

Africa Private Sector Development

Policy and Strategy



Policy Reforms

Prices
Tariffs
Privatization



Financial Markets

Investments
Foreign Exchange
Term Credit



Business Growth

Marketing
Production
Training

**AFRICA PRIVATE SECTOR DEVELOPMENT POLICY
AND STRATEGY**

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FOREWORD

This document was prepared by the Agency for International Development (A.I.D.), Africa Bureau as a guideline to its field Missions in Africa on ways to utilize and promote private sector capabilities as part of the country assistance programs. Nevertheless, we believe that others interested in African economic development will find that this policy/strategy provides substantial information on the Africa Bureau's major concerns and priorities regarding the role of private sectors in overall IDC development.

- Private Enterprise Office
Africa Bureau (AFR/PRE)

AFRICA PRIVATE SECTOR DEVELOPMENT POLICY AND STRATEGY

PART I: A.I.D. PRIVATE SECTOR POLICY

A major A.I.D. policy repeatedly enunciated by the Administrator and elaborated in the A.I.D. Policy Paper, "Private Enterprise Development," March 1985, is to strengthen and more fully integrate private enterprise development into the mainstream of Agency activity. Policy goals are:

- To encourage LDCs to open their economies to a greater reliance on competitive markets, trade and private enterprise in order to meet the basic human needs of their poor majorities through broadly-based self-sustained economic growth, and;
- To foster the growth of productive self-sustaining income and job-producing private enterprise in developing countries.

A. INTRODUCTION

The purpose of this paper is to lay out the Africa Bureau's strategy for the development of the private sector, which is inextricably linked to the development of African economies as a whole. The failure to create an environment in which the private sector can flourish has been the single greatest cause of economic stagnation in Africa. Accordingly, we must focus our efforts on assisting countries and governments to focus the role of the public sector on those economic areas which it is best suited to manage, or regulate, and on creating an environment for unleashing the energies of the private sector everywhere else. This is a long term endeavor, one that must overcome the history of colonialism, traditional patterns of donor assistance which promoted the expansion of the public sector into inappropriate areas, and lingering suspicions about the private business role in society and economic development.

This paper is divided into two parts. Part I presents the private enterprise policy setting. Part II presents the strategy itself as a set of private sector development actions in terms of both the program development process and program activities or actions. Missions should clearly understand that private sector development actions cited herein are illustrative of actions taken by A.I.D. Missions throughout Africa and elsewhere. For formulating their own private sector strategies and actions each Mission will select those actions that it judges are most appropriate to its country situation and that are consistent with the overall country strategy.

B. AFRICA BUREAU PRIVATE SECTOR POLICY

The Africa Bureau is committed to supporting and implementing Agency private enterprise policy with a profound conviction that private sector development is an essential element of economic development. The development of an indigenous private sector is necessary not only to broad-based economic growth, but also, over time, to the political stability on which economic growth must be founded. In this policy paper the term "private sector" encompasses all economic activity which is not performed by the public sector. This includes all for-profit firms from large multi-national giants to individual vegetable hawkers - whether formal or informal, foreign or indigenous, agricultural, industrial or service. It also includes non-profit private organizations such as trade associations, educational groups, labor unions, cooperative societies, PVOs, etc., insofar as those groups produce an economic service. Often, the for-profit segment of the private sector is referred to as private enterprise. The Africa Bureau views the fostering of market-oriented private sector activity as one of the key mechanisms for achieving the Agency's and the African governments' development objectives.

The development of a vigorous private sector and an expanded middle class in Africa also provides the most likely source of employment and economic growth among Africa's limited options, and offers the best hope of improving local investment climates which will induce both local and foreign investment to maximize their contribution to African development.

A.I.D.'s policy and this strategy apply equally to the informal as well as the formal business sector. Micro businesses that operate with loans from family, friends and local lenders typically comprise a significant economic sector in Africa. Missions should not neglect this important sub-sector when evaluating how to utilize and promote the indigenous private sector. The evaluation should include the degree to which very small and micro-enterprises contribute to total country production and services, and whether the productivity of these hard to reach activities can be strengthened and expanded without resorting to credit subsidies. We should work towards developing a favorable policy environment within which these enterprises will be willing to move into the formal sector.

The fact that the Agency and Bureau emphasize development of the private sector as one of the major vehicles of economic development does not demean the importance of a rational public sector development role. In every economy there is an important role for the government in providing "public goods", such as defense, basic education, certain types of infrastructure, research, etc.

Small LDC private sectors cannot alone finance and carry out large scale infrastructure, health and education activities. The private sector can, however, often participate in such activities and grow in doing so. LDC development needs the best efforts of both sectors and we believe that A.I.D. can utilize and promote the private sector more effectively to enhance economic development in Africa. Working with private sectors is one of the primary means to achieving development objectives; however, working with the private sector is no more an end in itself than is working with the public sector.

Central to a well-functioning private sector is an efficient public sector. Roads must be maintained, legal systems enforced, administrative procedures made simple and fair, the value of the currency maintained. In some special cases, the most appropriate use of A.I.D. funds may be to help rationalize and stabilize government finances. In other cases, A.I.D. development objectives may be served best by working primarily with the private sector. While A.I.D. funding of public sector programs would not be classified as private enterprise development, it would be part of a comprehensive restructuring of the roles of public and private sectors. The restructuring should include privatization, reduction of government deficits, increased efficiency in government, and policy reform aimed at improving the private sector environment.

Most importantly, Missions should seek practical ways to use the private sector as a delivery mechanism for resources and information in A.I.D. programs and projects. At least 10 African Missions are now utilizing private firms and PVOs to help implement traditional A.I.D. agricultural, health, infrastructure and other projects.

PART II. AFRICA BUREAU PRIVATE SECTOR STRATEGY

The Bureau and its Missions will carry out the private sector responsibilities and actions cited in this strategy to the maximum degree practicable within the varying stages of economic and private sector development that exist in different African countries. There are three central elements that underlie the Africa Bureau's approach to private sector development. They are:

The approach of our strategy must be to make private sector development an integral part of country strategies; it must be part of the warp and woof of our programs and projects.

The focus of our strategy is competitive market development, particularly financial and agricultural markets, through reducing government policy distortions, reducing investment risk and transaction costs, increasing market competitiveness, and strengthening market institutions.

The target of our strategy is primarily the development of the indigenous private sector, not promoting foreign private investment per se. Nonetheless, A.I.D. will facilitate foreign, particularly U.S., investment in partnerships with local business when it generates significant developmental benefits including employment, infusion of foreign exchange and technology transfer.

A. PRIVATE SECTOR DEVELOPMENT ACTIONS

The Bureau emphasizes the following actions in development of private sector programs.

1. Improve A.I.D. Knowledge of the Private Sector - Private Sector Profiles and Strategies.

Missions must develop a sound knowledge of the private sector's composition, capabilities and limitations. Each Category I and II Country Mission* must develop a private sector profile/strategy. Other Missions are encouraged to do so as well. These profiles should inventory the whole range of private enterprises existing in both the formal and informal sectors, the rural as well as the urban economy, service and production enterprises, macro and micro-enterprises and profit and non-profit organizations, including indigenous PVO's, cooperatives, trade associations, etc.

Profiles should identify constraints and opportunities with respect to governmental policies and regulations, raw material resources, foreign exchange resources, managerial and entrepreneurial capacity, labor supply and quality, credit availability, infrastructure, and information needs and other factors that affect the private sector's capability to contribute to broad based economic growth.

Given their private sector profiles, Missions can then develop private sector strategies by selecting a limited number of activities that best reinforce and institutionalize policy reforms and promote private sector growth as an integral part of their overall country strategy. Africa Bureau's Private Enterprise Office (AFR/PRE) will issue more specific guidance on preparing private sector profiles.

Missions should utilize all possible sources of information, including private sector personnel organizations such as Chambers of Commerce, banks and trade associations, PVOs and NGOs, accounting firms, business consultants, academics, and so on.

*Category I and II countries are: Sudan, Kenya, Liberia, Zimbabwe, Somalia, Senegal, Zaire, Zambia, Cameroon, Mali, Rwanda, Malawi, Mozambique, Guinea, Madagascar, and Niger.

At the same time, the Africa Bureau may conduct a series of studies of specific issues that cut across country lines. The most important of these would relate to economic policy, administrative and regulatory practices, and financial markets. The Bureau intends to evaluate private sector interventions in Africa and other countries of the developing world, by both A.I.D. and other donors, to determine what works and what doesn't, and what conditions are necessary to obtain best results. We will also act as a clearing house, disseminating new information on useful approaches to private sector development.

2. Strengthen A.I.D. Planning, Programming and Funding for Private Sector Development

Missions in Category I and II countries, and Category III countries that have significant private enterprise programs, are to provide narrative and budget data in CDSS, ABS, Country Action Plans and Program Week submissions, showing how private sector development falls within their overall country development strategy and programs. Such submissions should explain how the Mission is working toward achieving maximum practicable private sector involvement in its total development program. PRIVATE SECTOR STRATEGIES ARE TO BE AN INTEGRAL PART OF OUR DEVELOPMENT APPROACH, NOT AN ADDENDUM TO THE IMPORTANT WORK WE ARE DOING ELSEWHERE.

Mission program and project documents will report the flow of project and non project assistance resources through or to the private sector by means of dollars and local currency budgeted from DA, ESF, and PL-480. Specific guidance on how to do this will be provided.

Missions' success in incorporating, funding and measuring private sector-related elements within programs and projects will be an important focus of Bureau reviews of CDSS, ABS, Country Action Plans and Program Week submissions.

In designing PIDs and PPs, missions should consider the appropriate level of private sector involvement in implementation of all suitable projects, particularly in those cases where A.I.D. experience in similar projects elsewhere shows private involvement to be feasible. Where conditions warrant, projects can be designed and include resources required to expand private business activity into new areas over the life of the project. The Africa Bureau will make private sector involvement a major factor for consideration in PID and PP reviews. For their ongoing projects, all Category I and II Missions should explore the feasibility of modifying or amending projects to incorporate private sector-

supplied services and goods, when this will enhance the developmental impact of the project.

3. A.I.D./W Support to Field Missions

a. Training for A.I.D. and LDC Personnel

Bureau and Mission personnel have shown high interest in learning more about business practices, business policy, management techniques, credit/capital markets, and the role of enterprise in A.I.D. programs. The PRE Bureau holds a ten-day Private Enterprise course several times each year in the Washington area. Mission staff traveling to the U.S. and AID/W Bureau staff are encouraged to enroll. Also, AFR/PRE will help tailor this course for overseas use, and hold it in both West and East Africa. The overseas courses will be open both to Missions and key host country officers.

Mission and Bureau staff should develop plans and approaches for training African private and public sector leaders and technicians in roles and functions of both sectors in development. Training should emphasize short-term approaches such as workshops and travel to LDCs and the United States to observe how private and public sectors interact to promote business growth.

b. Private Sector Advisor Positions

REDSOs and large Missions are encouraged to establish private enterprise PSC positions when the volume of PE projects and activities warrants employing an individual with a solid business background. Private sector advisors should take the lead with Missions in analyzing and working with the private sector; assisting in the development, implementation and evaluation of private sector activities; and in designing, implementing and evaluating private sector components of projects including design of private sector delivery mechanisms for traditional A.I.D. projects in agriculture, health, etc. As examples, the advisor would assess, recommend and assist in developing actions and projects in such areas as loan funds through financial institutions, cooperatives and PVOs; bank guarantee funds; managerial assistance and training programs; assistance to Chambers of Commerce and trade associations; and development of materials useful to Missions' dialogues with governments to obtain changes in policies and regulations concerning price controls, foreign exchange, investment codes, repatriation of funds, labor laws, etc., that inhibit private enterprise growth.

c. A.I.D./W Assistance - Africa Private Enterprise Fund

Missions are encouraged to draw on the services of AFR/PRE and the Africa Private Enterprise Fund to obtain and finance a wide range of technical assistance to carry out this strategy and the actions set forth in Section B below. Areas of special interest have been: development and review of private sector strategies and programs; project design and preparation; analyses of formal and informal private sectors and of agricultural, commercial and industrial subsectors; organization and operation of intermediate credit facilities (banks, cooperatives, revolving loan funds, etc.) for term lending including associated business advisory services; information on A.I.D. private sector programs, projects and activities worldwide; business/investment climate studies; profiles/feasibility studies of selected potential business ventures; analyses of government policies and practices that inhibit private sector and overall economic development; and partial funding of private enterprise advisor positions staffed by individuals with strong private sector backgrounds.

To date, technical assistance has been provided on an ad hoc basis in response to each request for assistance. However, Missions may propose to AFR/PRE a program of requirements for U.S. business experts to assist them in preparing country profiles, analyses of private/public sector roles, private enterprise strategy planning and project design and support of other matters discussed in this strategy. Missions should present these requirements and budgets to AFR/PRE with details on the task to be done, rationale, summary scopes of work, and probable budget. If proposing help in project design, the concept must have previously been approved as part of the CDSS or recent ABS submission. If approved, blocks of funding from the Africa Private Enterprise Fund will be made available to individual Missions much as PD&S funding is now allocated. This will allow Missions to operate more independently, use their own discretion on programming consultants and assume direct management of the process.

The Africa Bureau intends to undertake a major impact evaluation of private sector development programs in selected African countries. This will include helping Missions monitor and track experiences with implementing private sector activities in order to feed back program and project design suggestions for use by other Missions. In addition, as policy reforms undertaken by African governments take place, we wish to assess their impact on the private sector. We believe that such on-going analyses will be invaluable to both the Bureau and field Missions.

The A.I.D. Private Enterprise Bureau also makes consultants available to assist Missions in a wide range of private sector activities comparable to the Africa Private Enterprise Fund, with special emphasis on financial markets development, divestiture and privatization. The PRE Bureau's Revolving Loan Fund can make loan financing available to private borrowers, particularly for intermediate credit operations. Also, the Trade and Development Program will share the costs of feasibility studies by U.S. and foreign private investors, if the proposed investment is likely to generate a substantial volume of U.S. exports. AFR/PRE is preparing a compilation of the various Washington-based sources of technical assistance to send to all Missions.

B. PRIVATE SECTOR PROGRAM ACTIONS/ACTIVITIES

Four categories of program actions are described below for Mission consideration in developing private enterprise strategies. These are the priority areas for private enterprise programming. The list is not exhaustive nor immutable but will be adjusted and refined by continuing experience. Nor do we expect Missions to develop programs in every area. Rather, Missions should be careful not to scatter financial resources and stretch staff resources with too many activities, but choose those areas where they can be most effective. As A.I.D. resources become more scarce, Missions face increasingly difficult choices as to which projects best achieve development objectives. PL 480, DA and ESF local currencies should be used more widely to offset dollar budget reductions. As an important financial resource, A.I.D. is making a concerted effort to make better use of local currencies. In this regard, the 1985 Food Security Act calls for increased use of Title I local currencies for private enterprise credit programs.

1. Promotion of Policy, Regulatory and Procedural Reforms

a. Reform: An A.I.D. Priority:

One of Missions' top priorities should be to continue to assist and influence host governments to adopt durable policies and practices that improve the environment in which the private sector operates.

In order to effectively promote necessary policy reforms it is imperative that policy dialogue be rooted in rigorous, on-going economic analysis which identifies, describes in appropriate detail, and quantifies when necessary or possible the reforms being proposed. Such analysis will establish credibility during the policy dialogue process, host country (and other donor) acceptance,

and lead to reforms with full host government commitment. Policies and practices sought include:

- efficient product prices;
- efficient factor prices, especially wages and interest rates;
- an exchange rate that is not overvalued;
- freely functioning markets with little control and with multiple marketing channels;
- a well functioning, well-articulated financial market, with market-determined interest rates for saving and borrowing;
- a tariff system which does not introduce unjustified and inappropriate effective protection;
- taxes which do not distort incentives;
- movement of economic functions out of the public sector into the private sector;
- a legal system that ensures private property rights, enforces contract obligations, and encourages expanded capital ownership among private entrepreneurs and workers;
- labor laws that allow firms to adjust employment levels to their own needs and reduce the use of wage floors to the minimum;
- and absence of undue governmental interference with private business or crippling administrative burdens on the conduct of business.

To accomplish this effectively, Missions should conduct business/investment climate assessments, as called for under paragraph A.1. above, aimed at identifying actions for Missions to take in order to eliminate policy and institutional constraints. Missions should search for ways to include policy and regulatory reform conditionality provisions in their own projects and activities, and to coordinate those provisions fully with multinational and other bilateral donors.

Fundamental to policy reform is rationalizing the roles of the public and the private sectors, privatizing public sector activities which are performed more effectively by the private sector, and reducing the controls and regulations which inhibit private entrepreneurs from investing their energies, capital and labor efficiently.

Given our objectives to increase income, employment, and private ownership, we are interested in efforts to improve the environment for small entrepreneurial businesses, particularly those that are rural based or have backward and forward linkages with rural and urban areas. This does not mean skewing incentives in favor of such firms, but rather, removing impediments to their growth and development.

b. Mission Policy Dialogue Agenda: Each Category I and II Mission must develop a policy reform dialogue agenda, describing which policies they think A.I.D. can best work at reforming, why these policies are important, and how the A.I.D. program will be directed at achieving these reforms. The agendas should be included in all Action Plans with annual updates in the ABS. In developing reform agendas and pursuing change, Missions will consult with appropriate public and private sector representatives.

2. Financial Market Development

Fundamental to any private sector development strategy is the development of a well-articulated financial market. The function of financial markets is to intermediate between savers and investors. In a well-functioning market, savers will have reasonable incentives to put off consumption, and to balance return of different financial assets with the risk of each asset, and investors will be able to borrow on terms commensurate with their project's expected risk and return.

An important aspect of financial markets is their articulation. By this, we mean the development of a broad series of financial institutions able to provide many different financial instruments. On the lending side this would include short-term working capital loans, real property loans, trade credit, medium term investment for capital equipment, etc. On the saving side this would mean the development of money markets, bond markets, stock markets, savings and thrift institutions, credit unions, etc. Lending would be available for a variety of purposes, under various conditions of risk and return, with different sorts of collateral. Credit would be available to all sectors from agriculture to industry to services. A well-articulated financial system would include all types of institutions, such as export credit agencies, venture capital firms, traditional deposit banks, investment banks, development finance institutions, and traditional money lenders. In such a system government regulation would be limited to overall control of the monetary system, reserve requirement rules, protection against fraud, etc.

Of course, few countries in Africa are ready for a financial intermediation system as sophisticated as described above. Yet, we should not underestimate the potential for financial market development if policies are permissive. One need

only examine the sophisticated instruments developed in the Gulf States by Sudanese and Somali nationals to offer financial services to expatriate workers in these areas to understand that the possibilities are greater than we currently imagine. In any case financial development is a very important element of the Bureau's private sector strategy.

All A.I.D. financial intermediation programs will operate under the basic A.I.D. policies with respect to credit terms and access. PPC will issue a new Financial Markets Development Policy Paper in 1987 with detailed guidance on working with intermediaries. In principle, subsidized credit is unacceptable. The end user of credit must pay all the costs of credit, including transaction costs, a premium for the risk of default, and a positive real interest rate that reflects the opportunity cost of saving. Whenever possible the cost of technical assistance to ultimate borrowers should also be covered by interest rates and fees. At a minimum, borrowers should be expected to share TA costs. Interest rates for savers should be sufficiently high to encourage domestic resource mobilization.

The basic role of A.I.D. assistance must not be to increase the domestic supply of credit, although this is likely to be a concomitant feature of our programs, but to improve the efficiency of financial institutions and markets, broaden capital ownership, reduce transaction costs, and reduce risk.

3. Privatization.

An important element of the Africa Bureau's policy involves privatization of economic and business functions such as marketing of agricultural inputs and commodities, production of agricultural and manufactured goods, and services such as curative health care, certain training and educational services, veterinary services, agricultural extension, housing and electricity. Not all of these activities in all African countries will be amenable to privatization. Nevertheless, depending on the availability of private sector service purveyors, the comparative advantage of private sector in supplying the service, etc., Missions should investigate privatization opportunities, both with respect to services provided by Government Ministries and those provided by parastatals.

A.I.D.'s privatization policy with respect to parastatals is described in Policy Determination No. 14 dated June 16, 1986 which states "A.I.D. assistance to or through a parastatal should be given in the context of exposing the parastatal to market forces and scheduled divestiture of the government interest ... A.I.D. projects designed to improve parastatal performance must have identifiable benchmarks upon which substantive progress towards divestiture can be

measured. The latter sentence is the ultimate condition upon which assistance is to be granted. In other words, the selected benchmarks must represent substantive evolutionary progress in moving the parastatal towards market-based operations and divestiture in order to qualify for A.I.D. assistance."

Policy Determination 14 also calls on A.I.D. Missions "to engage in discussions with their host countries about privatization activities, with the objective of having at least two privatization activities in each Mission by the end of FY 1987 and two new privatization activities each year thereafter."

4. Market Growth and Development

Missions should consider ways to improve market functioning by increasing competition in markets or reducing transaction costs. There are several approaches A.I.D. can consider to achieve these objectives:

a. **Developing Information Services:** Just as improvement in transportation broadens markets, so does improvement in market communications. Market information systems in particular can serve to improve market competitiveness. Helping the development of mass media market information services, technology or market development advisory services, trade journals, etc. can be justified as increasing equity and competition.

b. **Agricultural Markets:** Private agricultural market institutions must also emerge in rural areas and market towns to stimulate trade and make operative the reforms instituted in macro-economic policies as they affect the agricultural sector. Examples of private market institutions are: credit mechanisms; regional markets and storage facilities, including bazaars and wholesale/retail outlets; private packaging and transport facilities; sales outlets for farm inputs; and market news services. Local private business associations active in monitoring and recommending changes in government policies and practices also help relieve constraints on, or open opportunity for, business growth.

c. **Infrastructure:** Africa has a woefully underdeveloped transport and communications network. Efficient development of these systems reduces transaction costs, encourages production, increases competition, and reduces consumer prices. A market system cannot operate if transaction costs are so high as to exclude many producers and consumers from the market. In particular, Missions should encourage selective rehabilitation of existing infrastructure, and investment in new transport links with high rates of expected economic returns. A.I.D.-sponsored analysts can identify infrastructure improvements that could

accelerate private sector transactions. Given limited A.I.D. resources, financing for the infrastructure improvements themselves should be sought from domestic, IBRD or other donors before the use of A.I.D. resources is proposed.

d. **Business Services:** Missions are encouraged to provide support to local business organizations, Chambers of Commerce, consumer groups, labor unions or trade associations so that they might better articulate business community views on legislation and public policy. Technical assistance can also help such associations expand their services to members, train managers and workers of local industry, and help members identify markets and sources of credit.

Also, Missions can sponsor business advisory services to assist small business start-ups and turn-arounds or provide management training through financial or technical support. These services might be effectively extended to reach micro and informal businesses. However, services to profit-making business should not, and need not in most circumstances, be subsidized. Such services should be operated on a self-sustaining basis, and A.I.D. support should be provided with this objective in mind. That is, organizations providing subsidized services to business must consider and show how the subsidies will be eliminated over the period of the A.I.D. assistance. A.I.D.'s aim normally will be to help establish or expand business consulting services that operate on a fee basis.

e. **Investment Promotion:** Promoting business investments, whether in small scale indigenous enterprises or larger joint ventures with foreign partners, is not a discrete activity in and of itself. It is a process involving all actions set forth in this strategy; done effectively, it may call for policy reform measures, market liberalization, market information, business advisory services, and financial market access. A.I.D. assistance to the investment promotion process should be done in light of these controlling factors.