalization, exchange rate adjustment, relaxation of government economic controls, restructuring of financial institutions, moves to privatize and commercialize parastatals and the introduction of market-driven foreign exchange bureaus.

However, continued attention to reform must be emphasized if the country is to strengthen and consolidate its gains. Despite an improvement in tax collection methods and an increasing revenue base since fiscal year 1989-90, government deficits persist. In 1991-92 the budget deficit stood at 8.6 Percent of the GDP, and is projected to fall slightly to 8.3 Percent of GDP during 1992-93. Better government control of expenditure is needed.

The business climate in Tanzania has improved considerably since the institution of the economic recovery programs in 1986. These recovery programs have emphasized infrastructure rehabilitation, large-scale irrigation farming, export diversification (particularly of non-traditional products) and investment promotion. Definite opportunities exist for U.S. firms in the mining, tourism, financial and construction industries, as well as in agricultural machinery and equipment, chemicals, pharmaceuticals, consumer goods and used clothing.

The Tanzania investment code, increased tax incentives, the legalization of market-driven foreign exchange bureaus and export earnings retention schemes have made the country much more attractive and accommodating for foreign investment.

The economic growth rate in 1992 has been affected significantly by a shortage of electricity leading to widespread and extensive power rationing since August 1992. The power shortage is due to low water levels in the dams utilized by Tanzania's turbine generators, poor maintenance of generation equipment and the power grid and a significant increase in demand with no additional generating capacity. Embassy sources estimate the cuts will reduce GDP by about 15-20%. The GOT has requested donor assistance in developing short-term solutions, but the power shortage will continue to be a major economic brake in the near term.

Economic Reform: Economic Reform programs instituted on the recommendations of the IMF and World Bank have had a major impact on economic growth and the general structure of the Tanzanian economy. The government has continued to address the external trade balance by encouraging exports, discouraging unwarranted imports, devaluing the shilling, expanding the Open General License (OGL) and abolishing duty and tax on the import of raw materials for industry. However, the trade deficit remains a serious hurdle, although ameliorated by bilateral and multilateral donor support and debt relief. In 1991 targeted debt relief was US$ 220 million. The amount for 1992 is expected to be US$ 290 million.

Agriculture: Exchange rate adjustments since 1986, expansion of OGL, targeted reform of cooperative unions, crop marketing boards and the general availability of consumer goods have created a conducive climate for agricultural extension and crop husbandry. Economic reform programs have had major impact on production of maize, wheat, rice, beans, cotton, cloves and tea. Purchase of crops, particularly coffee, cotton, sisal, tea and pyrethrum, has been opened to private traders.

Minerals and energy: Tanzania is endowed with an assortment of mineral deposits including gold, coal, uranium, nickel, cobalt, phosphates, natural gas, diamonds and a variety of other gemstones. Lack of capital, managerial skills and a poor regulating environment have hampered effective exploitation of these resources. Nickel and gold mining within Tanzania show particular promise. Tanzania enjoys immense deposits of nickel ore, currently being explored by a multinational mining consortium. There are numerous alluvial gold deposits, readily exploited by artisanal miners, as well as substantial gold-bearing formations. Foreign investors are actively developing kaolin, gem mining, and other mineral resources.

Industry: The Tanzanian industrial base is primarily directed towards import substitution and largely dependent on imported raw materials. This sector has been plagued by mismanagement, political interference, bad planning and chronic shortages of foreign exchange which have resulted in poor performance. Industrial production has run at about 20-30 percent of installed capacity. With the introduction of donor import support, commercial operating criteria, and the advent of legal foreign exchange bureaus, industrial production is expected to rebound strongly and should increase to about 75 percent of capacity by 1993. The economic recovery programs have placed greater emphasis on industries which will utilize local raw materials, which produce for export, or which produce essential items decreasing dependence on imports.

Transportation: Major efforts have been underway to rehabilitate the country's road and rail networks as well as the port at Dar es Salaam. These efforts are on-going. Tanzania Railways Corporation (TRC) is being restructured and rehabilitated, while Tanzania-Zambia railway authority (Tazara) is implementing a 10 year US$ 360 million development plan with significant Chinese aid and technical assistance. Once completed, these rehabilitation efforts will ease transportation bottlenecks considerably and greatly increase the accessibility of various agricultural and industrial areas and aiding the growth of all sectors of the economy.

Telecommunications: Tanzania Posts and Telecommunication Corporation (T.P.T.C.) has instituted a five year development program (1991-1995) which aims to convert T.P.T.C. To customer oriented enterprises. In achieving these goals T.P.T.C. will undertake telephone rehabilitation and expansion programs in Dar es Salaam and other areas. The program calls for an investment of US$ 231.5 Million. The World Bank and donor agencies have already pledged US$ 186.7 Million.

Financial sectors: In August 1991, the Banking Reform Act was enacted which restructured the financial sector and allowed for the creation of private foreign exchange bureaus and private banking for the first time since 1967. To date, over 30 bureaus have been opened countrywide. Banks are restructuring and transferring their non-performing portfolios to a government institution, the loans and advances realization trust (LART), leaving the banks free to operate commercially. Standard Charter Bank and Meridian-Boia have been licensed and are expected to begin banking operations in early 1993.

Tanzania offers a potentially attractive investment climate supported by a new investment code (1990), and greatly improved macro-economic framework. Much of this improvement occurred in the past five years following major trade and foreign exchange liberalization. Producers are now able to import necessary inputs and machinery and to remit profits overseas. Devaluation of the shilling has increased the price competitiveness of Tanzanian products manufactured for the export market. Exporters laud this policy. The government as well as newly formed political parties appear to support the changes. Certainly the government's commitment has remained strong. Major investor incentives included in the new code are: (a) a five year tax holiday; (b) exemption from import duties and sales tax on all machinery, equipment, spare parts, materials and supplies that would be used for the enterprise; (c) access to foreign exchange (through forex shops) and the repatriation of up to 50 percent of retained foreign exchange receipts; and (d) no limitations are set for the amount of capital gains to be repatriated but a withholding tax of 10-20 percent is applied for dividends, royalties and interest payments abroad.

Additionally, the government now provides a central office for approval of new investment proposals, and improved commercial banking will be soon available due to licensing of new private foreign and domestic banks. The improved business environment also includes an on-going policy of the government to promote privatization of the parastatals, removal of directed banking credit, introduction of private banks, infrastructure rehabilitation (roads, railroads, telecommunications, energy, etc), and completion of domestic trade liberalization, including price decontrols. These should improve investment returns.

Political risk: Tanzania has, compared to other African countries, enjoyed an unusual degree of internal stability and social harmony. U.S. Mission officials envision the transition to multiparty democracy, begun in mid-1992, to culminate in peaceful national elections scheduled for 1995. Tanzania is not known to have involved itself in politically motivated damage to foreign property. An issue worth mentioning is the on-going controversy over indigenization in the process of privatization. GOT plans to divest over 300 commercial public enterprises and a commission has been established to direct this process. U.S. Firms may be interested in the privatization program. One risky issue concerns ownership. African Tanzanians fear that outright sale to the highest private bidders would put all the privatized enterprises into non-indigenous (a term focused largely on Tanzanians of Asian ancestry but also extending to foreign investors) ownership on account of the former's lack of capital to invest. To address this issue, proposals are underway to establish a privatization fund which would enable some African Tanzanians to own shares in privatized enterprises.

Issues of concern in business enterprise development

In the future, Tanzanian commercial and industrial development is expected to be based more on private sector initiative and less on government intervention. One area of continuing concern, being examined by government and the donors, is land ownership. Land in Tanzania belongs to the government. Despite the availability of long-term leases (up to 99 years and renewable), the inability to own or sell land, or to have it accepted by banks as collateral, discourages investment. The government has established a land commission which should recommend appropriate procedures to ameliorate this land problem. Other areas which head the list of government and donor priorities for the next few years include complete elimination of existing controls on internal trade, particularly for export crops such as coffee and cotton, rewriting of corporate laws and business regulations to reflect the private-sector orientation of the economy, licensing procedures and industrial land zoning

Tanzania's formal private sector comprises over 3000 establishments, each employing more than 10 persons and contributes over 65 percent of the monetary GDP. Formal businesses are concentrated in a few urban commercial centers: Dar es Salaam, Arusha, Mwanza and Tanga. At least 55 percent of the businesses are in agricultural- related activities, 10 percent in industry and 35 percent in services.

Perhaps Tanzania's main attraction to investors is its 25 million people, many of whom are literate, healthy and hard working. Current average wages are extremely low (less than US$30 per month for most workers). The natural resources of land, minerals and energy remain under-explored and largely untapped. Private foreign investors currently operating in Tanzania rank the country as a low cost production area in both labor and domestic resource terms. Concerns related to serious instability in the supply of power and water are both being addressed by government, with assistance from the donor community. The domestic market size of 25 million people offers some opportunity, but investors also have an eye to the larger east and south African market with well over 80 million consumers. The geographical advantage of Tanzania within SADC and the PTA regions provides the country with additional potential for access to the markets of Zambia, eastern Zaire, Malawi, Rwanda, and Burundi, which depend to a great extent on Tanzanian ports.

ZAMBIA

Summary: Zambia is in the second year of an ambitious structural adjustment program. Despite impressive and rapid liberalization on most frons, the program has ben hampered by continued high inflation and slow implementation of social sector programs, legal reform, civil service reform, and privatization. In 1992, suffering from severe drought, GDP fell by 2.5% and per capita GDP fell by over 5% --initial predictions of a 9% drop in GDP were not realized because of better than expected performance in the mineral sector. In 1993 the agricultural sector has rebounded with record or near record harvests of most crops, but the liberalized marketing system is plagued by start-up bugs. Copper output continues to be above target but sharp drops in world copper prices have hurt industry revenues. The transport sector was upgraded last year to help ferry drought relief but the poor conditions of roads hampers the sector. In manufacturing, export oriented firms are doing well but the greater number of firms are import dependent and suffering from devaluation, foreign competition and high interest rates. There has been some increase in investment but most inquirers are waiting to see if inflation is controlled and new legislation is implemented. The international donor community continues to offer very high levels of assistance to Zambia.

Current Economic Situation and Trends: The Zambian economy remains in a precarious state. In 1992, GDP fell by 2.5% and per capita GDP fell by 6.1%. The drought caused a sharp downturn in agricultural output and early estimates calculated GDP would fall by 9%. Higher than expected production and prices in the copper/cobalt sector helped to make up some of the difference. Agriculture made a strong recovery in production this year and Zambia is expected to export at least two million bags of maize. The copper sector is maintaining good production levels but copper prices have dropped sharply, lowering revenues.

Inflation was very high at 207% in 1992 when money supply increased by 100%. Although the overall budget deficit for the year was only 2% of GDP, at certain points the deficit was much higher due to three factors. The drought budget was in deficit for much of 1992 and the matching revenue did not come in until 1993. The government in april of 1992 took over the debt and the operational expenses of Zambia Airways, and those costs amounted to over half of the government deficit. Very large civil service wage increases also fuelled inflation.

Determined to tame inflation in 1993, the government committed to a cash-based budget and to avoid borrowing from the Central Bank. They have managed to stick to that commitment for government operations but did borrow to cover debt service in the first quarter. Though inflation began to moderate in March it increased again in April. It was discovered that ZimOil, a petroleum importing parastatal, had been allowed to borrow large sums from the Central Bank. Since then the government has moved to put the energy sector on a cost recovery basis, by decontrolling petroleum prices and raising electricity tariffs. In June the government succeeded in reducing the money supply and there are early signs that inflation may come down; July inflation was 11% for the month compared to 15% in June. However, ongoing wage negotiations with the civil service continue to prompt fears the

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government may be forced to give budget busting wage increases or be faced with widespread strikes.

Economic reform: The government has moved boldly in many reform areas, particularly in the financial sector. Insurance has been decontrolled and opened to competition. Price controls and subsidies have been removed. The government is withdrawing from agricultural marketing. Import and export licenses have been abolished, and tariffs have been lowered and simplified. Interest rates have been decontrolled. Bureaux de change were introduced in October 1992 and are allowed to buy and sell foreign currency at their own rates. This market quickly combined with the retention (retained export earnings) market. In December 1992 the government unified the official rate with the bureau rate, and now exchange rates are determined by the market. Most restrictions and limits on buying hard currency have been removed. Tax reforms announced in 1993 widened the tax base, lowered tax rates, and raised levels of exemption to provide relief to low wage earners. Reforms have been most successful where the government stops interventions. Reforms that require active government administration have fared less well.

The government has sound policy in most areas, but has had trouble implementing many of its policies. The social action program, which is supposed to improve schools, health facilities, roads and other public services is the most urgent case. Though donors have provided large sums of cash to support the social sector the government has lacked administrative capacity to carry out improvements. Civil service reform, which aims to transform the civil service into a leaner, better paid, and more efficient bureaucracy, has failed to take off, partly because the government does not have the cash for the large legally mandated redundancy payments. Poor management structure and lack of qualified personnel have also hindered privatization and legal reform. Legislation still awaiting presentation to Parliament includes a new company law, a new banking law, a revised investment code, new mining laws, new land laws, and a stock exchange act. Some of this legislation is expected to be in place by the end of the year.

Privatization: Privatization has moved very slowly--one year after the passage of the Privatization Act only two companies have been sold. It was expected that most of the 19 first tranche companies would be sold or liquidated by the end of September, but bidders, who made their offers last October, have complained that the sales have taken far too long to finalize, and so far, only two have changed hands. Progress on the second tranche is also well behind schedule. Negotiations with minority shareholders of four large companies in the second tranche have begun. In each case the government is asking that some of the shares be reserved for sale to the general public. A securities and exchange law goes before parliament this year to ease the way for the establishment of a stock exchange. The stock exchange organizing committee hopes to get it started this fall. The previously published schedule of privatization is being revised. The third tranche is currently being reorganized to focus on retail establishments and hotels.

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Mining: Mining was a strong point for the Zambian economy in 1992. ZCCM mined 432,000 tons of copper in 1992/1993 (ending March 31), nearly 2,000 tons above target. Both the higher production and higher than expected prices for copper and cobalt contributed to good results for the mining sector. In april 1993, however, copper prices took a dramatic fall and look to stay low for the year, but ZCCM will probably do better than its conservative 390,000 ton production target for the 93/94 mining year. Attempts by ZCCM to significantly boost cobalt production have been unsuccessful.

The government continues to move forward with plans to privatize ZCCM, but slowly. Stanford Research Institute (SRI) landed a contract under a World Bank mining sector loan to do a strategic survey of ZCCM, including an examination the best course to follow in privatizing the company. Many complicated issues need to be considered. Currently mined copper deposits are due to run out by the end of the century, but Zambia has large undeveloped reserves. The ministry of mines is actively seeking foreign partners to develop these reserves. Zambia has dozens of other minerals in commercially exploitable quantities but aside from gemstones and marble, there has been little interest in developing these resources. Gemstone mining remains informal and difficult to quantify.

Agriculture: Zambian agricultural production has made a solid recovery from the drought. Maize production is estimated at 18 million bags. The tobacco crop is the largest on record at 10 million kilograms. Hectarage planted in cotton, wheat, sorghum, groundnuts and sunflower was up from 10-40% from the previous year with good harvests in all cases. Agricultural marketing has been a problem, particularly in maize. Liberalized marketing began last year for most crops, but because of the drought, maize marketing remained in the hands of the government. This year maize marketing is supposed to be done by the private sector, but a lack of finance and storage, low demand, uncertainty over prices, and high inflation/interest rates have combined to keep most potential buyers from entering the market. The government is tentatively planning to allow only 2 million bags of exports. There is growing concern that the harvest may not be bought, transported, and stored before the rains come and farmers prepare for the next season in November.

Agriculture remains one of Zambia's most promising sectors. The increased hectarage planted in response to liberalized marketing is a positive sign. Problems in marketing may temporarily dampen that enthusiasm, but once the marketing system gets over its growing pains, agriculture should continue to grow. An EC program to lend money in support of non-traditional exports has benefitted several niche agriculture products with loans so far to the tobacco growers, the coffee growers and the horticultural grower's organizations. Future reforms in land policy to improve tenure and increase access to land should further encourage sector growth. There continues to be interest in Zambia from South African and Zimbabwean farmers.

Manufacturing: The manufacturing sector continues to struggle. Most manufacturing in Zambian is highly dependent on imported inputs, which have become expensive with the advent of a market exchange rate. At the same time trade has been liberalized and tariffs

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lowered. Manufacturers have had a hard time competing with imports, especially those from South Africa which enjoy export subsidies. Manufacturers are pushing for countervailing duties to balance the subsidies. High inflation continues to erode incomes and demand is sluggish. Many Zambian manufacturers have quality problems, but interest rates are high and medium and long term finance is unavailable making it difficult for them to upgrade their factories. Factory utilization rate remains low at 25-30%. Bucking the trend are companies that process domestic raw material for export which continue to prosper.

Communications: The Zambian telephone system is unreliable, but functions fairly well by African standards. Foreign firms have shown interest in investing in a privatized telephone company but the government has been slow to move in this area. A USAID- funded regional project is assisting the ministry of communication to draft regulatory law for a private communications sector. In the meantime the government continues to stall on applications for building a cellular system in Zambia. A Japanese-funded project is laying new cable.

Energy: Electricity production has recovered in the wake of the drought. In 1992 Zambia imported electricity from Zaire, and briefly ran load shedding operations. In 1993 exports to Zimbabwe resumed as water levels came back up. The government is increasingly skeptical about the proposed large hydro plant on the Zambezi River at Batoka gorge--a joint project with Zimbabwe. However, ZESCO (Zambia Electric Supply Co.) is moving ahead with plans to build a second dam in the Kafue gorge and TDA has funded a feasibility study for this project.

The price of electricity had not been adjusted for several years and the US dollar price had fallen to about one half cent per kilowatt hour. ZESCO recently announced 700 to 800% tariff increases to bring the prices up to 3.5 To 4 cents per kilowatt hour. The price increases have caused an enormous outcry, especially from commercial farmers and manufacturers. ZESCO has also been the company of choice for late payments, and to counter this tendency they have announced they will charge market interest rates on overdue bills. With interest rates at 130% this is strong incentive for timely payment. ZCCM is the largest electricity consumer.

Petroleum has been a problem in 1993. Despite a touted decontrol of petroleum product prices, the government continued to pressure the petroleum parastatal ZimOil to hold prices down. When the kwacha rapidly devalued after foreign exchange liberalization, prices failed to increase to match dollar costs. The inevitable result was that ZimOil was unable to cover the dollar price of new shipments. Nonetheless, the Bank of Zambia provided ZimOil with dollars, effecting what amounted to a 19 billion kwacha loan, which increased money supply and fuelled inflation. In the face of the crisis, ZimOil had to make, and the government to approve large price increases. Prices are now supposed to adjust automatically to the dollar exchange rate.

Retail and services: The retail sector has benefitted from liberalized trade and from the fact that goods are a better store of value than many cash investments in the current high inflation environment. Those who use credit to finance inventories are concentrating on stock which turns over quickly. The banking sector has to manage carefully in these days of liberalization and high inflation. High reserve ratios to counter money supply growth leave banks scant room for maneuver. Treasury bills are competing for depositors money. Most banks moved quickly into the bureau de change business, and many are poised to be active brokers when a stock market is established. On the whole, service industries have fared better than manufacturers under the economic reforms.

Investment climate: The 1991 Investment Act is the current law, offering investors incentives such as improved repatriation of profit, exemption from import duties, and protection against expropriation. Although an improvement, the Act is still not considered competitive by world standards. A revised version of the Act is before parliament this year. It is supposed to further improve profit repatriation, but eliminate some tax incentives which disadvantage existing businesses.

Zambia offers a democratic political environment and an enviable record of stability. Many us companies operate successfully in Zambia. Bordering eight other nations, Zambia has the potential to become a regional trading hub as regional tariff barriers are removed. The most attractive sectors for investment are agriculture and food processing, mining and minerals processing, and tourism. Transportation, communications, and manufacturing offer some opportunities. When land reform is complete property development and construction should become growth industries.

Outlook: The outlook at the moment is uncertain. The Zambian government has so far done a good job of putting through a very ambitious reform program. However, the two top priorities for 1993--controlling inflation and improving implementation, especially of social programs--have seen little progress. Unless that changes, the program is set to run into serious public opposition. Already there has been a rising chorus of criticism and complaint about the reform program which focuses on rapidly increasing prices and the lack of social sector improvements. The government continues to support the program because there are no viable alternatives. But if public dissatisfaction grows as elections near, there will be an increasing temptation to stifle public criticism by turning on the printing presses.

If the government can manage to keep civil service wages down and help get maize marketing moving, then inflation should begin to come down, and interest rates along with it. This would give the economy some breathing space and activity would begin to pick up. The outlook for Zambia rests heavily on its ability to tackle inflation. It could go either way. The government's commitment to tackle inflation and not resort to printing money is strong. But the pressures on them to do so are also strong. If the fight against inflation fails, then the economy will continue to face a never-ending series of crises, one of which, sooner or later, will torpedo reform efforts. If inflation is brought under control, people and businesses will be able to respond to the market signals and begin to reorganize the economy along more efficient lines.

ZIMBABWE

In the decade following independence from Rhodesia, in April 1980, Zimbabwe has progressively worked towards social and economic restructuring and has emerged with high marks in the areas of education, trade and banking. Zimbabwe's economic growth in the decade was uneven, fluctuating in conformity with the effect of rainfall on agricultural production, with world prices for the country's main exports, and with changes in government economic policy. None the less, with an abundance of natural resources, a well developed infrastructure and a diversified industrial sector, Zimbabwe is better placed than most African economies to withstand the effects of commodity price fluctuations, and to recoup short-term set-backs.

Tobacco is the country's largest export commodity, accounting for 22% of all export earnings, followed by gold (16%), cotton lint, textile products, footwear, nickel, asbestos, ferrochrome, sugar, copper, meat and other products. This list illustrates an unusually high level of export diversity for an African country.

Fuel is Zimbabwe's principal import, the country being totally dependent on imported petroleum. Petroleum products enter the land-locked country through a 300-km pipeline running between Mutare and the Mozambique port of Beira. Gasoline is blended with locally produced ethanol in a proportion of 90 to 10. The government intends to increase the capacity of the Triangle ethanol distillery from 40 million to 75 million liters per year, but this has been delayed by a lack of water needed to expand sugar production in the lowveld.

Private Sector/Investment: President Mugabe and the ruling party, Zanu (PF), advocate the establishment of a one-party state based on socialism. In practice, government economic policies have been relatively pragmatic in dealing with the private sector. Zimbabwe's diversified industrial sector remains largely in private hands, and 4,500 privately owned commercial farms are the backbone of the agricultural sector. Government policies have been directed at speeding the redistribution of wealth to the previously neglected black majority, but the government has explicitly rejected the expropriation of private property as a means to this end. The government recently introduced legislation to address an inequitable distribution of land. The details on the timetable and implementation of this program are still being developed, but it appears that the government intends to restrict foreign ownership of land and purchase underutilized commercial farmland for transfer to black farmers.

Parastatals: The government's participation in and control of the economy is considerable. Approximately 30 parastatal companies account for over 25% of GDP. Most of these were established by the previous regime. The government has also acquired equity positions in a few private companies, either as a direct purchase or on a joint venture basis.

Zimbabwe has long had an ambivalent attitude toward foreign investment. Government officials recognize that foreign investment is needed to bring in expertise, capital, and technology that Zimbabwe has no other way of obtaining. At the same time, they appear to be somewhat suspicious of foreign investors. This attitude toward investment has been changing recently. The government, in May 1989 issued guidelines for investors in a document entitled "The Promotion of Investment: Policy and Regulation." The document recognizes that foreign capital has played an important role in Zimbabwe's development, but emphasizes that Zimbabweans should have opportunities to participate fully in the country's development.

Manufacturing: Output in the manufacturing sector has been hampered by growing problems with transport and energy, and the chronic shortage of foreign exchange. Industrial production has remained fairly strong in 1990, but companies are being increasingly affected by a deteriorating capital base. This situation should improve when a US$120 million African Development Bank industrial rehabilitation loan is disbursed over the next few years. Industrialists highlight price controls and foreign exchange shortages as their chief problems, but they expect some relief as part of the new economic program.

Tourism: Tourist arrivals grew an estimated 10% in 1989 to nearly 500,000 and spending reached an estimated US$106 million. Prospects for continued growth are good. Air Zimbabwe has increased its capacity with new equipment, several new airlines have been granted landing rights in Harare, and construction projects such as the US$50 million reconstruction of the Elephant Hills resort at Victoria Falls will provide tourists new options.