PN-ABJ-357
73643

International Science and Technology Institute, Inc.

Headquarters 1429 20th Street, N.W., Washington, D.C. 20036
202/785-0831 • Telex 272785 ISTI UR • FAX 202/223-3865

USAID/BOTSWANA
PRIVATE SECTOR STRATEGY STUDY

SEPTEMBER 1987

Cameron L. Smith

Robert E. Laport

U.S. and Overseas Offices

Arlington, Virginia • Lewes, Delaware • Dakar, Senegal • Colombo, Sri Lanka • Rabat, Morocco • Cairo, Egypt

USAID/BOTSWANA

PRIVATE SECTOR STRATEGY STUDY

TABLE OF CONTENTS

ab

b

C'

USAID/BOTSWANA

PRIVATE SECTOR STRATEGY STUDY

EXECUTIVE SUMMARY

The following summarizes major recommendations and findings of the above study. Terms of reference appear in Appendix A.

This is an internal USAID study which is intended to support national and Mission program objectives of employment generation through stimulation of the private sector. The study contains action-oriented recommendations for USAID and other donors, the GOB, parastatals and, most important, the private sector itself. Three current USAID-commissioned studies - Strategy Assessment and Evaluation, Investment Climate Survey Update and a series of focus group interviews with managers of firms of various sizes - supplement this study's interviews and reference to experience of other countries. The studies represent the views of the consultants and do not necessarily reflect the views of U.S.A.I.D.

A. RECOMMENDATIONS

1. Key Areas

The findings summarized in Section B and the above reference materials support recommendations in the following key areas:

- Incentives for, and facilitation of, capital transfer to productive enterprises;

- Management and entrepreneurial development;
- Investment promotion;
- Small- and medium-scale enterprise credit access;
- Licencing and residence/work permit facilitation;
- Access to land.

2. <u>USAID Current and Projected Activities, or Programs of other Donors</u>

<u>Capital transfer to productive enterprises</u>:

- Provide training to organizations leveraging business access to resources, e.g. Botswana Building Society, Tswelelo, NDB and credit unions, and possibly commercial banks.
- Urge providing an income tax credit for local investment in productive enterprises and eliminating capital gains tax in cases where funds are reinvested locally.
- Support regulatory changes leading to the establishment of four types of specialized financial services.

<u>Management and entrepreneurial development</u>:

- Provide curriculum design assistance to increase student contact with Batswana entrepreneurs and course material supporting employment in or founding of SSEs.
- Give Peace Corps support to teaching in the above area.

<u>Investment promotion</u>:

- Place an OPEXer in BDC to provide liaison with enterprises seeking to add value to cattle non-edible by-products.
- Participate through ATIP in a high value-added, comprehensive agriculture development project.
- Urge broadening into services and commerce, simplification and increased labor subsidies for FAP.
- Encourage legal changes to encourage the responsible expansion and self-regulation of the tourist industry.
- Target US parent companies with operations in RSA as likely candidates for investment in Botswana.

Small- and medium-scale enterprise credit access:

- Provide an OPEXer to Tswelelo to increase its SSE TA and lending.
- Use any available US agricultural assistance (PL480) funds to capitalize a SSE-lending guarantee fund.
- Assist BEF in helping professional firms to prepare for-profit but affordable planning and TA packages for smaller enterprises.
- Provide TA and funding to a local firm entering the field of foreign collaborative-venture brokering, with eventual expansion into the rest of the SADCC region.
- Urge expansion of Tswelelo capabilities through cooperation with commercial bank branch networks.

Licensing and residence/work permit facilitation:

- If requested, help recruit a specialist to support the Regulations Review Committee.
- Urge package grants of licences, residence and work permits based on a project's business plan.
- Support the policy of promoting more citizen employment and company ownership rather than restricting non-citizen investment and residence, through seven specific activities (see Chapter II, C.5).

Access to land:

- Urge GOB's auctioning large blocks to private-sector developers with acceptable sub-division plans and resources.
- Recommend GOB's providing negotiating support to land deals between investors and tribal authorities controlling peri-urban land.

3. General

- Fund the expansion of the English-medium schools.
- Develop an inter-donor formal coordination strategy in support of the private sector.
- Establish cooperative industry-group vocational training.

- BEF should, working with the Government, promote the acceptance and application of the Code of Conduct for Foreign Investors.
- Major foreign companies should present assessments of schemes which they have experienced in other similar countries addressing the above key areas.

B. RESOURCES, CONSTRAINTS AND OPPORTUNITIES FOR EMPLOYMENT-GENERATING INVESTMENTS

Although many opportunities exist, new domestic and foreign-sourced investment is far below the level necessary to create the estimated 12,000 new jobs per year for school-leavers in the formal sector, let alone make a dent in the existing 25% level of unemployment. Constraints too nearly balance resources, leaving too little room for opportunity.

1. <u>Summary of Key Resources</u>

- Stable political environment;
- Southern African Customs Union for supply and SADCC, EEC, and Arab Bloc for markets;
- Plentiful supply of inexpensive labor;
- Investment incentives for manufacturing, agriculture, and small mining investments (FAP);
- Large foreign-exchange reserves with no constraints to import of raw materials and supplies, and liberal profit remittance;
- High liquidity in the financial system, resulting in low real cost of local borrowing and generous leverage (gearing) limits to creditworthy (as banks traditionally define the term) firms;
- Reasonably good infrastructure in major population centers;
- Skilled assistance from international accounting firms and banks for the qualified potential investor;
- Large underutilized land area, some with potential for irrigation;
- The diamond and cattle industries, which as the largest foreign exchange earners, show every sign of

continuing strength assure a high probability of long term financial prosperity for the country.

2. Summary of Key Constraints

- Small size of the local market (approximately 115,000 consumers in the cash economy), making it necessary to export in order to achieve a reasonable economy of scale;
- Strong competition from RSA to supply the local market;
- Lack of incentives for, and facilitation of, capital transfer to productive enterprises;
- Lack of small- and medium-scale enterprise credit access;
- High tax environment for a country in Botswana's stage of development;
- Need for, and high cost of maintaining, expatriate technical and managerial staff;
- Shortage of housing and international schooling to be provided to expatriate staff;
- Regulatory and bureaucratic framework encompassing business licenses, residency and work permits, and other documentary requirements which form a major barrier to all but the most powerful or persistent potential foreign investor;
- Lack of incentives (FAP) in key areas such as services;
- The ever present possibility of destabilization efforts by RSA.

3. Summary of Opportunities

- Agriculture using modern irrigation techniques which conserve water offers opportunities, from household or town to commercial scale. Following appropriate underground water studies, large scale, highly technical export-oriented projects appear feasible. Satellite farming, involving local growers under guidance from a core operation is probably applicable in the larger operations.

- Exploitation of new properties with known diamond reserves, the reopening of old gold properties, the commencement of the soda-ash project and continued and expanded exploration efforts will add employment in this sector. If petroleum reserves are found, a new industry will result.
- Manufacturing opportunities are focused on Botswana's political position as a member of the Southern African Customs Union on one side and SADCC and Lome III (EEC) on the other. A Botswana location affords access to markets now closed to multinational and indigenous firms presently located in RSA.

With the easing or elimination of controllable constraints, as recommended in this study, the realization of opportunities will increase, and the consequent increase in productive investment will generate new employment proportionally.

C. IMPACT OF FINANCIAL MARKET AND INVESTMENT PROMOTION ON EMPLOYMENT GENERATION

The availability of credit is ample, so money is not the problem; a lack of credible, credit-worthy borrowers with sufficient data to support their ability to repay the loan, or a lack of acceptable collateral when such is a limiting factor - are the major constraints. Amongst the more sophisticated there is a tendency to understate earnings for tax purposes which, on the other hand, does not reveal the true borrowing capacity of the firm.

Insufficient use of inventory and accounts receivable finance, and medium term vehicles, such as equipment leasing, impede financing of a greater percentage of total value. However, present tax laws no longer favor leasing as a means of finance. Commercial banks finance factory buildings, and now the Botswana Building Society has entered this arena.

Tswelelo has become the focal point for small to medium business lending beyond the activities, mainly short term in nature, performed by the commercial banks through their rural branch system. However, Tswelelo is a relatively new entity and does not have anywhere near sufficient human resources to expand either its lending or its counseling services. Conversations should be initiated with the commercial banks, as their branch systems could offer instant geographical expansion and a pool of trained manpower to Tswelelo.

The formation of equity capital, and its wider distribution are the major financial requirements, along with the simultaneous development of human managerial capability. The Sechaba Investment Trust of BDC is a first step; it allows BDC to make liquid a part of its portfolio for new investment, providing an investment vehicle for both individuals and pension funds. However, the biggest potential source of internally-generated equity capital would occur if Government were to give a credit of half of the corporate income tax, providing that companies spend that money to expand existing business or form new businesses. If the large businesses were placed in this position, they would become active promoters of new investment in Botswana.

The "infrastructure" for investment promotion (resource surveys, facilitating institutions, top-level policies, financial resources) has begun to be established. However, organizations charged with promotion (e.g. TIPA) are still mostly reactive rather than proactive. GOB pronouncements and general policies strongly encourage an open economy with increasing investment. But some of the specific regulations applicable here act as disincentives. Botswana does not have the luxury of waiting for domestic and foreign entrepreneurs to come forward with investment proposals, then discourage all but the most persistent.

1

I

INTRODUCTION

A. OBJECTIVE OF STUDY AND ISSUES TO BE ADDRESSED

1. Objective

This is an internal USAID study which is intended to support national and Mission program objectives of employment generation through stimulation of the private sector. The study contains action-oriented recommendations for USAID, the Government of Botswana (GOB), parastatals and, most important, the private sector itself. It is designed on the assumptions that:

- There is a limited number of key areas - constraints and opportunities - which if properly addressed will lead to major increases in private-sector employment-generating investment;
- The above four partners, plus in many cases other donors, have interrelated roles to play in addressing these areas, that is, all partners have resources to contribute to each area which strongly affects private-sector job creation.

2. Issues

- What changes might be made in USAID present projects/programs within present funding levels to give greater emphasis to the private sector, specifically to stimulating employment-generating investments?
- What policy and procedural areas could be identified, for discussion with the GOB, requiring change to strengthen the private sector and especially increase local job-creating investment?

- What new projects, within current overall levels of funding, and/or high-leverage but smaller interventions, should USAID consider to help strengthen the private sector within the country to help create jobs?
- What are some specific employment-generating, private-sector opportunities and recommended actions for the private sector, GOB, parastatals, other donors or USAID to increase foreign investment and what are the constraints?

B. BACKGROUND

There is no shortage of studies relevant to the above objective and issues. Major private-sector firms and the other partners mentioned above have ample files of investment feasibility, public-sector policy and other types of studies. Further, many members of the above partner groups have strong opinions on how to promote employment-generating investment in the private sector. Finally, other countries have faced similar issues in this field; some of their experience is relevant to Botswana.

To identify key leverage points for USAID intervention and to provide convincing recommendations for other partners' complementary roles, this study taps important previous studies, the opinions of members of all partner groups and experience in other countries. Three USAID-commissioned current studies provide particular support for this one; summaries are attached:

- Strategy Assessment and Evaluation. In June and July of this year a group of specialists examined the relevance of current USAID projects (in the education, training and agricultural fields) to employment creation. In particular, the study examined general constraints and opportunities in the private sector.
- Investment Climate Survey Update. Coopers & Lybrand in July updated a 1985 survey summarizing relevant GOB policies, resource factors, growth prospects, locally available business resources and the major elements of the private sector.
- Focus Group Interviews. With the help of a skilled local moderator, the above firm held separate roundtable discussions with managers of small, medium and large firms.

Although not statistically projectible, these interviews gave insights into the private sector's view of major constraints against and opportunities for employment-generating investments.

The study was carried out by U.S. consultants Cameron Smith and Robert Laport and represents their views. It does not necessarily reflect the views of USAID. Each of these consultants have more than 20 years of international, strongly developing-country, private-sector management experience. One, with marketing and general management experience, was a member of the Strategy Assessment and Evaluation team. The other has 28 years of commercial and merchant banking, as well as private investor, experience. During three weeks in August 1987, following talks in the USA with former Botswana businesspeople and advisors, they interviewed members of all partner groups, participated in a Small Scale Enterprise (SSE) assistance roundtable, digested major studies and benefited from the advice of a public/private-sector reference group. The authors wish to express their deep appreciation to the Government of Botswana inter-ministerial group chaired by Messrs. Mothibatsela and Dewah of the Ministry of Commerce & Industry, and to other Government officials and to members of the Botswana private sector for valuable assistance provided. We wish also to thank USAID for its help, and in particular Will Elliott, Project Development Officer, who worked closely with us in our field work in Botswana and had a basic implementation responsibility for support of our survey.

,4'

II

RECOMMENDATIONS FOR USAID PRIVATE SECTOR STRATEGY

A. KEY AREAS

The chapters following this one give examples of employment-generating investment opportunities and the constraints affecting them, along with conclusions on which constraints inhibit investment the most. For such an area to be listed below, it must have both a large potential investment/employment effect, and the public or private sector must be able to significantly change it.

An additional source of the conclusions shown below are analyses of successful employment-growth situations elsewhere. For example, analysis of the Massachusetts employment-growth experience indicates that the three key factors for private-sector investment and employment increases are high levels of entrepreneurship, a rapid process of technology transfer and aggressive capital financing. A study of technology transfer to small manufacturing firms in Spain, Ireland and Mexico indicates that the most valuable source of technology transfer across countries is the foreign firm or foreign supplier to the domestic firm. Of much less significance are the efforts of government-sponsored research institutes, universities and trade fairs. "International gatekeepers", individuals who serve as conduits for technical information by acting as links between industries in one country and scientific and technology-oriented individuals in another are critical players in the technology transfer process.

Key areas are:

1. Incentives for and facilitating capital transfer to productive enterprises;
2. Management and entrepreneurial development;
3. Investment promotion;
4. Small- and medium-scale enterprise credit access;
5. Licencing and residence/work permit facilitation;
6. Access to land.

Sections B and D detail how USAID can address these key areas in its present and projected future projects. Recommendations for the position which USAID should take in discussions with GOB on their policies are in section C. Short sections recommending the roles which other donors and the private sector itself should play in addressing the key areas conclude the chapter.

B. CHANGES IN CURRENT USAID ACTIVITIES

1. Current Projects

a. Primary Education Improvement Project (PEIP) and Junior Secondary Education Improvement Project (JSEIP)

The findings in the Strategy Assessment and Evaluation regarding private-sector-oriented curriculum development are confirmed. In particular, the primary and junior secondary curricula should include increased emphasis to entrepreneurial consciousness, and visits of successful Batswana entrepreneurs to schools and subsequent work on the disciplines necessary for founding or working in Small Scale Enterprises (SSE) (see Appendix F for definition).

As an example of how these projects could support technical collaboration between US business and the Botswana "growth industry" of teacher training, the projects should investigate supporting the adaptation of already-existing interactive videodisk training hardware and software, e.g. for math teachers.

b. Botswana Workforce and Skills Training Project (BWAST)

This project is admirably structured to support experts' interventions in organizations having a highly leveraging influence on the above key areas. BWAST should provide:

- Training to organizations leveraging access to resources (such as Botswana Building Society and credit unions (comprising resident and expatriate Batswana working in large enterprises) and possibly commercial banks;
- An Operational Expert (OPEXer) to Tswelelo to develop successful-SSE profiles by industry, work with such SSEs and TA to help Tswelelo's resources by helping more "bankable" SSE's develop projects and take them to local commercial bank branches for financing (under an arrangement that Tswelelo receive the difference between its normal rates and bank rates as a commission);
- Training and technical assistance to GOB and other large buyers to substantially increase purchases from local businesses;
- An OPEXer to BDC to provide liason with local and foreign enterprises seeking to add value to cattle non-edible by-product processing, especially in labor-intensive ways (e.g. pancreatin and other hormones, dog chewing bones and blood fractions);
- Training for a local entrepreneur wishing to establish a local credit bureau (see Appendix F).

c. Agricultural Technology Improvement Project (ATIP)

During this project's remaining years it should consolidate its contributions on opportunities which are already almost at the stage of supporting employment-generating private-sector investment. In particular, it should:

- Inventory agribusiness opportunities which it and others have already studied;
- Concentrate on supporting efforts to fill manageable gaps ("single missing ingredients") inhibiting opportunity realization.
- Organize and support one model project incorporating all elements of innovative agribusiness development (literature search and interviews with successful local and neighboring producers, a conference to reach technical and organizational concensus, development of a set of strategies to support the innovation's taking root, establishment of demonstration plots or farms in all

representative growing areas, orgainizing the supply of supporting elements such as tractors or transport, recruiting and training competent extension agents, arranging for the block grant of licences and long-term residence/work permits for necessary expatriate farmers or providers of marketing/logistics support, recruiting such expatriates, starting extension efforts with local farmers). Examples are:

- Growing fresh vegatables for local consumption and/or freezing them for export;
- Wide-spaced maize plowing, growing, and local storing/milling.

2. Possible PL480 Monetization

Current USAID assistance under PL480 Title II does not generate counterpart funds. If a shift to Title I were to take place, counterpart funds could be generated. In order to reduce the inflationary impact of these funds on the local economy, USAID might consider a SSE-lending guarantee fund. Although the National Development Bank (NDB) already has such a fund, Botswana needs to encourage all sorts of lenders (commercial banks, credit unions, Botswana Development Corporation (BDC), Tswelelo and others) to provide working-capital credit to SSEs which lack normal collateral but have good cash-flow prospects. See Annex F for details. The advantage of using any available PL480 local currency for such a fund is that it avoids inflationary monetizing except to cover defaults.

3. Collaboration with Peace Corps and International Executive Service Corps (IESC)

Three key areas are:

- Adding entrepreneurial content to primary and junior secondary education;
- Technical assistance and access to credit for SSEs (e.g. Peace Corps volunteers to Tswelelo as field promoters);
- Providing support to the collaborative-venture brokering service discussed in section D.

C. USAID PRIVATE SECTOR STRATEGY IN SUPPORT OF GOVERNMENT OF BOTSWANA POLICIES

1. Value of Pula

The present Rand/Special Drawing Right (SDR) balance in determining the pula's value is appropriate and should not be changed. GOB can take other, more specific, measures to encourage local production and exporting, some of which are recommended below.

2. Financial Assistance Policy

It seems clear that changes are required in the FAP, but changes should not be piecemeal. The GOB should carry out a formal evaluation before making adjustments. The following are changes which might be recommended:

- Include employment-generating service and commerce projects;
- Make benefits automatic (by tying into tax forms and allowing negative taxes) but subject to audit;
- Do not increase capital grants or lower interest rates in other GOB-supported projects (raises danger of supporting firms earning below-market rates of return);
- In analyzing applications, drastically reduce or eliminate concerns over established competitors' reactions (change focus to possible criminal restraint of trade);
- The Strategy Assessment and Evaluation (Chapter IX) makes the following further recommendations:
    - Consider lengthening the wage subsidy beyond its current five-year limit to motivate business to permanently use labor-intensive production methods;
    - Set the labor subsidy at the difference between the minimum wage and the shadow cost of labor (this would significantly raise the subsidy under current conditions and would motivate GOB to keep minimum wage increases small);
    - Increase the number of Rural Industrial Officers to help SSE applicants for FAP to qualify.

3. Other Investment Incentives

Eliminate capital gains tax on a citizen's or non-citizen's disposal of a business as long as the proceeds are re-invested locally.

GOB should change the company income tax laws to allow a tax credit of up to 50% of the tax payable when the company agrees to reinvest the funds in new plant or equipment for its own use, or to invest in a new local enterprise (perhaps excluding cattle). This would reduce the tendency toward creative tax avoidance, increase private sector equity for investment and make the large institutional tax payer a partner of government in attracting new foreign investment. This capital pool would form the basis for the development of a Botswana/foreign entity joint venture effort. Funds could be controlled by the commercial banks acting as agent for the Ministry of Finance and Development Planning.

4. <u>Minimum Wage</u>

Continue with the present policy of making increases slightly below the inflation rate. Do not make increases retroactive, as firms do not usually have cash reserves to cover such unforseen contingencies.

5. <u>Investment, Residence and Work Permits</u>

Basic policies of the Government strongly encourage investment, but regulations often mitigate against this objective. In Botswana there is the special problem of the inherent conflict in many specific cases between GOB's desire, on one hand, to increase total citizen employment through allowing the private sector freedom to invest and manage and, on the other, to increase the proportion of citizens in the workforce and especially at management or ownership levels. To help resolve this conflict, consideration should be given to:

- Re-establishing the Regulations Review Committee with Botswana Employers' Federation (BEF) representing the private sector; GOB should provide a permanent, exclusive secretariat, if necessary employing an AID-recruited specialist, and have the committee report to the Office of the President;
- Facilitating package grants of licences, residence and work permits tied to a project's business plan (which

should include projections of total and citizen employment by year); promote compliance during operations rather than before-the-fact proof that the applicant will comply;

- Set and enforce a three-month internal deadline for a positive or negative decision, as in Kenya (as one-stop documentation shops have a spotty record both in Botswana and elsewhere, such a time limit should be broken into sub-limits for each regulatory agency, such sub-limits arbitrated and controlled by the above committee secretariat);
- Promote more citizen employment and company ownership rather than restrict non-citizen investment and residence:
    - Facilitate student contact with citizen entrepreneurs during school years;
    - Make low-cost night courses available for employees through public-sector vocational training schools, and encourage private ones to follow suit;
    - The Regulations Review Committee should prepare a list of regulations having greatest impact on SSEs and negotiate their reduction (regulations are usually harder for the poor, uneducated and rural dwellers to follow than for more privileged);
    - Support expansion of Tswelelo;
    - Expand Sechaba Trust to non-BDC companies and support the BDC stock-brokerage project (with special emphasis on allowing commercial firms to sell controlling interest to Batswana at a reasonable profit);
    - Eliminate the capital gains tax on all domestic share sales;
    - Provide technical assistance on meeting GOB and parastatal tender specifications (including labor-only contracts and separating items likely to be sourced locally from others).

6. <u>Promote Growth of Low-volume, High-service Tourism</u>

Even taking into full account the need to limit tourism for ecological reasons, a low-volume, high service-level industry would directly create about 1000 jobs in game-viewing lodges alone. Little GOB intervention is needed, but USAID should urge it to promote the formation of a competent, private-sector Tourism Association. GOB should then pass a simple law that new establishments conform to an industry code, to which the Association would recommend changes from time to time. GOB should also establish a high-quality vocational training center in Maun specializing in tourism.

7. <u>Promote Establishment of Specialized Financial Institutions Rather Than Yet Another Commercial Bank</u>:

There is no reason why the establishment of a fourth commercial bank, even an American one, should markedly improve the assets-flow problems described in the following chapters. As the new bank's lending criteria would be very similar to those of the established ones, applicants who do not have "bankable" assets for collateral would be no better off. Instead, USAID should urge GOB and the Bank of Botswana to make the necessary regulatory changes and to promote the establishment of tne following types of financial institutions, some of which might be partial or full subsidiaries of existing private-sector institutions:

- Bonded warehouse, for inventory financing (This institution or facility will allow loans to be made with a firm's inventory (raw materials, goods in process, and finished goods) as part of the security or collateral);
- Equipment leasing/"rent-all" firm (business people interviewed felt that Financial Services Co. is interested only in financing cars and furniture);
- An accounts-receivable factoring house (including facilities for the firm to sell short-term paper to companies with temporary working-capital excesses);
- An import/export finance and insurance facility (This item would go beyond the short-term nature of a letter of credit [LC] and guard against all types of risks [foreign exchange fluctuations, damage, theft, etc] involved in the international exchange of goods and services).

In addition, GOB should pass a law making check-bouncing a crime. It should also contract one of the big accounting firms to provide a series of seminars to all interested firms on how to use specialized financial facilities such as the above.

8. Support Investment-brokering Efforts of Private Sector and BDC.

The private sector will be more effective than GOB at brokering actual deals (see next section and Appendix G). However, with the cooperation of such a brokerage firm, GOB should provide high-level officials to greet major prospective investors and follow up on their efforts to get government clearances. When important new resources are discovered or outside events make existing ones more attractive, GOB should contract opportunity seminars, inviting local businesspeople, those from southern Africa and a few highly-selected ones from other countries. A recommended supporting legal change is to make refundable grants for export-promoting trips (as the costs of such trips are presumably now allowable expenses under the present tax code, this recommendation does not increase GOB's compliance-auditing load). If it has not done so already, GOB should provide other export and investment incentives up to the level which competing countries and areas (e.g. RSA homelands) do but on the understanding that such incentives will in themselves only make the playing field level, not on their own attract significant investments.

9. Facilitate Legitimate Access to Land

One of the main causes of the present constraint is the much faster than projected private-sector growth, exacerbated by the inflexibility of the present system of GOB's having to provide serviced lots. In the short run GOB should ease this crisis by auctioning large blocks to developers with acceptable subdivision plans and resources to realize them. However, in the longer run it is unrealistic for business to insist on land within 10 minutes' drive of the center of Gaborone. No major capital cities offer such facilities. Instead, GOB should provide negotiating support to land deals between investors and tribal authorities who control more remote land. Supporting this policy, it should give loan guarantees through existing lenders to Batswana wishing to set up transport between population centers and employers' facilities.

D. POSSIBLE USAID ACTIVITIES WITHIN CURRENT FUNDING LEVELS

1. Credit Facilitation Between Banks and Small Enterprises

There is no need for USAID to capitalize SSE lending facilities. However, as AID is probably the donor with the most success in SSE lending projects, it can play a useful technical-assistance role. Specifically, it should give technical assistance in preparing business plans to a number of existing organizations wishing to enter or expand SSE assistance (e.g. commercial banks, Tswelelo, tribal authorities, Private Voluntary Organizations [PVO]). However there is little reason to support entirely new organizations. It should also give GOB technical assistance in establishing a loan-guarantee scheme to support the above organizations' borrowing. As business-plan preparation and technical assistance have been bottlenecks for existing Batswana SSE-assistance organizations, USAID should give BEF support in helping members prepare for-profit but affordable planning and technical-assistance packages for SSE's. Whether the above activities should form a separate project or come under BWAST II is primarily a question of USAID's programming convenience.

2. Foreign Collaborative-venture Brokering

As explained in Appendix G, the activities of such a firm are to prepare business plans for local entrepreneurs, seek local or foreign business contacts, handle preliminary negotiations and seek government permissions. USAID may provide expertise and funding through BWAST or centrally-funded projects. A key design issue is whether the brokering organization should be private with some GOB officials on the board or a parastatal. We recommend the former approach.

The organization should start with the simplest deals - those involving local capital and management, with perhaps foreign licencing or franchising elements. Then it should move into deals with more involved foreign participation, preferably from nearby. The design and intitial support of such a brokering effort is a possible AID-regional project. It could support a Southern African Development Coordination Conference-wide (SADCC) investment brokering network. Such a design effort should start with an analysis of a current Norwegian SADCC countertrade study and Barclays experience with regional countertrade. The environment for such an effort seems lately to have improved. According to "SADCC: Investment in Production", "What SADCC is now looking for are companies and investment institutions willing to make a long-term commitment to the development of the region, willing to share the costs and risks of investment, on the understanding that they will also share in the benefits. SADCC believes that it is only in this context that the region will be able to attract the capital, technology and expertise necessary to strengthen and develop further the region's productive sector." A typical deal might be to convert some of Botswana's foreign exchange to investment in imported processing equipment and complementary raw materials and combine these assets with other members' primary raw materials. Primary processing might take place in other SADCC countries, but final processing would happen in Botswana, adding value, creating jobs and reducing shipping costs before final export. Such a project is probably too broad to fit into BWAST.

3. <u>Support of Technical Assistance-regulatory (TA) Change Project</u>

As discussed in Section B under ATIP, the project should undertake one comprehensive project (or play a supporting role if such a project is beyond ATIP's scope) to show how one is done. But the same project can also demonstrate the need to smooth GOB regulatory barriers to investment. In such a project USAID should link its offer of TA, technology and market access in a major opportunity area (e.g. vegetables) with changes in land access and work/residence permits. USAID should therefore choose a project having two major constraints - technology/market and skilled, long-term expatriates.

E. PROJECTS FOR OTHER DONORS, PVO's and MULTILATERAL ORGANIZATIONS

Fund the expansion of the English-medium schools. Foreign investors report that the present school is at capacity and that lack of spaces inhibits other expatriates' decisions to come to Botswana.

Develop a formal coordination strategy for employment generation through support of the private sector. Swedish, German and Norwegian donors, as well as United Nations Development Programme (UNDP) and perhaps others, all have admirable projects, closely complementing those of USAID both technically and in spirit. These donors should, under coordinating leadership of the GOB, share project development tasks to support most effectively GOB's policies.

F. PROJECTS BY THE PRIVATE SECTOR

Naturally, the private sector's main task is to develop and run specific employment-generating investments. However, there are several things it can do as a group:

- Industry groups should establish cooperative vocational training. It is unreasonable to believe that the Polytechnic or other public-sector vocational training institutions will ever provide the very specific training which the mostly unskilled Batswana workforce needs to raise the productivity of most industries. Businesspeople questioned said that they would be willing to supplement such public-sector training with cooperative experience in their own businesses. BEF might give the initial spark for such efforts, but formal or informal industry groups will have to make such schemes work.
- BEF should, working with the Government, promote the acceptance and application of the Code of Conduct for Foreign Investors. BEF and its members should appreciate GOB's and voters' concern about investors' behavior. The Code of Conduct for Foreign Investors is not a kind of law, but it should act as a communication device to help clear up all sides' misapprehensions of the others' expectations, particularly towards foreign investors. Endorsement of the Code of Conduct by

foreign investors could possibly be sought at the time that work permits and residence permits are issued.

- Major foreign companies (e.g. Barclays Bank) should present assessments of schemes which they or others use elsewhere to address the above key areas. Most developing countries have the same kinds of key constraints as does Botswana, and many have involved the private sector more in addressing them, if only because they have been around longer to do so. Major foreign companies with experience in these areas should prepare short papers for public discussion which tell about these efforts.

III

ASSESSMENT OF CURRENT INVESTMENT PROMOTION ACTIVITIES AND ORGANIZATIONS

A. PRIVATE SECTOR (FOR-PROFIT AND NON-GOVERNMENT ORGANIZATIONS)

1. Domestic Investment

BEF and individual businesspeople regularly participate on mixed boards and commissions, mostly focusing their efforts on changing GOB regulations to favor investment. These commissions have had moderate success in changing laws, but major opportunities remain for smoothing day-to-day implementation. Further, since, presumably, informal networking is a major channel for new investors (domestic or foreign) to discover opportunity areas, it is strange that there is so little effort in Botswana to make networking work better, e.g. through business associations.

2. Foreign Investment

The only organized assistance activities known are through accounting firms; these only start when a potential investor retains a firm. Banks' investment guides are very useful if investors take the initiative to use them, but naturally such guides cannot give critical descriptions of local assets or facilities, so there is a definite limit to their usefulness. Expatriate investors' informal networking with foreign colleagues is presumably a strong influence. Therefore, it is unfortunate that most foreigners contacted said that, they commended GOB policies to their colleagues but warned them about major regulatory delays.

B. GOVERNMENT OF BOTSWANA (INCLUDING PARASTATALS)

1. Domestic Investment

Major promotion vehicles are Financial Assistance Policy (FAP), the Brigades, BDC, Integrated Field Services (IFS), NDB and Tswelelo. Historically the first two have created the most jobs (see Strategy Assessment and Evaluation); an issue is whether the Brigades have created jobs or only trained employees. There is a good potential for Tswelelo to support small- and medium-scale investment. It has the major elements and policies which have worked elsewhere to stimulate enterprise growth (see Appendix F). For this reason we recommend elsewhere that USAID provide expansion assistance to Tswelelo. Part of this assistance must be to improve the organization's image among potential clients. It is likely that the latter do not understand that in the long run a businesslike relation with an SSE-assistance organization is better than a dependent one, which was, for example, BEDU's trademark. No organizations, including Tswelelo, are likely to be able to help on any appreciable scale in founding new enterprise. Entrepreneurs themselves must do this.

Significant GOB promotion potential for GOB and parastatal purchasing power remain to stimulate enterprise growth. We have made recommendations on how GOB, with USAID technical assistance, can do this.

There is a major discrepancy between the positive, promoting thrust of major GOB policies and the restrictive effect at the implementing level. Compared with many other developing countries, the restrictive effect is mild. But in these countries expectations are lower, often because of known government-officer conflicts of interest or the need for outright bribery. Further, many developing-country governments express an ambivalent attitude towards the private sector. In Botswana, on the other hand, the above two conditions are much more positive, so investor expectations for rapid, efficient treatment are high.

As in other countries (see Appendix G), efforts to develop model investment projects within ministries are not seen as a major resource by private investors.

2. Foreign Investment

It is not suprising that the few GOB-sponsored trade and investment missions have had limited success. Such occasional efforts seldom work elsewhere because they do not support foreign investors' decision processes (see Appendix G). As is the case for domestic investment, "off-the-shelf" model project descriptions seem to have had little effect. Experience elsewhere indicates that they are seldom useful to potential investors.

BDC joint-venture partner search mechanisms (e.g. through foreign public-sector board members), while reportedly adequate so far, are likely to have little capacity for expanded deal flow, particularly considering that the present system depends mostly on local or foreign investors' taking the initiative. Using commercial attaches is likely to increase support of in-process deals but not be effective for initial foreign-partner searches.

C. DONOR AGENCIES

Domestic Investment

Donor support of BDC, IFS and Tswelelo has been vital to their progress. Compared to other developing countries, GOB and donors have worked well together to make the most of such support. Particularly impressive is GOB's insistence that project designs have some time horizon when outside support is no longer needed. Resource studies (e.g. water, oil, agriculture production methods) and financing public-sector training and OPEXers have so far provided good background for potential projects. However, as the economy becomes more sophisticated, the potential for such efforts contributing to job creation as in the past, will decline.

Some donors have tried to establish local- to home-company links. It appears that such efforts have not been very successful, not suprising because donor agencies do not traditionally have good home-company contacts, and their major local contacts are in the government. On the positive side, however, donors in Botswana appear to have reached a consensus on the importance of private-sector stimulation, have complementary projects in preparation and have high potential for a coordinated approach.

D. CONCLUSIONS

The "infrastructure" for investment promotion (resource surveys, organization establishment, top-level policies, financial resources) has begun to be established. However, organizations charged with promotion (e.g. TIPA) are still mostly reactive rather than proactive. Top GOB policies are friendly to investment but much less friendly at the implementing level. Botswana does not have the luxury of waiting for domestic and foreign entrepreneurs to come forward with investment proposals, then to discourage all but the most persistent.

IV

BUSINESS OR INVESTMENT OPPORTUNITIES BY SECTOR

A. INTRODUCTION

1. Approach to Chapters IV and V

The most important contribution which these two chapters can make is that of pointing the way towards a continuing, self-sustaining process of business opportunity generation, as opposed to an exhaustive evaluation of specific proposals which happen to be apparent now. These two chapters illustrate the beginnings of the above process; for each major segment of the private sector we:

- Suggest key resources which might support employment-generating investment opportunities;
- List constraints which, alone or separately, are likely to impact potential opportunities;
- Give examples of apparent opportunities;
- Illustrate what kinds of opportunities remain after considering the above resources and constraints, showing the sensitivity of opportunities to changes in those constraints which are at least somewhat controlable;
- Conclude, at the end of Chapter V, what overall resources, constraints and opportunities are most important in terms of their employment-generating or restricting effects.

2. Overall Resources and Constraints

Section D, Chapter V, contains conclusions as to the resources, constraints and opportunities (generic qualities and specific examples) which Chapters IV and V reveal.

There is a vast number of possible combinations of resources and constraints, each combination leading to opportunities with varying feasibility of employment-generating investment success. A major problem is, even for illustrative purposes, to determine what few have the greatest expected impact on employment. i.e. greatest absolute impact times probability of success. In real life, efforts to do analyses on a large scale, particularly by the public sector, are not very likely to be helpful. This explains the recommendations to remove barriers to decision making by the market. Promoting investment brokering, encouraging equity flows through improved financial institutions and facilities and revised tax laws, reducing regulatory barriers and strengthening entrepreneurial growth - among others - are all aimed at promoting the market's duplicating the analyses below but continuously and on a vastly bigger scale.

B. AGRIBUSINESS

1. <u>Resources</u>

Notwithstanding a lack of rainfall and variable soil quality in the land areas suitable for agriculture, improved technologies can provide means to increase present agricultural production considerably. In addition, there appear to be a number of possibilities, although limited and at this time not adequately studied, to irrigate agricultural land in a number of regions. Irrigation will provide the means to increase the production of existing crops and, more importantly, to diversify that crop base.

The cattle grazing industry, which is the traditional base of Botswana life, is well developed and provides a number of opportunities for upgrading and creating employment through the expansion of industries utilizing cattle by-products.

Lastly, the application of appropriate technologies to agriculture should permit the replacement of many South African products in the local market. Similarly, the loss of important markets through sanctions against South African products, particularly in the European Economic Community (EEC) and the

Arab Block, create a market opportunity in the future for agricultural products produced in Botswana.

2. Constraints

Agriculture faces a hostile environment. However, one can reasonably predict that major growth in the agricultural sector is possible since Botswana has the good fortune that it possesses substantial financial resources to overcome a number of the natural and developmental constraints that presently exist.

Irrigation may be one key to this future growth, however, studies identifying the areas where replaceable underground water resources exist are not sufficient at the present time.

Many of the likely areas for irrigation are not serviced by adequate roads at this time. However, once areas to be developed into irrigated agriculture have been identified, it is likely that government would be willing to invest in the extension of roads.

The cost of highway transport of agricultural products to relatively small markets is indeed a constraint, and this economic factor also is complicated by the ready availability of South African product in the Botswana. The competition from Republic of South Africa (RSA) should not be taken so seriously that Botswana fails to try to supply its own market in vegetables and other products for daily consumption.

The development of irrigated agriculture is both management and labor intensive. Management, initially, will most likely have to be supplied by expatriates which brings up the question of obtaining residence and work permits, establishing oneself, and then arranging the finance for the more capital intensive type of farming. The larger the acreage under cultivation and the more diverse the crop cultivation which takes place, the greater the level of management and technological skills required. Batswana can obviously be trained into these jobs, but it should be understood that advanced agriculture is more complicated than the majority of the manufacturing businesses existing in Botswana today. Therefore, the process of training local employees to the level of management of a large farm will be a long one.

In order to permit Botswana to participate in the international agricultural commodity markets, a grading system will have to be established and standards set. Access to foreign markets depends upon the ability to provide accepted standards and uniform quality.

3. Examples of Apparent Opportunities

The most immediate apparent opportunites are connected to existing industry or technology available in Botswana. The grazing of cattle, goats, and sheep is the most common agricultural activity in the country. BMC has already introduced processed meat products, and additional products are under study. Tanning of leather beyond the wet-blue stage is not being undertaken by BMC. This would suggest that the leather industry could be developed, and beyond that, a leather article and clothing industry might be possible.

The existence of a large cattle industry and the beginnings of a poultry industry also create the opportunity for the upgrading of their products through the production and use of animal feeds. We understand that a few of the larger cattle owners are doing this on a small scale at the present time and that the higher quality of their animals is realized. They receive higher prices as a result. This initial trend should be encouraged.

There appear to be opportunities for non-edible beef by-products. Examples are pancreatin, other hormone extracts and blood components (dry plasma and haemoglobin). The BMC is presently exploring a number of possibilities in this area.

The greatest potential area for the expansion of agriculture and the creation of employment would appear to be in the area of irrigated farming. Rain-fed agriculture, as generally accepted, cannot proceed much beyond its present state, although improvements in production are possible. However, not enough is known about the availability of underground water resources for irrigation. Rivers which are permanently filled are far from the market place. Studies to quantify the availability of renewable water resources need to be done along with studies to cost out the transport of the water to the land. However, if government were to employ some of its considerable resources toward coming up with these findings and were able to provide irrigated land to farmers at less than the full cost, a world of opportunity to grow new products for the local market and for export and which would create employment would open up.

On a smaller scale, drip and condensation technology is available in-country which could bring the capability of vegetable growing at the village level virtually country wide. Relatively small plots can supply a village, water is already present, so what appears to be needed is the dissemination of the technology and a continuing program of technical assistance, including the provision of seeds, pesticides, etc. The Brigades would appear to be the most logical medium for the dissemination of this information and assistance.

Other smaller-scale opportunities are luxury hair from sheep and goats, game farming (if laws can be changed to allow ownership of species which are normally wild), distilling ethanol from elephant grass and other crops (only in remote areas where water is available and petroleum fuel is expensive) and labor-intensive integrated vegetable growing and freezing (e.g. asparagus).

4. <u>Examples of Feasible Opportunities</u>

Botswana Meat Commission (BMC) production of biltong to supply a part of the 20 ton/day RSA demand is in the advanced planning stage.

Studies on EEC and Arab Bloc demand for product as a result of the halt in imports from RSA should commence immediately. Given long lead times in some areas like citrus, investment in producing nursery stock could begin in anticipation of the estimated demand. This would also be true with regard to preparing additional irrigated land for cultivation.

A leather industry with the possibility of eventually upgrading to the manufacture of leather articles for export is under study.

The drip and condensation methods of small scale veget-ble production are tried and proven in-country, and dissemination of these techniques to town and even household level could be achieved at any time if, for instance, training and use of the Brigades were made. Government investment in underground water resource studies and joint efforts with the private sector, both at township level and on a medium entrepreneurial scale will begin to open the many opportunities in irrigated agriculture which are available.

C. MANUFACTURING

1. Resources

Botswana has much unskilled labor capable of being trained and, over the longer run, capable of achieving highly responsible positions. The training requirements have been surveyed in the Strategy Assessment and Evaluation. The findings of this report are highly valid and positive with respect to the outlook for the future. The in-country human resources indeed are important and capable of being developed to run major industrial enterprises.

Similarly, Botswana's economic and political environment is conducive to attracting foreign investment. Political stability is always one of the first things that a prospective investor seeks.

Botswana is economically healthy and financially sound. Given the high level of foreign exchange reserves, there are no financial constraints in terms of obtaining foreign exchange for the import of raw materials and supplies. The commercial banks are highly liquid. Credit is available to fund almost all business requirements if the banks' institutional criteria are met. There are restrictions on the amount of credit available to foreign investors. However, these are generous at three times invested capital.

Botswana enjoys access to the SADCC and RSA markets. Imports from its .est supplier, RSA, enter duty free. Exports to SADCC require proof of value added. A number of new industries have been established specifically to supply the SADCC countries. Botswana also enjoys access to EEC through the Lome III Convention.

2. Constraints

A number of constraints limit the attractiveness of Botswana as a manufacturing base. Some are endemic and are beyond the power of man or government to change. The landlocked position of Botswana, geographically, is such a constraint. Other constraints can be changed. Examples are:

- Lack of sufficiently skilled local manpower which results in a need for expatriate personnel in key function initially;
- A limited local market, which obliges exporting to achieve reasonable economies of scale;
- Expensive and sometimes unreliable electric power;
- Expensive transport and an inadequate transport (communications) infrastructure;
- High overheads in general due to all of the above, especially the high cost of maintaining expatriate personnel in Botswana;
- Low productivity during initial years while training takes place and experience is gained, and the cost of that training;
- Lack of serviced land (with public utilities installed)
- Difficulty in meeting the restrictive criteria needed t obtain finance;
- Expensive delays obtaining manufacturing licenses, and work and residency permits;
- Generally speaking, a high-tax environment for a developing country seeking investment and employment generation opportunities;
- Competition from South Africa under Customs Union rules
- Lack of contact with foreign importers and knowledge of market requirements.

3. Examples of Apparent Opportunities

It is beyond the scope of this report to go into specific manufacturing opportunities. Many other reports have been prepared on this subject and the local business sector could undoubtedly come up with many more. We mention the following simply as an indication of the range of possibilites which exist and as an indication of the variety of skills which will eventually need to be developed by the Batswana working population.

- Manufacturing for SADCC countries and the local market;
- Adding value to local raw materials presently exported, such as improved leather tanning and an expansion of leather goods manufacturing;
- Agro-industrial fabrication of products through processing, freezing, canning, and manufacture of higher grade products, such as vegetable oils and processed meats;
- Small scale production of synthetic fibers to supply the local textile industry.
- Production of new or refurbished small electric motors and other similar products such as pumps;
- Expansion of the building supplies industry starting with cement and continuing through the whole line to PVC piping, reinforcing rod manufacture, and the fabrication of steel shapes and components;
- Expansion of the paper and cardboard packaging manufacturing industry which will be necessary to support the new consumer products industry;
- Expansion of the assembly of electronics consumer products for the local and SADCC markets;
- Textile exports to the USA under quota;
- Multinationals operating in RSA seeking "insurance" on SADCC access and support of RSA operations

4. Examples of Feasible Opportunities

While all of the industries mentioned in the above list are feasible, the industries and products mentioned here are those which can be produced for the local market and for eventual export to markets of known and quantifiable demand. Some have already been studied and implementation plans are in the works. Others, such as the development and expansion of the local citrus industry are much longer term.

- The entire leather industry: from steer, sheep, and goat hide raw materials good possibilities are sheepskin jackets to kid gloves with the entire range of leather products in between;

- moderately capital intensive industries such as building materials (except cement) and chemicals (mixing and packaging), employing RSA-produced raw materials;
- Non-perishable agro-industrial exports to ECC and the Arab world bear close study: concentrates, juices, and canned tropical fruits, nuts, and vegetables might find good seasonal demand;
- Manufacture of animal and poultry feeds;
- Refurbishment (as opposed to new production) of small electric motors, dynamos, pumps, transformers, etc., for the local market;
- Assembly of numerous medical products: thermometers, intra-venous systems, disposable test kits, etc., under license for the SADCC and local markets;
- The entire range of supermarket shelf consumer products presently produced in RSA could be candidates for mixing, assembly, and packaging in Botswana for sale locally and in the SADCC markets.

The major stimuli which if implemented would produce increased manufacturing investment are an effective reduction in the corporate tax by half (especially a tax credit for new investment of equal amount), export incentives, and increased management and vocational training for local personnel.

D. MINING

1. Resources

Botswana is demonstrably resource rich. Diamonds provide much of the wealth of the nation at the present time. The industry is highly developed, well managed, and according to professional reports, is in a position to maintain itself in good health for decades to come.

After diamonds, there is coal, gold, nickel, semi-precious stones, soda-ash, and other lesser known mineral deposits. There may even be oil and gas, presently being researched under the auspices of the Canadian National Oil Company.

The truth is that Botswana does not yet know the full extent of its mineral resources. Mineral trends have been identified in neighboring countries which appear to stop at the

Botswana border. This is of course unlikely. However, the studies necessary to prove that the trends continue have not yet been performed. There are, however, enough signs that further discoveries could be made that it is imperative that the exploration effort be continued.

2. Constraints

Present price levels in the non-ferrous metals area preclude major new investment unless very high grade ores were discovered, and even then the find could be only marginally viable due to infrastructure costs.

The vastness of Botswana in itself is a constraint to detailed hammer and chisel prospecting. Sand cover over a significant area of the total country is an even greater constraint to the exploration process.

The supply of available water on or near the site of a find to support the mining and concentrating process could be of concern, and in some cases curtail exploitation of the site.

3. Examples of Apparent Opportunities

Three proven diamond properties under control of Debswana are not being exploited. If Government desired, a third party could be attracted to negotiate with Debswana to take over their rights under full exploitation risk, or on a contract, for fee basis.

The seismic work presently being performed by Petro-Canada could warrant exploratory drilling after analysis.

A change in the economies of fossil fuels could someday render Botswana's coal assets economic for extraction and sale to the world market.

Continued exploration of the national territory will provide employment for scientific professionals and logistical support people as well.

Development of the semi-precious stone resource into a cutting/polishing, and perhaps jewelry industry would create new employment.

4. Examples of Feasible Opportunities

Government has within its power to decide whether to open discussions with Debswana leading to the possible exploitation of the three new known diamond properties.

Development of a semi-precious stone cutting and polishing industry, with the opportunity to upgrade this into a finished jewelry industry should be explored. Accelerated exploration efforts by Government would increase knowledge of the country's resource base and might attract new investment.

E. SERVICES

1. Resources

The services sector covers a tremendously wide range of employment skills. At the top end of the scale are the doctors, lawyers, and accountants, while at the low end the service sector is probably the largest employer of unskilled labor in the urban environment. In some countries such as the United States, the service sector is the fastest growing sector of the economy and, therefore, is the greatest source of new employment at this time.

Botswana has a large pool of unskilled labor and an underdeveloped service sector. There should be numerous opportunities for the entrepreneur and for new employment in the service sector at almost any level of sophistication and capital intensity.

2. Constraints

In that the list and range of service industries is so broad, the following are only a few examples of the types of constraints which might be encountered. They naturally differ from business to business, and what might be a constraint for one, for instance in a capital intensive business, would not be for another which is solely labor intensive.

- Lack of trained personnel from the level of plumbing and electrical repair technicians, medical-technical staff, to auto, truck, or computer repair;
- Services often do not qualify for receiving credit under existing lending criteria;
- Services do not qualify for FAP incentives under present regulations: all services are lumped together for purposes of FAP; no distinction is made between a tourist hotel operation which is heavily capital and employment intensive, and an auto repair operation which is much less so;

- Transport, which is heavily capital intensive, does not qualify for capital grants;
- Lack of private-sector vocational training, especially night classes (including transport and child care).

3. Examples of Apparent and Feasible Opportunities

Tourism is one of the highest generators of employment per unit of capital invested of any industry in the private sector. The number of jobs created per tourist is a multiple of between two and three, and this does not include the indirect employment generated by a tourist facility. Botswana has fantastic touristic resource acrcss its northern border area. At the same time it does not wish to disturb this unique environment, and rightly so. Therefore, in order to gain the highest returns within the tourist volume limits which are being suggested by government, it would seem that the low volume but high spending tourist who is given the best of service should be the market niche which Botswana strives to attract. If capacity in the area is increased from 1800 tourists per day to 2500 per day it would appear that an additional 1000 jobs could be created.

Just a few other examples of apparently feasible service businesses are shown below:

- Fast food restaurants;
- Home repair services of all kinds, plumbing, electrical, carpentry;
- Vehicle, office equipment, industrial equipment repair;
- Hotel, tour operators, and other services connected with the tourist industry;
- High rise service apartments for rental as temporary dwellings;
- Consultants to expedite permits, licenses, etc.;
- Agencies to supply temporary help;
- Support services for mining, large scale agriculture, government, and industry in more remote areas.
- Countertrading in SADCC.

As competition with RSA is not as much of a problem in this area as it is in others, the main constraints inhibiting further development are restrictions on permits for skilled expatriates and the lack of well-trained support staff.

Increased training, the extension of FAP eligibility to some services which are more capital intensive than others, and again, a reduction in company taxes or credits for reinvestment would animate the services sector.

F. COMMERCE

1. Resources

Adequate foreign exchange to allow the purchase of goods from all over the world is the sector's major resource.

2. Constraints

An economic market size of only 115,000 people in the cash economy, spread around a country the size of France, is the sector's major constraint. Further, RSA mass retailers and mail-order firms understand the market and appear to have penetrated most segments of it.

3. Examples of Apparent Opportunities

Except for the artificial opportunities of commercial areas reserved for Batswana or given GOB preference, there are no major opportunities.

4. Examples of Feasible Opportunities

Because of the above, there are no major direct opportunities. However, the sector is a stepping stone for Batswana entrepreneurs' entry into more promising sectors. Therefore, unlike other sectors, it is important that GOB discourage foreign investment in commerce and protect citizen entry into it.

G. SMALL-SCALE ENTERPRISES

1. Resources

The converse of the above constraint is that there are 900,000 poor people (the total population, less the 115,000 mentioned above) with at least potential demand for inexpensive goods. Many of these people cannot afford even mass-merchandized RSA goods. Further, as the prices of inexpensive goods are often heavily influenced by transportation costs, local production has an advantage. To the extent that SSEs have lower production costs (they reportedly pay below the minimum wage and almost certainly are in the position to use scrap raw materials, for instance), they can take advantage of this opening. This is particularly true for services (e.g. repair of inexpensive motors) and manufacturing of high weight-to-value items (e.g. cement blocks). Finally, the supportive attitude of the GOB (unlike many developing-country governments, which favor heavy industry) is likely to keep the policy environment favorable for SSEs.

2. Constraints

Major constraints are access to credit (SSEs rarely have mortgageable fixed assets or financial records which would please a banker), supplies at reasonable prices (reportably buying supplies in RSA is a difficult, cash-only process), management deficiencies which only become apparent during periods of high growth when the danger for disaster is great, and access to the largely RSA-controlled local distribution channels (GOB makes this problem worse with a prim attitude towards informal marketplaces and zoning for small business).

3. Examples of Apparent Opportunities

The following examples give a flavor of the considerable opportunities which SSEs can consider:

- House-painting and maintenance (including privatization of GOB services);
- Supply of inexpensive goods which have high transport costs relative to value (e.g. cement blocks);
- Vehicle and motor repair;
- Services to GOB and parastatals which do not require high quality and are purchased in small quantities (e.g. window-washing);
- Urban transport;
- Industries restricted to Batswana, such as school uniforms and burglar bars, but which provide experience to enter larger market segments;
- Industries in small niches, using unusual local resources and characterized by highly specialized export markets, e.g. clothing made from game skins, wild animal parts used in Oriental medicine;

- Contractors specializing in inexpensive construction;
- Elementary vocational training, such as typing schools.

4. Examples of Feasible Opportunities

The above constraints, particularly that of lack of credit, make opportunities greatest when the buyer is a benevolent "big brother" who has interests besides short-term economic ones to see a SSE supplier succeed. Supplying GOB, parastatals or large local firms, at least to a level to cover SSEs' fixed costs, is thus a major opportunity. Therefore, the extent to which GOB, parastatals and large firms can develop SSE suppliers is critical, as is, more generally, the success of SSE-assistance (loans and management training) organizations. There is, however, no reason why such efforts must result in permanent, or in many cases even temporary, subsidies, because of the potential ability of many SSEs to undercut RSA suppliers.

H. PRIVATIZATION OF PARASTATALS

We do not see the need to consider the privatization of existing parastatal companies at this time because a lack of local private sector capital. However, there are undoubtedly several functions being performed within all or many parastatal agencies which could be transferred to the private sector to generate entrepreneurial opportunity and promote efficiency as opposed to the generation of new employment. Examples are:

- Housekeeping activities;
- Grounds maintenance;
- Building maintenance;
- Car service as opposed to vehicles and chauffeurs for less than senior officials;
- Security functions in all but very sensitive areas.

V

BUSINESS OR INVESTMENT OPPORTUNITIES

BY SOURCE OF INVESTMENT

A. LOCAL CAPITAL

1. Resources

With a prime rate at 10% and inflation about the same, the real cost of capital in Botswana is only the premium which a borrower has to pay above prime. Further, because of bank excess liquidity, restrictions on converting local currency and GOB surpluses which preclude the development of a government paper market - large savers have no organized, attractive investment alternatives. Thus the cost of equity capital (the expected return which a firm would have to offer investors) should be low. Therefore projects to be funded by local-currency debt or equity should be able to offer a return only slightly above the inflation rate and still attract funds - if the capital market were better developed. A still nascent but high-potential source of capital for locally-financed projects is savings of resident and expatriate Batswana workers, mostly in large enterprises, mobilized through credit unions.

GOB's restrictions on access by foreigners (e.g. to land) is another resource of locally-financed projects: the resulting collateral is available for local borrowing. Finally, a number of institutions (e.g. BDC, NDB) provide local financing at market rates but offer free management counseling.

2. Constraints

Access to long-term financing is the greatest constraint. This in turn is a function, as discussed elsewhere in this report, of many projects' lack of counterpart equity financing. Other constraints facing locally-financed projects come from having low or no involvement of a foreign investor. Thus access to foreign markets, technology and in some cases skilled and comitted management are all especially acute problems. The capital gains tax, which discourages liquidation of low-yielding investments and reinvesting in higher-yielding ones, is a major impediment to the free flow of capital and thus is a major constraint on local investment.

3. Examples of Apparent Opportunities

The opportunities open to local capital in general are similar to those already discussed for SSE in particular. Examples are property development, building materials, game-viewing tourism and bricks.

4. Examples of Feasible Opportunities

As explained in the section on SSEs, a good area for feasible opportunities is enterprises which sell to the GOB, parastatals or large firms. Similarly, those tied to property development, including building materials, would tend to be feasible. Those having to do with game, e.g. game ranching or tourism, also appear to be feasible if the underlying projects are sound. However, as explained above, the imperfection of the local capital market makes the most necessary characteristic of feasible projects the access to private equity capital.

B. FOREIGN INVESTMENT

1. Resources

Foreign Investment as a source covers the full range of investor, from the multinational corporation opening a new factory to the immigrant from a neighboring country who comes to Botswana with his skills and his capital to settle on a permanent basis. Investment in this context means not only the transfer of money or fixed assets but also resources such as trained manpower, access to foreign markets and process technology. As the real cost of capital in Botswana (prime rate less inflation) is close to zero, foreign investors are likely to prefer transferring resources other than money. This low cost of capital is one of Botswana's major assets.

The multinational corporation, or the corporate applicant in the act of relocating from a neighboring country brings capital, product technology, an access to markets, and management expertise which are extremely important to the development of Botswana.

Similarly, the foreign, potential immigrant, entrepreneur desiring to relocate to Botswana brings some capital and skills important to the country but is far more reliant upon local institutions than the multinational, and runs a much higher risk of failure.

The multinational, will always be a guest in the host country, subject to policies and decisions made far away in corporate headquarters as well as to local laws.

The immigrant foreign individual may seek Botswana citizenship, raise his family in the country, and retain his wealth here investing in its continued growth.

Both ends of the scale contribute to the development of Botswana by generating employment, training and developing the skills of its citizen employees, and eventually contributing to the number of Batswana senior managers, entrepreneurs and skilled technicians. Government has the sovereign right to decide who can come and who cannot, and what is permitted to be done and what is not, and with the exercise of these powers, the responsibility for the future direction which the country will take.

2. Constraints

Business licenses dictate the answer to what will be done by whom, both foreign investor and citizen. Residence and work permits dictate whether or not the foreigner will be permitted entry and the nature of his employment over a two year term.

Present immigration regulations make no distinction between the status of a multinational corporate executive or technician, institutionally employed, for whom a two year permit may be adequate as he expects to be replaced, and the immigrant entrepreneur who would bring minimal capital as the two year horizon is a disincentive to bringing significant personal capital into the country.

The present social infrastructure of Botswana, housing and the international school particularly, are inadequate because of rapid growth and too deliberate planning and development. There is also a backlog in the availability of industrial space, particularly in the capital, but in other areas as well.

Constraints such as high transport and power costs, small local market, and lack of skilled labor, housing, and lack of capacity in the international schools have been mentioned elsewhere.

3. Observations

It is unlikely that a major dent in current unemployment along with the need for the creation of an estimated 12,000 new jobs per year in the formal sector can be made without significant foreign investment of all types. The most likely source of foreign investors will be in neighboring countries, South Africa, Zimbabwe, and Zambia. They will be corporations or individuals seeking, or at least open to giving careful consideration to the unique advantages which Botswana has to offer. They will be sufficiently knowledgeable of the region, and sufficiently well capitalized, to be able to accept and live with Botswana's constraints. Foreign investment is most likely in areas where Botswana offers major resources to export (e.g. minerals) or provides an "insurance policy" to continued presence in RSA.

Ideas to remove constraints which, if adopted, would greatly enhance the prospects for foreign investment would be a) packaging a number of residence and work permits with each licence for new foreign investment, b) giving extended, perhaps indefinite, residence and work permits for foreign immigrants starting new businesses, c) reduction of the corporate tax, or the provision of credits for reinvestment, and d) providing export incentives. With regard to item (b), residence and work permits, these documents could allow the GOB legal recourse if individuals acted in a questionable manner. Land, housing, and education are also fundamental constraints that can be relieved.

C. JOINT VENTURES

1. Resources

The joint venture, in its broad definition, includes not only the joint ownership of an enterprise in which the foreign partner contributes capital, technology, management, and markets along with the capital, management, and local expertise of the local partner - but also licensing and other forms of technology transfer such as franchising. Licensing, accompanied by technological assistance and access to foreign markets, might prove an excellent vehicle for the expansion of an established local industry. This formula significantly expands the universe of possible foreign connections available to Botswana as there are many firms worldwide which, while not interested in investing in Botswana or Africa, would be willing to share technology for a royalty and provide technical assistance and markets for a fee. The licensing concept includes a range from the highest of scientific technology transfer to the use of name and knowhow in a fast-food franchise.

At present, the joint venture is more likely to occur as a result of the Batswana enterprise's seeking an arrangement with a firm in a neighboring country, or elsewhere, for their mutual benefit, rather than a foreign firm's initiating the deal.

The Botswana enterprise should not allow capital to become a constraint since, even if the foreign technology partner does not wish to enter with capital, a three-way venture between the local enterprise, an entity such as the BDC and the foreign technology partner is always possible if the project is sound.

The true joint venture which has a local identity has several advantages which a purely foreign firm might not enjoy. For one, the joint venture might have better access to the public sector as a customer. Second, the local partner in the joint venture would have a better understanding of local labor practices. Last, the joint venture might find less pressure from government for the localization of management than a 100% foreign earned firm.

2. Constraints

An investing joint venture partner faces the same constraints faced by a foreign investor. However, he has the assistance of his local partner in overcoming the obstacles.

The constraints faced by the foreign technology partner are mainly legal in nature, ensuring that licensing agreements are legally enforceable and duly registered.

Providing technical assistance requires residence and work permits depending upon the requirements of the situation. Housing also becomes a factor.

Ability to interest potential partners in relatively small projects is, of course, a major constraint.

3. Observations

There are no restrictions on the level of foreign ownership once an investment is approved. A foreign firm relocating or expanding geographically is likely to take the 100% owned approach unless he sees an advantage in joining with a local partner.

Some special areas such as leather might result in joint ventures since, for instance, BMC has stated that it would only enter the field on a joint venture basis. If a foreign firm wanted BMC as a partner, it would have to contribute management plus at least 50% of the venture's capital.

The likeliest type of joint venture at this stage is the technology joint venture consisting of a licensing agreement and an arrangement for technological assistance. The Kentucky Fried Chicken franchise is an example of this type of arrangement.

Controllable constraints for joint ventures are similar to those for foreign investment, and will eventually result in more foreign connections for Botswana if relieved.

D. CONCLUSIONS TO CHAPTERS IV AND V

Although many opportunities exist, new domestic and foreign-sourced investment is far below the level necessary to create the estimated 12,000 new jobs per year for school-leavers in the formal sector, let alone make a dent in the existing 25% level of unemployment. Constraints too nearly balance resources, leaving too little room for opportunity.

1. <u>Summary of Key Resources</u>

- Stable political environment;
- Southern African Customs Union for supply and SADCC, EEC, and Arab Bloc for markets;
- Plentiful supply of inexpensive labor;
- Investment incentives for manufacturing, agriculture, and small mining investments (FAP);
- Large foreign-exchange reserves with no constraints to funding, import of raw materials and supplies, and liberal profit remittance;
- High liquidity in the financial system, resulting in low real cost of local capital and generous leverage (gearing) limits to creditworthy (as banks traditionally define the term) firms;
- Reasonably good infrastructure in major population centers;
- Skilled assistance from international accounting firms and banks for the qualified potential investor;
- Large underutilized land area, some with potential for irrigation;
- The diamond and cattle industries, which as the largest foreign exchange earners, show every sign of continuing strength assure a high probability of long term financial prosperity for the country.

2. <u>Summary of Key Constraints</u>

- Small size of the local market (approximately 115,000 consumers in the cash economy), obliging export in order to achieve reasonable economy of scale;
- Strong competition from RSA to supply the local market;

- Lack of incentives for, and facilitation of, capital transfer to productive enterprises;
- Lack of small- and medium-scale enterprise credit access;
- High tax environment for a country in Botswana's stage of development;
- Need for, and high cost of maintaining, expatriate technical and managerial staff;
- Shortage of housing and international schooling to be provided to expatriate staff;
- Regulatory and bureaucratic framework encompassing business licenses, residency and work permits, and other documentary requirements which form a major barrier to all but the most powerful or persistent potential foreign investor;
- Lack of incentives (FAP) in key areas such as services;
- The ever present possibility of destabilization efforts by RSA.

3. <u>Summary of Opportunities</u>

- Agriculture using modern irrigation techniques which conserve water offers opportunities, from household or town to commercial scale. Following appropriate underground water studies, large scale, highly technical export-oriented projects appear feasible. Satellite farming, involving local growers under guidance from a core operation is probably applicable in the larger operations.
- Exploitation of new properties with known diamond reserves, the reopening of old gold properties, the commencement of the soda-ash project and continued and expanded exploration efforts will add employment in this sector. If petroleum reserves are found, a new industry will result.
- Manufacturing opportunities are focused on Botswana's political position as a member of the Southern African Customs Union on one side and SADCC and Lome III (EEC) on the other. A Botswana location affords access to markets now closed to multinational and indigenous firms presently located in RSA.

With the easing or elimination of controllable constraints, as recommended in this study, the realization of opportunities will increase, and the consequent increase in productive investment will generate new employment proportionally.

VI

THE FINANCIAL MARKET'S IMPACT ON INVESTMENT AND EMPLOYMENT GENERATION

A. EFFECTIVENESS

The commercial banks are in a very healthy situation; on May 29 liquidity was high with cash and cash items at 47% of deposit liabilities, loan to deposit ratio low at 64%, and gearing low with capital and reserves at 10% of deposit liabilities.

Given the quality and experience of the institutions involved, one must consider that the commercial banks are effective in terms of servicing the clientele which meet their requirements. Many firms in the small to medium size category fail to meet those requirements, or reach prudent borrowing limits leaving unfulfilled requirements. Many times these requirements could be met if business practices, such as bookkeeping, planning, and other management tools were practised on a more developed level so that lenders had credible information on which to base decisions. While in many cases banks state that they still lend, this is obviously a hindrance to further credit expansion.

Other institutions exist to extend credit to firms as a supplement to commercial banks, or to those that do not meet commercial bank criteria, or have requirements outside normal commercial banking services. The National Development Bank lends heavily to agriculture and to both small and medium sized industrial firms. The BDC provides both equity capital and loans to new investment and expansion of existing plant to large firms with sophisticated planning which, without exception, fall into the large category. Tswelelo, an entity three years old owned jointly between BDC (40%), NDB (40%), and the Dutch donor agency FMO (20%), has made 80 loans to small business, 70 medium size loans (P5 - 25 thousand), and 40 large loans (P25 - 150 thousand). Loan terms are relatively strict, secured whenever possible, and are accompanied by business advisory or counselling services.

One can generally state that those who were first in line and met bank's criteria were and are being effectively served. However, the numbers that have received credit are few. There are upon study, major improvements in the system which need to be made. Particularly there is a lack of readily available medium term credit for machinery and equipment, vehicles, etc. Entities such as the BDC and Tswelelo very much need to be prudently expanded in as expeditious a manner as possible.

B. CONSTRAINTS

The medium to large end of the market which is made up of relatively sophisticated businesses, successful to a greater or lesser degree, but highly geared, sometimes has difficulty providing security satisfactory to the lending institutions since receivables, inventory, and even machinery or vehicles are not readily accepted as fully realizable security. Cattle, a store of wealth which are often offered as security, are diffcult and expensive to control.

When used, the overdraft system of banking does not provide month by month control to the lender, nor discipline to the borrower.

- The under-capitalized foreign entrepreneur, unless considered creditworthy by the commercial banks, has few places to go since Tswelelo is for citizens only.
- Tswelelo needs to be considerably expanded to attend to the size and number of local businesses with loans in the 1,000 Pula to 25,000 Pula range on a nationwide basis.

- Bank interest rates are reasonable relative to interest paid on deposits or the cost of funds from Government (BDC and NDB). Commercial bank prime is now 10%, with a maximum of 15%, and small loans from Tswelelo would run about 18%. Government charges BDC and NDB 8 1/2% and funds are re-lent at prime plus 2% or above.

C. CONCLUSIONS

The availability of credit is ample, so money is not the problem. The problem is:

- A lack of credible, credit-worthy borrowers with sufficient data to support their ability to repay the loan.
- A lack of acceptable collateral when such is a limiting factor.
- A general lack of equity capital to support the level of borrowing requested. Most firms are highly geared. The high tax rate does not provide a suitable incentive to accumulate capital via retained earnings.
- Amongst the more sophisticated, a tendency to understate earnings for tax purposes which, on the other hand, does not reveal the true borrowing capacity of the firm, but what is the banker to believe?
- Insufficient use (and perhaps a need for specialized institutional development) of inventory and accounts receivable finance, bonded warehousing, and medium term vehicles such as equipment leasing so that a greater percentage of value can be financed. However, present tax laws no longer favor leasing as a means of finance.

Commercial banks finance factory buildings, and now the Botswana Building Society has entered this arena. Since commercial banks have little incentive to accept savings, as they are overly liquid, the Botswana Building Society system should be greatly expanded, both balance sheet-wise and geographically, so they can accommodate both housing and industrial needs.

Tswelelo has become the focal point for small to medium business lending beyond the activities, which are mainly short term in nature, performed by the commercial banks through their rural branch system. However, Tswelelo is a relatively new entity and does not have anywhere near sufficient human resources to expand either its lending or its counseling services. The rural branch systems of the commercial banks, particularly Barclays and Standard Chartered offer instant geographical expansion and a pool of trained manpower to Tswelelo. It would seem a most worthwhile suggestion that Tswelelo and the commercial banks seek a common ground for combining efforts in the supply of financial resources to this sector.

The formation of equity capital, and its wider distribution are the major financial requirement, along with the simultaneous development of human managerial capability. The Sechaba Investment Trust of BDC is a first step; it allows BDC to make liquid a part of its portfolio, providing an investment vehicle for both individuals and pension funds. This in turn gives BDC re-investible equity funds. One commercial bank has raised new capital in a private floatation of shares and intends to do more. However, the biggest potential source of internally-generated equity capital would occur if Government were to give a credit of, say, half of the corporate income tax if companies would spend that money to expand existing business or form new businesses. If, for instance, a large tax-payer like Barclays Bank were permitted to make use of a 50% tax credit in 1986, Pula 1,650,000 could have been retained in the private sector as equity and new employment would have been created. If they didn't want to invest, they could pay the tax. If the large businesses were placed in this position, could one not assume that they would become active promoters of new investment in Botswana? This type of incentive has worked very well in other countries, most notably in Brazil in their drive to develop the North East region (which is similar to Botswana but with a population of 30 million) during the late 1960's.

APPENDIX A

TERMS OF REFERENCE

PRIVATE SECTOR STRATEGY STUDY

OBJECTIVE

To produce an internal USAID study which will support national and Mission program objectives of employment generation through stimulation of the private sector by producing action-oriented recommendations for USAID, the GOB, parastatals and, most important, the private sector itself. Emphasis should be on developing recommendations which:

- Are consistent with the fact that private firms are driven by the desire to achieve acceptable profits over time and primarily consider business factors (e.g. market size, availability of technology, labor supply and finance).
- Require, at most, temporary support from GOB or donors.
- Are consistent with, and build on, the results of previous studies in this field, as well as the opinions of private-sector elements and GOB officials concerned with the private sector.

SPECIFIC ISSUES TO BE ADDRESSED, WITH EXPECTED ACTIONS

1. What changes might be made in USAID present projects/programs within present funding levels, to give greater emphasis to the private sector, specifically to stimulating employment-generating investments? Possible action is the allocation of funds within

existing projects to better support the above objective. The just-completed Strategy Assessment indicates that changes might be concentrated - and probably limited to - the following areas:

- o Education (JSEIP, PEIP and BWAST) - curriculum reform to increase entrepreneurial consciousness and pre-vocational training among students;
- o Training and technical assistance (BWAST) - increased emphasis on providing consulting expertise to high-leverage, private-sector based initiatives likely to result in rapid employment generation, especially opportunities to provide brokerage between existing assets (e.g. high bank liquidity) and private-sector elements to which the asset is the sole "missing ingredient" for expansion.

PL480 monetization and closer collaboration with the Peace Corps are among the new executing means which should be addressed.

2. <u>What policy and procedural areas could be identified, for discussion with the GOB, requiring change to strengthen the private sector and especially increase local job-creating investment</u>? Such recommendations and supporting rationale will justify USAID's modest investments in policy studies and back up USAID policy discussions with the GOB. Expected policy issues are the value of the pula, Financial Assistance Policy (FAP) simplification and the minimum wage. Recommendation/study packages should address the extent to which private sector elements see such policies as crucial in their investment decisions and should estimate the expected employment-generation potential of the policy changes. The study needs to clearly identify constraints and develop specific recommendations on how to overcome them. The study should identify, to the extent possible, specific local industry investment possibilities.

3. <u>What new projects, within current overall levels of funding, and/or high-leverage but smaller interventions should USAID consider to help strengthen the private sector within the country to help create jobs</u>? Such recommendations should be based on the reduction of key constraints to private-sector employment generation, which USAID has a particular advantage in

addressing. One possibility might be strengthening credit linkages between lending institutions and small enterprises, and consultancies under BWAST, e.g. financial markets assistance.

4. What are some specific employment-generating, private-sector opportunities and recommended actions for the private sector, GOB, parastatals other donors or USAID to increase foreign investment and what are the constraints? Areas for emphasis are opportunities for foreign, particularly US, collaborative ventures (including licencing, marketing and investment), in such areas as tourism, housing, cattle-industry spinoffs, rural-based industries, etc. What privatization of parastatals is possible/desirable?

SCOPE OF WORK

Two U.S. consultants - both with strong international business qualifications, one with previous involvement in the just-completed USAID Strategy Assessment (team leader) and one with a financial background - will contribute experience with similar efforts elsewhere and will be responsible for final report preparation. A local financially-oriented, private-sector consulting firm will organize background material, execute a private-sector survey and provide general logistical support to the study. USAID will also provide logistical, office and secretarial support for the international consultants.

Specific tasks are as follows:

1. Update 1985 Investment Climate Survey. Using and citing readily-available published material (including the Strategy Assesment report) and brief statements of professional opinion offering conclusions on employment-generating potential, the local consultants will update the survey (see the 22-page Dimpex Study, July 1985). A guide to survey elements follows:

GOB policies, regulations and procedures

- Political stability and risk
- National Development Plan
- Business formation and investment
- International remittances
- International trade restrictions

International agreements

Taxes

Investment incentives

FAP Automatic Financial Assistance incentives

FAP Case-by-case Financial Assistance incentives

Labor laws

Government controls and interference

Banking and credit policies and regulations

Availability of business advisory and promotion services

Summary and conclusions

Basic economic, market and resource factors

Economic and market stability and growth prospects

Production resources and services

Basic materials and parts

Infrastructure

Local credit and capital

Business services

Entrepreneurial and managerial talent

Shortages of skilled labor

Non-skilled labor

Other facilities

Composition of major elements of the private sector.

2. Survey a sample of key private-sector elements. With the objective of providing direct private-sector input into the resolution of the above four specific issues, the local consultants will design and execute (after USAID approval of the design) a survey plan. Because of expected difficulties in distinguishing real opinions of constraints and opportunities from narrpw lobbying efforts, the use of several homogeneous focus groups and a skilled moderator - perhaps followed with limited confirming survey work - will probably be necessary. Discussion and survey work should emphasize constraints against and opportunities for specific employment-generating investment projects with which the respondents are personally familiar. Findings may be presented informally, in bullet style.

3. Confirm the validity and importance of hypotheses which are generated by the update of the Investment Survey and the survey

52

of the private sector, and prepare final action recommendations. The local consultants will support the U.S. consultants in the latter's efforts to validate, draw conclusions and prepare a report. These efforts will include talks with a GOB/private-sector reference group which the GOB is expected to establish, as well as interviews and site visits with public- and private-sector elements representing key constraints or opportunities. In addressing the four questions cited earlier, the U.S. consultants (with support from the local consultants) will (A) assess the structure, method, and practicality of the current investment promotion activity and organization, and make recommendations for changes as necessary, (B) prepare an analysis of business or investment opportunities by sectors like agriculture/agribusiness/industry, etc., and (C) prepare a practical/functional analysis of the financial market and its effectiveness and its constraints as they impact on new business development particuarly indigenous small and medium business.

LEVEL OF EFFORT AND TIMING

The local consultants will devote five person-days to task 1, ten to task 2 and ten to task 3. The foreign consultants will spend 36 person-days on task 3. Draft reports for tasks 1 and 2 must be completed by August 1 and task 3 by August 31.

APPENDIX B

ACRONYMS

ATIP	Agricultural Technology Improvement Project
BDC	Botswana Development Corporation
BEF	Botswana Employers' Federation
BMC	Botswana Meat Commission
BWAST	Botswana Workforce and Skills Training Project
EEC	European Economic Community
FAP	Financial Assistance Policy
FMO	Dutch Donor Agency
GOB	Government of Botswana
IESC	International Executives Service Corps
IFS	Integrated Field Services
JSEIP	Junior Secondary Education Improvement Project
NDB	National Development Bank
NGO	Non-government Organization
OPEX	Operational Expert
PEIP	Primary Education Improvement Project
PVO	Private Voluntary Organization
RSA	Republic of South Africa
SADCC	Southern African Development Coordination Conference
SDR	Special Drawing Right
SSE	Small Scale Enterprise
TA	Technical Assistance
UNDP	United Nations Development Programme

Notes: Batswana — Citizens of Botswana
Motswana — A citizen of Botswana

APPENDIX C

PEOPLE CONTACTED

GOB/Private Sector Reference Group

L. Mothibatsela	Director, Industrial Affairs, Ministry of Commerce & Industry (MCI)
E. Dewah	Director, Commercial Affairs, MCI
T. Valentine	Employment Policy Coordinator, Ministry of Finance & Development Planning
R. Bird/R. Sherriff	Barclays Bank (Managing Director/Manager Corporate Banking)
M. Chakalisa	Senior Labour Officer, Ministry of Labour & Home Affairs
M. Setlhare	Special Advisor to the General Secretary, Botswana Federation of Trade Unions
M. Mbaakanyi	Director, Botswana Employers' Federation
J. Motshubi	Partner, Coopers & Lybrand

In USA

Michael Dixon	International Finance Corporation
John P. Hummon	Director, USAID/Botswana
Alan Morris	World Bank
Amb. Donald Norland	Former US Ambassador to Botswana
Malcolm J. Odell, Jr.	Former training advisor, GOB

Dr. Marcia L. Odell	Consultant on Botswana SSE projects, SIDA
Nancy Pielemeyer	AID/W, former advisor to Ministry of Health
Betsy Stephens	Former advisor to Ministry of Health
Michael J. Tiller	Former Officer BDC, specialist on African debt-to-equity swaps
Clay Wescott	Consultant to US corporations disengaging from RSA

In Botswana

N.H. Bellocchi	Ambassador, U.S.A.
Richard Betz	Asst. Field Coordinator, Academy for Educational Development
Robert Brink	Coopers & Lybrand
N. Burrows	General Manager, Tswelelo (Pty) Ltd.
M. Clinch	Deputy Managing Director, Barclays Bank
T. Courtenay	R.E.T. Courtenay (Pty) Limited
G. Devdevan	Chief Accountant, Tswelelo (Pty) Ltd.
T.C. Dikgaka	Mining Commissioner, Ministry of Mineral Resources and Water Affairs
D. Finlay	Executive Chairman, Botswana Meat Commission
D. Fuzzie	Managing Director, Sarnia
B.I. Gasennelwe	President, NDB
N. Glickman	Managing Director, Bothakga Handknit
H.C.L. Hermans	Governor, Bank of Botswana
Mark Hopkins	Manager, Financial/Transport Division, BDC
D. Khonat	Managing Director, Algo Industries (Pty) Ltd.,
Dr. N. Locke	Dept. of Geological Survey
D. Magang	Member of Parliament
K.O. Matambo	Director Economic Affairs, MFDP

36

A.J. McMurray	Group Co. Secretary, BDC
M. Molefane	General Manager, BDC
Janis Mullan	Mullan Associates;Chairperson, Tourism Association
L. Nchindo	Resident Director, Debswana
C. Neary	Consular Officer, U.S. Embassy
G. Nilsson	Sanitas
D. Norman	Chief of Party, Agricultural Technology Improvement Project
Anthony O'Dwyer	Managing Director, Standard Chartered Bank
Robert Porter	Director of Bank Supervision, Bank of Botswana
R.M. Sachse	Senior Project Officer, Tswelelo (Pty) Ltd.,
Jon Thompson	Commercial Manager, Botswana Telecommunications Corporation
T. Thompson	Pol/Econ Officer, U.S. Embassy
E.K. Tibesigwa	Assistant General Manager, Development Banking, National Development Bank

APPENDIX D

INVESTMENT CLIMATE SURVEY OF BOTSWANA

1. INTRODUCTION

This report, report prepared by Coopers & Lybrand Services (Pty) Limited, Gaborone, Botswana, examines the climate for private investment and development in Botswana. It was commissioned by the United States Agency for International Development in order to provide input into the Private Sector Strategy Study which in turn was part of an overall program evaluation carried out by the agency in June to August 1987.

Much of this report is based on the opinions of individuals in Botswana's private sector drawn by the consultants through several years experience in the country and supplemented by interviews and discussions held during the June to August 1987 U.S. AID private sector study. Where possible the opinions are supported with statistics and summaries of Government policies, regulations and laws.

Whilst care has been taken to ensure that this document is accurate in terms of summarizing opinions, quoting statistics and explaining Government rules and regulations, we must stress that it is intended to give the reader a very broad overview of Botswana's investment climate and existing private sector. Reference should be made to the reports and documents listed in the appendix.

The opinions expressed in this document do not necessarily represent the opinions of the United States Agency for International Development.

This report is divided into four parts:-

Summary;
Botswana Government policies, regulations and procedures;
Basic economic, market and resource factors;
Composition of the major elements of the private sector.*

*This part is not included in Appendix D but can be found in the complete text of the survey which is available from USAID/Botswana.

2. SUMMARY

In many respects the investment climate in Botswana is highly favourable:-

Botswana is politically stable and has a pragmatic, private sector orientated approach to economic development. Rapid growth in the mining industry has enabled the country to set liberal rules and regulations pertaining to foreign trade and the movement of capital. Various trade agreements with South Africa, Zimbabwe and other Southern African countries, the United States and the EEC offer investors potential markets throughout the world. Overall labour relations are quite good. In general most goods and private services are readily available.

There are, however, constraints which hinder private sector development in certain areas:-

Obtaining permits, land, and investment incentives can be laborious. Work permit regulations make it quite difficult to recruit expatriate staff. The local market is quite small, and there is strong competition from imported goods, especially South African. Most raw materials have to be imported. Utility rates are high, and skilled workers are in short supply.

3.13 Summary and conclusions

Table 1 summarizes the overall impact which the Government's various policies, regulations and procedures have on private sector development:-

Highly favourable

Botswana ranks highly favourable in terms of the country's political stability and risk, national development priorities, international remittances, policies regarding international trade, and regulations allowing foreign investment. Botswana has a pragmatic, private sector orientated approach to economic development.

Moderately favourable

Considered generally favourable are the Government's laws pertaining to local labour and the overall lack of Government control over private business activities.

Investment incentives have been given only a moderately favourable rating because many investors find the benefits inadequate or unavailable, and the approval procedures quite slow. The local preference scheme has been largely ineffective in providing support to local industries. Investment incentive rules are rather inflexible in that investors are limited to one form of incentive.

Neutral

The free trade policy within the region has worked to the advantage of some investors and the Government hopes that additional investment will be encouraged by the prospect of exporting to South Africa. However, strong competition from South Africa has made it difficult for other firms to become established in the Botswana marketplace.

The regulations pertaining to borrowing by non-citizens are not overly restrictive. However, there is some indication that the regulations could possibly be preventing some companies from obtaining finance.

Moderately unfavourable

The area seen to be moderately unfavourable is that of business regulations dealing with licencing, especially as applied to industrial licences. Obtaining an industrial licence can take several weeks and applications can be refused.

Highly unfavourable

The areas seen as highly unfavourable are taxes, labour laws as applied to non-citizens, and Government advisory services.

The corporate tax rate of 40% with no accelerated depreciation for plant and equipment is considered excessive for a country with adequate revenues from other sources and attempting to promote new industry.

The work permit regulations can make it quite difficult for investors to recruit the necessary expatriate staff. New investors must also contend with the requirement to renew their own permits every two years.

The Trade and Investment Promotion Agency has no power to ensure that investors are granted the licences, financial incentives, land, and services which they require. Therefore, efforts made by the agency often meet with limited success.

Table 1

EVALUATION OF GOVERNMENT POLICIES, REGULATIONS AND PROCEDURES IN TERMS OF ENCOURAGING PRIVATE SECTOR DEVELOPMENT IN BOTSWANA

Factors	Nature of Impact: Favorable		Neutral	Unfavorable	
	Highly	Moderately		Moderately	Highly
Political stability and risk	X				
National development priorities	X				
International remittances	X				
International trade policies					
As permitting overseas trade	X				
As related to regional trade			X		
Taxes					X
Investment incentives		X			
Labour laws					
As applied to local staff		X			
As applied to expatriate staff					X
Government controls		X			
Banking and credit			X		
Business formation regulations					
As permitting foreign investment	X				
As pertaining to licencing				X	
Government advisory services					X

62

4.3 Summary and conclusions

Table 2 summarizes the evaluation of the various economic and market factors present in the country in terms of encouraging private sector development:-

Highly favourable

A highly favourable rating was given to the high level of integrity present throughout the country's institutions, both public and private. Corruption is virtually nonexistent. The independent judiciary offers recourse in legal disputes.

Moderately favourable

Moderately favourable ratings were given to the general availability of facilities and goods. In general most goods and private services are readily available. There are problems related to schooling for the children of expatriates.

The abundance of unskilled workers is offset to a certain extent by the high training component involved in the setting up of most industries.

Neutral

Neutral ratings were given to credit and capital and business services. Although there is excess liquidity in the economy, the shortage of sophisticated financial institutions and a stock and bond market can make it difficult for some businesscs to obtain finance.

Although professional assistance is readily available in the country, problems can be encountered in obtaining specialised technical repairs and service.

63

Moderately unfavourable

This rating was given to the availability of raw materials and parts, infrastructure and entrepreneurial talent. Most raw materials have to be imported. Serviced land can be difficult to obtain. Utility rates are high. There is a shortage of skilled local entrepreneurs with adequate finance to invest.

Highly unfavourable

The size of its local market and lack of skilled workers are seen as major constraints to growth in the country's private sector.

Table 2

EVALUATION OF ECONOMIC AND MARKET FACTORS
IN TERMS OF ENCOURAGING PRIVATE SECTOR DEVELOPMENT IN BOTSWANA

Factors	Nature of Impact: Favorable Highly	Favorable Moderately	Neutral	Unfavorable Moderately	Unfavorable Highly
Size of market and growth prospects					X
Basic materials and parts				X	
Infrastructure			X		
Credit and capital			X		
Business services			X		
Entrepreneurial talent				X	
Skilled workers					X
Unskilled workers		X			
Other facilities		X			
Integrity, functioning legal system	X				

USAID/BOTSWANA

SAMPLE SURVEY OF KEY PRIVATE SECTOR ELEMENTS

1. INTRODUCTION

A series of focus group meetings were held during the first week of August 1987 in order to provide direct private sector input into the Private Sector Strategy Study commissioned by the United States Agency for International Development as part of its overall program evaluation.

There were three separate meetings, respectively designed to represent small, medium and large scale business interests. The participants were not chosen at random. Instead, invitations were made so as to ensure that each group represented a cross section of the various ethnic and business types making up each category of businesses.

The businesses represented over the course of the three meetings included small shop owners, transporters, farmers, manufacturers, builders, small scale enterprises, wholesalers and bankers. Included were citizens, non-citizen entrepreneurs and non-citizen employees of foreign owned companies. Participants were selected by Coopers & Lybrand in conjunction with the group moderator, Mr G. Kgoroba, and U.S. AID.

The participants were asked to discuss the specific problems relating to their own businesses as well as any constraints which they saw retarding the overall development of the private sector in Botswana. Their replies consisted of complaints and criticisms as well as suggestions for relieving constraints and encouraging private sector expansion.

The complaints and criticisms should not be taken as an indication of the respondents' overall opinions regarding living and running a business in Botswana. In fact the general

66

consensus of each meeting was that Botswana is a great place in which to live and work. The participants were pleased to have been asked to discuss their problems and to share their experiences with other business people.

The important message to be gained from the meetings is that more can and should be done to develop the private sector in Botswana. According to the private sector representatives, there are many policy changes which the Government could make to encourage private sector development and the creation of jobs.

The following summary is a record of what took place at the meetings. The opinions expressed are not necessarily those of Coopers & Lybrand Services, the moderator or the United States Agency for International Development.

101

2. CONSTRAINTS AND PROBLEMS

Summary of main constraints and problems mentioned over the course of the three private sector focus group meetings:

2.1 Lack of credit and finance facilities

Credit in Botswana is generally limited to the commercial banks. The normal lending by commercial banks is for short term purposes, in most cases for working capital. Botswana has little in the way of long term finance such as a stock exchange, merchant banks, etc.

The commercial banks were accused of being too conservative. In mitigation the banking representative mentioned that the legal system is rather weak in terms of debt collection, establishing clear title over security, etc.

The regulations of the Bank of Botswana could also be limiting the amount of credit available. Specifically mentioned were rules pertaining to the amount of lending available to any one company. There is also conflicting instructions coming from the Bank of Botswana regarding lending to resident, non-citizen firms. Whereas some departments within the Bank of Botswana are encouraging local borrowing by non-citizens, others deny the actual permission to do so.

The interest rates were seen to be too high. The National Development Bank was seen as being the worst in this regard.

2.2 Customs union

Most participants agreed that membership in the Southern African Customs Union was, at least under the present agreement, a disincentive to investment.

South African government protection results in high capital costs for Batswana businesses. Botswana has little control over which goods carry duty. Botswana can not protect its own industries, but must pay additional duties to protect South Africa industries.

2.3 Small local market and difficulty in exporting

The Botswana market is quite small, and Botswana is bordered by the strongest industrial country in Africa. The Zimbabwe government sets quotas and local content requirements which make it difficult or impossible to sell there, but their producers are allowed to sell in Botswana. The combinations makes it extremely difficult for local producers to compete in this region.

The best alternative would be to exploit export markets, but the high cost of shipping makes it uneconomic.

2.4 Personnel

There is a shortage of trained staff in Botswana. Expatriates must be used, but work permits are always a problem. Businessman must battle for each permit. Delays in processing permits creates uncertainty for the employees and causes many to leave.

Training is expensive. The present educational system does not prepare school leavers to work in the private economy.

Minimum wage legislation creates problems for the smaller businesses who can not afford to employ qualified staff and are often forced to retrench after each increase. Despite the apparent high rate of unemployment among Cambridge leavers they appear to be a reluctant to work at the minimum wage rate.

2.5 Land

Both commercial and residential land is difficult to acquire and generally expensive when found. The present land allocation system is not working well. Rentals are therefore quite high which forces up the price of labour.

2.6 Utility costs

Utility costs are far too high. Electricity is expensive to install, unreliable and usage charges prohibitive. In Botswana, factories are charged more per unit of power as consumption increases, whereas in other countries rates are reduced with higher usage.

2.7 Professional assistance

Small businesses and farmers have difficulty in getting advice. Small businesses require accounting assistance; farmers need technical assistance.

2.8 Lack of purchasing support by Government

The Government does not provide sufficient support to local industry. The local preference scheme is not adequate.

2.9 Bureaucracy for new investors

New investors face a variety of bureaucratic hurdles when they come to Botswana. The one-stop shopping for investors is not working. They must apply for several licences and permits which take months to process.

2.10 High tax rates

Although Botswana does not require the revenue, it has increased the company tax rate and introduced capital gains taxes in recent years. There are now plans to introduce a sales tax which will be difficult to collect.

2.11 Proliferation of chain stores

Although the business community has advised against it, there continues to be a proliferation of new chain stores. These are destroying the small businessman.

70

2.12 Chamber of Commerce

The private sector needs a stronger voice when speaking to the Government. Our Chamber of Commerce is just too.weak. It needs a full time secretariat.

2.13 Overtrading

In some businesses there is overtrading. There is no coordination between the local licencing authorities, the Ministry of Commerce and Industry and the private sector in deciding upon licence applications.

3. MAIN RECOMMENDATIONS

Summary of main recommendations mentioned over the course of the three private sector focus group meetings:

3.1 Finance

Interest rates should be reduced, especially at the National Development Bank. The Government should implement a loan guarantee scheme so that commercial banks would be more willing to loan to small businessmen. A fourth commercial bank should be encouraged, preferably an American bank so that there could be more competition in lending.

Long term finance must be made available to businesses and individuals. More sophisticated financial institutions should be set up such as confirming houses, merchant banks, a venture capital scheme and a stock exchange. The Government should set up a fund to lend to citizens for the purchase of buying shares.

The Bank of Botswana regulations should be evaluated to determine if they are over restrictive and therefore contributing to the liquidity problem.

Efforts should be made to enforce the legal aspects of debt collection so that the banks and businesses would be more willing to extend credit.

3.2 Land allocation

The land allocation system should be reviewed and adapted so that industrial land can be available for industrial projects. Land should also be provided to businesses in order that they could build staff housing.

3.3 Personnel

The work permit system should be revamped and possibly eliminated. Long term residency status should be made available to investors. Training courses should be run for the private sector.

12

3.4 Bureaucracy

The one stop service centre concept for investors should be implemented.

3.5 Taxes

The company tax rate should be reduced. Long term tax holidays should be granted to manufacturers. Company tax for small businesses should be eliminated.

The new sales tax should not be implemented.

3.6 Utility costs

The cost structure (both installation and usage) of the utilities should be studied with an aim to bringing rates more in line with those in the rest of the region.

3.7 External trade

The possibility of giving rebates to importers of capital goods from outside the Southern African Customs Union should be investigated. In the long term Botswana should consider whether membership in the customs union is in the long term interest of the country.

3.8 Local preference

In its own purchasing the Government should give greater preference to local producers. This should extend to the large parastatals such as the BMC and the utilities.

3.9 Industrial incentives

There should be a "high powered" study made of the Government's investment incentives. Consideration should be made of export incentives, investment zones, free trade areas, transport subsidies, a financial Pula, change in the tax rates and elimination of capital gains, etc.

3.10 Agriculture

Improved technical advice and less expensive inputs should be made available to farmers. Markets with trained graders should be set up in the major centres.

3.11 Chamber of Commerce

The Chamber of Commerce should be given a full-time secretariat.

74

APPENDIX E

USAID/BOTSWANA

STRATEGY ASSESSMENT AND EVALUATION

EXECUTIVE SUMMARY

The following summarizes major findings and recommendations under the headings Overall Policies, USAID Strategy, Manpower and Skills Development and Employment Generation. A more detailed summary of conclusions and recommendations, keyed to the chapters which support them, appears in Chapter IX. A description of this study, including summary terms of reference, is found in Chapter I.

A. OVERALL POLICIES

- While there has been spectacular overall GDP growth since independence, a disaggregation of the Botswana economy shows stagnation in economic sectors upon which future employment growth depends. The rapid overall 1981/82-85/6 average annual Gross Domestic Product real growth of 15.3% and a major increase in foreign exchange reserves mask the fact of limited growth, outside mining and quarries, of 4.0% per annum. Manufacturing actually declined by .04% per annum. Rather than sparkling growth, what emerges is a picture of a sluggish economy, one in which a policy environment that promotes both development and diversification is essential. Not surprisingly, non-government formal-sector employment grew by only 2.5% per annum, vs. population growth of 3.4-3.7% per annum. There is clear evidence of a serious unemployment problem; the present unemployment rate is

24.5%. The precarious state of indigenous agriculture and the uncertainty over future employment in South African mines lend additional urgency to further addressing the employment-generation problem.

- These are key policy concerns in a generally satisfactory policy environment. Monetary, fiscal and commodity-pricing policies are generally sound and are an excellent example for developing countries. Major policy concerns include the comparatively high value of the pula and a relatively high formal sector wage rate, both of which may inhibit employment growth. A major government program to subsidize labor costs, the Financial Assistance Policy (FAP), may not be fully effective.
- Government's high foreign exchange reserves policy is a needed protection against growing risks. Reserves have grown over the last two years primarily because of an improved market for and supply of diamonds and the strength of the dollar (in which most exports are priced) vs. the rand (in which most imports are priced). But these factors could easily reverse. Political and economic uncertainties in Southern Africa are rising, increasing the risks on seaport access and employment in RSA mines. The GOB is also determined to follow prudent development policy, avoiding non-economic programs. Drought continues at the same time as the need to continue importing 90% of food and to increase strategic

76

food reserves. A parallel finding is that, because of this need for high reserves, consistent concessionary donor support is justified.

- At the same time, there is insufficient use of private-sector institutions to stimulate economic growth and employment. The private sector's lack of growth in spite of easy credit and access to foreign exchange is a disquieting feature of the economy. In several key areas blocks appear between abundant resources and the ability of private-sector elements to use them. For example, despite high bank and Government liquidity, small and informal-sector firms report difficulties in obtaining working-capital credit for business expansion. Government must also focus on the question of incentives, e.g., reducing company taxes. The question of privatization of parastatals should be looked at in the follow-on private sector study, e.g., the Botswana Housing Corporation.

B. USAID STRATEGY

- The present strategy focusing on skills development and employment generation is soundly conceived and well executed. The strategy is important in basic education, which in turn is a necessary although not sufficient condition of an employable work force. The strategy also has had a significant impact on skills levels and future employment generation through training and operational experts (OPEX).

77

- Suggestions for modifying the strategy are intended primarily to redirect it even more toward employment generation and the revitalization of the private sector. The means for doing so are mainly already in place and the modified package proposed should not require much if any increase in funding.
- The education projects are excellent; however, there should be greater emphasis on curriculum development in both PEIP and JSEIP, particularly in the latter. The PEIP project is rapidly becoming institutionalized and assistance for primary education can be reduced. On the other hand, support to curriculum planning at the higher secondary level might be considered.
- There is a need to strengthen linkages among research, extension and the farmers in ATIP. The Agricultural Technology Improvement Project has an important role because of the key position of agriculture within Botswana and the relationship of agriculture to, and as a part of, rural employment. ATIP has things to say in approaches and technology affecting dry-land agriculture and these should be disseminated in better fashion.
- The BWAST project is impressive and has the benefit of flexibility. It can be used in several areas to promote private sector and employment generation.
- USAID has carried out successful drought relief support. Although not the focus of this report, USAID has done an excellent job, working with the GOB, to support drought relief through Food for Peace and Disaster Assistance.

- Additional Considerations.

- Stronger emphasis should be given to support for family planning.
- USAID should consider working with the University in the establishment of an MBA program. This might be carried out under BWAST auspices.
- There is a weakness in the linkages between those needing and those supplying credit, investment funds, technology and vocational training opportunities. There might be a possible direct role for USAID in rural employment generation to improve credit linkages between lending institutions and smaller enterprises.
- The Peace Corps should be used wherever appropriate and possible in support of and complementary to USAID projects.

C. MANPOWER AND SKILLS DEVELOPMENT

- There is a critical shortage of high- and middle-level manpower. One indication of this shortage is the large number of non-citizens in employment and self employment, about 7500, the great majority in the private sector. The need to upgrade the skill content of the Batswana labor force is unquestioned. The timing of the likely crossover from a shortage to a surplus of high and middle level manpower requires further careful study, as does the question of skills and labor demand projections. Uncertainty about future private sector manpower requirements suggest that at each level of education, the formal educational system should focus on those basic skills that are common to all or most of the future opportunities open to school leavers.

- Generally strong primary and junior secondary education programs pose some concerns: Under the concept that such education is a basic right for all Batswana, enrollment levels have risen dramatically and a major expansion is planned in junior secondary. This means a need for more, and more intensively-used teacher-training facilities. As school leavers at this level form the bulk of the labor force, there is also need for curriculum reform stressing more general familiarity with private-sector opportunities and simple bookkeeping skills, as well as agriculture (already incorporated). At the same time, the formal education system should focus on instilling general rather than specific skills. The private sector should be encouraged to undertake specific skills training.
- Higher education must be viewed as an investment good. Consideration must be given on how rapidly to expand senior secondary and university levels, given the economic cost. The eventual crossover from overall deficit to surplus of high and middle level manpower will exacerbate the problems of inflation of job requirements and place severe pressure on the higher education system. Moreover, the bonding system will tend to make the government the employer of last resort, bonding the government to the student rather than the other way around.

- Technical and vocational training must be more flexible and accessible. Encouraging such training in the private sector (including formal- and informal-sector apprenticeship), subjecting public-sector training institutions to market forces, facilitating access through private-sector efforts and attempting to assure that training institutions deliver their products at stated and consistent quality levels but at the same time avoid rigid content standards - are all recommended measures.

D. EMPLOYMENT GENERATION

- Slow non-mining private sector growth and employment are the result of several basic constraints. Among these are the precarious arable agriculture situation, the maturity of the cattle industry, competition from South African industries, a small domestic market and the lack of effective access to foreign ones, high formal sector wages, the lack of skilled manpower and the high cost of expatriates, blocks between high bank liquidity and small firms' access to working capital finance, and generally well-conceived but overly-restrictive and complicated Government support policies.
- Various activities are likely to enhance private-sector employment expansion. USAID is sponsoring a special private-sector follow-on study which should result in more detailed conclusions and recommendations. USAID's

ATIP, Rural Sector Grant and BWAST have all played constructive if limited roles in stimulating rural employment and helping in overall employment generation. Most importantly, there are several GOB programs in place to encourage investment and provide employment. But more, and sometimes less, should be considered. There should be simplification of certain GOB policy procedures (e.g., in investment and subsidy areas), greater access of primary and secondary students to knowledge of opportunities and requirements of private-sector work, establishment of brokering efforts to make present assets (e.g., working-capital credit, international venture partners and skills-training opportunities) more available to those who can use them to build employment, and consideration of basic factors important in developing rural enterprises (e.g., access to credit). Means to increase production in dryland agriculture also are fundamental; agriculture is a major employer and source of income; it is important to help slow a premature drift from rural to urban areas.

July 23, 1987

APPENDIX F

SUMMARY OF EXPERIENCE WITH

SMALL SCALE ENTERPRISE ASSISTANCE PROJECTS

INTRODUCTION

Botswana has had ample experience with small-scale enterprise (SSE) (1) assistance (FAP and BEDU are examples of two programs in this field). However, besides an apparently successful but very small Barclay's Bank experiment, the country is only now making its first attempt, through Tswelelo, to provide SSE assistance on even semi-commercial lines. Assumptions behind previous attempts, and even to some extent those behind Tswelelo, have been that a project must provide such intensive services to SSE clients that the clients will never be able to pay enough, through fees or interest, to come near to covering the project's full costs.

A key assumption of any SSE assistance project which intends eventually to break even is that enough clients will enter the project to allow it to reach reasonable lending scale

(1) Definition: poor-owned, owner-operated, 1-10 employees, movable assets less than $5000 per employee.

(say 500-750 loans averaging $1000-5000) quickly (e.g. within three years), at low enough default/delinquency rates and operating costs to break even at an interest rate charged which is well below clients' return on invested capital. A supporting assumption is that there is now enough generally-applicable accumulated worldwide experience with SSE-assistance projects to allow a project to develop plans and policies which will provide clients with help and control but also have a good chance to lead to the project's viability.

This appendix outlines a general model by summarizing a few key lessons which experience with successful and unsuccessful SSE-assistance projects in Latin America, Africa and Asia teaches. Most statements below do not carry references because they are generalizations from recent experience in 14 countries, conference presentations and study of papers, mostly unpublished. The reader seeking further corroboration or details might wish to consult some of the references in the bibliography.

OBJECTIVES

A good rule of thumb in designing a successful SSE-assistance project is "make it big and keep it simple". An objectives statement such as, "Significantly increase incomes and sustain or increase employment levels of selected segments of the working poor, while covering all project costs," is challenge enough. Projects which add objective elements such as increasing the average size of firms aided or restricting efforts to rural firms, tend to mix strategies into objectives (therefore decreasing project flexibility) or make such a daunting set of objectives that the risk of project failure becomes unacceptably high.

Successful projects can support creation of a job for each $500-2000 loaned and increase owner's income and payroll in the 25-40% range during the first year of a loan. There is less evidence for accomplishing this on a significant scale (see section below), since only the most recent projects tend to have portfolios in the thousands of loans, while the number of

SSE's in a major city is measured in the hundreds of thousands (e.g. Lima, with 5.5 million population, has 300-500 thousand SSE's).

MARKET SEGMENTATION

As stated, the total number of SSE's in a given operating region almost always greatly exceeds any imaginable project's organizational or financial assistance resources. This provides a great luxury for projects and one which successful ones exploit: define and serve only those market segments (homogeneous groups of SSE's) which can best benefit from those resources the project can provide, and which are in a position to repay those resources without too much supervision. The parallel with other successful marketers is clear. Mercedes-Benz seeks out and serves segments of the automobile-buying market which appreciate high performance and luxury, while at the same time are able to afford a high price. All Mercedes' product design, marketing and pricing decisions are geared to the selected market segments (target groups). There is no talk of the average car-buyer's preferences.

In the case of SSE-assistance projects, astute market segmentation does not mean excluding the poor; SSE's are defined as all being owned by poor people. Almost always, employees are poorer still. Proper segmentation merely assures that the minority of the total SSE market which a project has resources to reach will be those segments most likely to benefit (in terms of project objectives) from such assistance and to be able to pay the full cost of services provided so that the project will be able to rotate the resources among more SSE's and raise more capital from the commercial market in the future.

Some of the SSE-market dimensions along which successful projects segment are as follows:

SSE return on invested capital: Probably because capital is so expensive and scarce, many SSE's which have survived for a few years achieve very high (40% p.a. or greater) return on invested capital. Those which do not generate such returns cannot produce the cash flow to pay off loans or the margins to afford to purchase on credit at prevailing informal-sector interest rates (often in the 20% per month to 20% per day range) and so fail. By selecting high-return firms as customers, successful projects can avoid backing enterprises which are en route to failure and can legitimately charge effective interest rates in the 20%-30% range.

Type of business: Many projects which start out dealing with all sorts of businesses find later that successful customers tend to fall into 5-10 categories. These vary by location, but the limited number allows loan officers to develop rapid, effective screening techniques. Therefore a good strategy for a new project is to plan to channel most project resources into a limited number of customer business types - without, however, concentrating the portfolio so much that the project's success is tied to the fortunes of one or two industries - as soon as experience indicates which business types to concentrate on.

Key business needs: Gross (see bibliography) characterizes two sets of assumptions, A and B, which project management may make about the key business needs of their SSE customers.

"Type A: The micro-entrepreneur does not know how to use credit effectively. For this reason, before loans may be disbursed, the prospective borrower must receive training in accounting, costs, marketing and personnel management. The entrepreneur does not know his business sufficiently well, either. Therefore, he should pass through the stages of pre-selection, selection, diagnosis, and training, which will enable him to better understand his business. Without this educational process, credit will probably do more harm than good for the entrepreneur, indebting him to the point where he cannot cancel his loan, effectively eliminating his chances of receiving other credit. Besides, many micro-entrepreneurs really do not need credit. What they really require is management training. Thinking that their primary need is

96

credit, many micro-business people take the required training courses in order to receive it. During the management training period they learn how to use their own resources better and realize that, in reality, they do not really need credit.

"The premise of the Type B model may be summarized as follows: Like their counterparts of the large, medium and small business sector, the micro-business needs capital to function. the major obstacle to expansion of the micro-business is not management training, but credit assistance. The micro-entrepreneur knows how to use credit if it is disbursed in the small amounts he is accustomed to using. The micro-entrepreneur needs training in the use of credit, but the most efficient manner to learn how to use credit is precisely by using it in his business."

A project desiring to break even should seriously consider trying to select clients satisfying Model B because a Model A strategy has been shown to rarely, if ever, break even.

Technical assistance level: Projects which follow Model B largely avoid the problem - unsolved so far - of highly subsidized technical assistance (TA) components. As private-sector marketers know, customers will only pay for what they think they need, which may not correspond to what they really need. Thus, in SSE assistance projects offering major TA components, customers are typically willing to pay fees in the range of 2-5% of the amount loaned. When questioned, customers often say that they consider such payments part of the cost of the loan, which they are willing to pay not because they value TA but because, even with the "surcharge", the total cost of funds is below that of informal-sector loans or supplier credit. However, given that TA costs are rarely below $100 per customer, the average loan size would have to be in the $3000 area to allow the "surcharge" to cover costs. Experience shows that it is risky to make loans this large, at least at the beginning of the relation with the customer, at which time TA is generally given.

RISK MANAGEMENT

Successful projects achieve low delinquency and default rates (in the 3-12% and 0-2% ranges, respectively) by building risk management strategies into all phases of their operations - especially customer selection - not just their collection policies. Some successful strategies are as follows:

Lend only to existing businesses: Contrary to some early theories, running an SSE tends to be a permanent vocation. This means that owners are very often mature people who have had up to 20 years of experience in their chosen industries, first as employees, then as owners. There is thus likely to be an ample pool of established, proved applicants, run by serious people in business for the long haul. The best way to help startups is probably to lend to these existing SSE's, which will then hire young people and give them the experience needed to start their own businesses.

Determine present capacity to amortize future loans: In their application screening procedure, successful projects usually concentrate on determining an applicant's minimum net cash flow over recent months. Initial loans are then limited by the requirement that minimum past cash flow must be some multiple (say 2) of the project loan's monthly amortization requirement. Thus the undertaking which the proceeds are used for can fail to improve cash flow, but the customer can still repay. If the undertaking is successful, then the application for a subsequent loan will automatically yield a higher loan limit.

Credit agility: SSE owners are used to paying very high rates for informal-sector or supplier credit but also to receiving it quickly. Projects which delay more than a week from receiving an application to disbursing funds (or turning down the application) tend to build two problems for themselves. First, the customer perceives that the project is not businesslike, in the terms he is used to. Therefore he tends to disregard subsequent demands for loan repayment. Second, circumstances are apt to change quickly for SSE's. An undertaking which makes sense at the time of application may depend on an opportune purchase of inventory of a seasonal sales upturn. Loan approval delay can force the SSE to devote the funds, when they do arrive, to a less profitable use, thereby lowering his ability to repay.

Tailor guarantees to SSE circumstances: As stated above, successful projects base lending decisions on applicants' cash-flow calculations and business/personal stability. This reduces the need for ordinary collateral, although projects do take title to any equipment which loans may finance. In place of collateral many projects have had success with solidarity-group lending. Under this arrangement, a loan officer will require an individual applicant to bring together 4-10 similar SSE's, all of which will apply and be jointly and severally responsible for repayment. Moral pressure to repay thus comes both from the project and the customer's peers.

Finally, a few countries (e.g. Panama) have successful, for-profit credit bureaus. For a nominal fee such bureaus provide repayment experience which other lenders or suppliers have had with a loan applicant. Studies have revealed that an applicant who has never defaulted on personal or business credit will almost never default in the future.

Almost all SSE's operate purely domestically. Therefore they need to borrow in local currency and will repay in it. This means that it is usually inappropriate for projects to borrow hard currency. International guarantees, in which hard currency remains abroad but backs up local wholesale borrowing, is an established solution for large businesses, especially multinational subsidiaries, and has had some success for SSE assistance projects (see bibliography). In Botswana, there is probably a need to make Rand financing because some SSE's purchase raw materials in RSA and may eventually export to it.

Keep up-to-date on delinquencies: As an SSE loan becomes longer and longer overdue, the chances that it will be repaid at all decrease drastically. The problem feeds on itself because the project quickly gets the reputation of being "soft". This encourages other customers to delay payments. Also, remaining funds have to go to new customers rather than present, delinquent ones, thus diverting staff time from collection efforts. Tactics to encourage prompt payment - such as reminding the customer a few days <u>before</u> the due date, charging a late-payment fee which at least covers extra collection costs, and automatically (without board approval) giving seriously delinquent accounts to a tough collection agency - work. However, they depend on excellent, up-to-date records, which are very often a project weak point.

What progress there is on the scale question indicates that three strategies are important:

<u>Marshall private-sector local-currency lending resources:</u> Charge customers interest rates which allow project borrowing at local prime and mobilize local savings.

<u>Minimize subsidized project bottlenecks</u>: For example obligatory TA partially supported with low-cost or grant funds, limits project expansion to the availability of those funds and de-motivates local director involvement because of the uncertainty of future funding availability and fears of "outside meddling".

<u>Avoid, or grow beyond, dependence on one special leader:</u> Many projects owe their success to an especially able, dedicated leader. Just as with large companies (e.g. Ford Motor Company), scale-up attempts in these cases often provoke a management crisis. For successful scale up, projects must build in strategies to avoid this crisis (see bibliography).

CONCLUSIONS

Blayney and Otero (see bibliography) name nine institutional characteristics which are related with successful SSE assistance projects:

1. Simple, well-articulated goals and objectives;
2. Concentration on a few activities, formed with some customer input;
3. Diversified funding resources;
4. Organization structures which maximize field staff

decision making;

5. Simple, well-managed internal record keeping and planning systems;
6. Highly committed staff, often with performance incentives;
7. Local private sector partnership;
8. Regular audits and evaluations;
9. Understanding of the relation between project activities and national needs and policies.

There are exceptions, but many successful projects organize on two levels:

Direct lending and other assistance to SSE's: A local organization whose "culture" supports SSE assistance and whose staff is physically and socially close to SSE owners, but with links through the board to the larger community;

Wholesale lending and control: A national or international organization sophisticated enough to handle international aspects of funds and information flow, remote and tough enough to provide an "excuse" for an unbending local interest rate and collection policy.

BIBLIOGRAPHY

Jeffery Ashe, "Lending to Micro-enterprises: Perspectives on the Creation of an International Poverty Bank", Accion International, 1985.

Robert G. Blayney and Maria Otero, "Small and Micro-enterprises: Contributions to Development and Future Directions for A.I.D.'s Support", AID/S&T/RD/EED, 1985.

Stephen H. Gross, "Models for Microbusiness Support in Latin America", Accion International, 1985.

Cameron L. Smith and Bruce A. Tippett, "Study of Problems Related to Scaling up Micro-enterprise Assistance Programs: Phase I", World Bank, 1982.

Cameron L. Smith and Bruce A. Tippett, "Guarantee Programs to Support Small Scale Enterprise Lending": AID/PRE, 1984.

APPENDIX G

AN A.I.D. SUPPORTED COLLABORATIVE-VENTURE BROKERING MODEL FOR ECUADOR

This appendix provides background for recommended USAID-supported collaborative-venture brokering in Botswana. The scope of recommended activities in Ecuador goes well beyond those feasible for Botswana, but the principles discussed are relevant.

A. INTERNATIONAL INVESTOR DECISION PROCESS

Environment and policies set the parameters within which investment decisions are made. However, the decision process is itself complex and dependent on many institutional and personal factors. Even the most favorable environment and policies will not guarantee an adequate inflow of foreign investment if the decision process does not function smoothly. The four main steps in this process and the principal constraints in the Ecuadorean context are briefly analyzed below. This analysis is based on discussions with 16 individuals who are or work for foreign investors in Ecuador, a literature search on foreign investment in developing countries, known experiences of U.S. investment companies and multinational investors and Non-Traditional Agriculture Exports Project experience to date.

1. Discovery of Opportunity.

In all cases examined foreign investors discovered investment opportunities in Ecuador through direct experience.

For example, they or close associates may have a trading or investment operation involving Ecuador. There do not seem to be cases where a commercial or public sector activity has generated investments "from scratch", that is, without the investor's having had prior contact with Ecuador. This means that the relatively small number of potential foreign investors which can gain from an Ecuadorean investment but which do not have direct contracts are not likely to discover Ecuadorean investment opportunities in the absence of a concerted effort to raise awareness of these opportunities. This appears to be the greatest gap in the investment chain and the one most in need of improvement.

2. First Contact with Potential Local Partner.

Usually this contact takes place when the potential investor first visits Ecuador, although sometimes the potential local partner travels abroad to make the contact. Various investment missions, including those which the Project sponsors, facilitate such contacts, but they have the weakness of not being regular and are often not well targeted toward potential investors with the strongest interest. In line with the "personal" route to investment opportunity discovery described above, initial contacts may take place at the initiative of the investors. In some cases, however, there may be need of an institutional mechanism to facilitate the contact.

3. Foreign Investment Business Plan.

Such a plan is necessary to gain government investment approval and to provide outside financing, which is often necessary in agribusiness investments. For example a local enterprise may provide raw materials, processing labor and local management; a foreign joint venture partner processing technology and foreign distribution. It is not at all certain, however, that the foreign partner will be able or willing to add hard currency financing to the already considerable non-financial resources which it is contributing. This means that a third party, either foreign or Ecuadorean, must often provide financing; a business plan is necessary if this is to happen. A plan also provides a bridge over cultural differences which very often surface to mar otherwise sound relationships.

The Ecuadorean Investment Development Center (CENDES), an autonomous Government of Ecuador (GOE) agency, does produce some model plans and this Project will produce more. However, there is not now an entity in Ecuador skilled at helping to produce internationally acceptable business plans. This appears to be the second greatest weakness of the investment chain.

4. Approval and Registration.

As indicated above, even though there are superficial complaints about red tape in obtaining investment approval and registration, those who are actually involved in it (both those seeking to register projects and those doing the registering) report that the problem is not great enough to deter investment projects which are sound. Local law firms and, to a lesser extent, CENDES aid in this registration process. Moreover, there is a movement within GOE to liberalize registration requirements.

B. CONCLUSION - FEASIBILITY

Environmental and policy factors are, on the whole, favorable to an investment promotion effort for Ecuador. The major environmental constraint identified - limited market size - is mostly applicable to investments in import substitution activities which have predominated in Ecuador over the past two decades. The promotion of investments in export-oriented agribusinesses will not be hampered by this constraint. The policy context has improved markedly in recent years, particularly under the current administration, and appears highly favorable, especially compared to other countries in the region. On the other hand, there are bottlenecks in the investment decision process which require attention, principally in the discovery of potential investors and the preparation of quality business plans. Given the favorable context in Ecuador, improvements in these areas should have a significant impact on increasing foreign investment, especially in technology transfer and foreign market access (which a recent, high-level AID inquiry among Ecuadorean businessmen found as their greatest need), but also to some extent in stimulating hard-currency inflows.

C. PROPOSED ACTIVITIES

1. Investment Promotion and Support Services

This activity comprises two related functions. First, it will establish within an existing Ecuadorean company the capacity (in the form of a subsidiary or profit center called the Investment Support Services Company, ISSC) to promote foreign investment by bringing potential foreign and national investors together and by providing support at key points of the investment decision process. ISSC's key services, corresponding to the constraints described earlier, are in the identification of investment opportunities and the development of quality business plans for promoting those opportunities. The company will charge for its services normal commissions and fees that will allow it to become profitable. ISSC's clients in almost all cases will be Ecuadorean firms which wish to attract investors. In a few cases Ecuadorean investors looking for projects may pay ISSC's fees. Potential foreign investors will almost never be clients.

The activity's second function is to provide the marketing support assistance mentioned above and described in more detail below.

- Investment Opportunity Identification. ISSC will identify investment opportunities by screening potential projects which organizations such as CENDES and the efforts of the Project will make available, as well as ideas which individual entrepreneurs bring in response to the company's advertising and press releases. ISSC may also undertake its own independent efforts to identify opportunities. The range of possibilities is wide. For example, in addition to the 11 small (maximum permitted fixed assets, less land and building, $312 thousand) investment projects which it has already stimulated (value $3.2 million) through the Investment Credit Facility, the Project has identified investment opportunities covering five types of products. Furthermore, existing Ecuadorean agribusiness ventures now suffering from overcapacity or lack of technological management or marketing direction are rich sources of projects, as are otherwise-sound operations which will be hit with sucretized dollar debt coming due in about 1987. A number of investment missions have identified some 323 investment opportunities. Finally, GOE privatization efforts may yield some opportunities for Ecuadorean-foreign joint ventures.

Screening will be a job for a professional skilled in investment and the agribusiness sector. It will be important for the company to screen out all projects which do not have a good chance of interest abroad and eventual success, because the international investment company network will soon lose interest if it is flooded with poorly conceived, unfeasible projects. Some rules which such a screening effort should include are the following:

- Extent to which the project fits generic competitive advantages (source: Boston Consulting Group's competitive study of Sweden) for developing countries, e.g., slowly changing technology, little need for highly skilled labor, simple and concentrated selling process, simple distribution patterns, demand which is predictable and not sensitive to distance from market, and existing production units small relative to world demand. It is further likely that an investment project interesting to a foreign investor in many cases will have as a core an already existing production operation.
- Extent to which the project conforms to Ecuador's particular resource endowments and therefore offers sound prospects of achieving international competitive advantage. It is likely that Ecuadorean projects will have to emphasize material cost savings and perhaps low labor costs to compete successfully for foreign investment.

Business plan preparation. When a suitable investment project is identified, ISSC will offer its assistance in preparing a business plan. Similar projects have experienced the need to prepare many business plans to finally achieve one investment project. For example, U.S. venture capital companies typically review as many as 20 submitted business plans for every one investment made. This does not count plans which are rejected out of hand and not even reviewed.

On the other hand, U.S. investment companies report that a business plan prepared according to a formula which is acceptable to them greatly increases their interest and the chances that they will consider investment. In the course of setting up an international investment company network, the U.S. contractor (see Activity No. 2) will determine one or a small number of formats which investors prefer and train ISSC in producing them. A rough idea of such a format is the following:

- Introduction and summary;
- Objectives;
- Key strategies;
- Benefits - return on investment, summary cash flow, and other benefits to the foreign and Ecuadorean investors and others;
- Market - identify unfilled market need which project will address;
- Unresolved issues and pre-project activities planned to resolve them;
- Project description;
- Experience of Ecuadorean investors or promoters, and required qualifications of U.S. partners;
- Next steps;
- Annexes - projected income statements, balance sheets, cash flow statements, discussion of legal and regulatory issues, technical analysis, photos or videotapes, background information on Ecuadorean patterns, etc.

97

ISSC will translate the plans into appropriate languages (English, German and, perhaps Japanese) and distribute them to members of the international investor network which are likely to have the types of foreign investor contacts which the business plan calls for. In some cases ISSC may pay a foreign consultant to locate directly a small number of highly specific potential investment partners. ISSC will need a professional who can be trained to prepare internationally-acceptable business plans. It will also need high-quality translation services.

- Negotiation support services and finance brokering. Subsequently, ISSC will receive investors which the international investor network refers to it, those brought in through the other Project components, and those becoming interested in Ecuador on their own. It is unlikely, however, that the latter will happen often. The International Country Risk Guide (December 1984) ranks Ecuador 70th (vs. 46th in January 1984) among all countries as to level of political, financial and economic risk. Thus ISSC's "client", the one who pays the bills, will almost always be Ecuadorean, and the foreign partner search process must be highly specific.

ISSC will provide normal "hand-holding" services at commercial rates, such as help in preparing detailed investment plans, reference checks of potential foreign investors to reassure potential Ecuadorean joint venture partners and vice versa, search for other Ecuadorean suppliers, and referrals to specialized consultants or public sector technical agencies. Importantly, ISSC will assist in putting together local financing packages to complement the foreign investment by securing local financing through banks, development banks and investors. In this regard, the company will promote, with AID support, the creation of an independent venture capital pool to provide local-currency equity financing which is unlikely to come from abroad. An expansion of the Investment Credit Facility will also be available (see Activity 3). In the area of investment approval and registration, ISSC will probably not have to do more than refer investors to competent law firms. However, if it sees a profit opportunity in forming a closer bond with such a firm or hiring its own lawyers, the Project will not prohibit this.

It is expected that the ISSC will also provide occasional contracted support to GOE agencies involved in investment promotion, such as MICEI and CENDES. Examples of this assistance could include information on investment opportunities or potential investors and advice to the GOE on making its investment promotion activities more effective, based on the contacts, insights and experience which ISSE will gain.

There is no company in Ecuador that has existing capacity to provide this range of services. However, there are several types of companies in related fields which would likely be interested in expanding, perhaps through the establishment of a subsidiary, non-bank financial services company, into investment promotion. These include commercial banks, agribusiness export companies, and consulting and accounting firms. Several have expressed interest. The advantage of using an existing company is that it will be able to provide, at marginal cost, the administrative and communications infrastructure necessary for mounting an investment services unit. More importantly, the demonstrated success of an existing company is evidence that it has the skill and motivation to make the new investment services unit profitable and self-sustaining within LOP.

2. Foreign Investor Identification

This activity will establish a mechanism to help ISSC to promote Ecuadorean investment opportunities among potential investors in the U.S. and other industrialized countries. This promotion will utilize a targeted approach based on concrete business plans which are channeled to investors selected for their likely interest in a particular investment opportunity. The approach will also support ISSC's ability to form profitably such foreign links for its clients after EOP.

A U.S. firm will be contracted to set up a network of venture capital firms, investment houses, and other private companies which themselves invest or maintain extensive linkages to potential investors. Examples of investment companies include: the International Resources Group (a "niche" bank which specializes in Latin American investment), Citicorp Investment Company, EAL Trading Company, Security Pacific Trading Company, international venture capital funds such as TA and Churchill International, agribusiness oriented investment companies, large European and Japanese trading companies, investment companies which have expressed interest in South America such as the presently in-formation Condor Corporation, and investment companies associated with Ecuadorean investment finance institutions such as the National Finance Corporation (e.g. SOCFINCO Belgium, Arab Bank for Latin America, Bank of Tokyo, and Deutsche Sudamerikanische Bank). While the initial focus of the U.S. contractor's networking efforts will be in the U.S., the contractor must also be able to expand the network into at least Canada, the United Kingdom, and Germany, with eventual possible expansion to Japan. These countries account for approximately 80 percent of total private investment by the industrialized world in developing countries.

After initially setting up the international investment company network, the U.S. contractor will brief each member of the network on the generic qualities of Ecuador and agribusiness investment opportunities, determine the required business plan formats, and train the Ecuadorean firm to write them. The contractor may at first channel specific business plans from Ecuador, as they are produced, to selected investment companies in the network. However, he will quickly train an ISSC contact person to do this alone, structuring mailing lists to the needs of each ISSC deal. Network companies will treat such plans just as they would any other; that is, either passing them to their internal investment boards or to individual investors (institutions or persons) who they feel would be interested in such ventures. Typically,

100

these interested investors would sign secrecy agreements which prohibit them from passing the business plans to others, and would also agree to the investment companies' normal fee structures or requirements for doing business through them in the vent that an Ecuadcrean investment were consummated.

The U.S. contractor will also be encouraged to identify individual investors through its own (unfunded) efforts and will be allowed to receive investor fees from such efforts. In certain cases, it may be desirable for an interested foreign investor to travel to Ecuador to meet with potential joint venture partners, or vice versa. It may also be useful for representatives of certain investment companies in the network which show strong interest in Ecuador to visit the country. In these cases, the U.S. contractor will arrange for and, if considered appropriate, provide partial or total travel funding.

In general, investment companies will probably seek investors that need supplies of agricultural raw materials or semi-finished products which Ecuador can produce, that have surplus equipment or technology suitable for Ecuador, or that have international sourcing networks in need of geographic diversification. This will undoubtedly be a very small proportion of all potential investors, but if the network is large enough and properly selected, it will be able to interest a sufficient number for Ecuador's purposes.

The U.S. contractor will complement the international investment company network by sending selected business plans, in addition, to all or some of the following public-sector organizations which might be interested in working directly with the investments or passing the plans on to their contacts: UNIDO; the U.S. Department of Agriculture Office of International Cooperation and Development; the International Finance Corporation; and the Department of Commerce TOP program, as well as similar organizations in other major developed countries such as the Japanese Export-Import Bank. In addition, the contractor will make maximum use of GOE commercial attaches, giving them project orientation as well. The U.S. contractor may also facilitate contacts between the international investment company network and OPIC. The contractor will, however, deal only with public-sector intermediaries which respect the confidentiality of the ISSC clients' business plans. Few ISSC clients are likely to want "billboard" publication of their plans, and few serious investors will want to see a deal which they are considering to appear in such a way.

The intermediation function of the U.S. contractor will be temporary. After the international investment company network is initially established, the contractor will begin providing technical assistance and training to an ISSC counterpart in the process of promoting investments through the network. The training will include direct observation of and participation in the U.S. contractor's networking operations and contacts with selected investment companies in the network. The U.S. contractor will also provide ISSC with data bases on investment sources which will facilitate future expansion of the network and may possibly assist the company in establishing a U.S. presence. FEDEXPOR's existing Project information base will also be useful. Through these and other means, the U.S. contractor will gradually transfer its responsibilities to ISSC. By the end of the Project, the latter should be directly making its own contacts with the network.

Alternatively, the Ecuadorean company may find it useful to occasionally contract some form of foreign-based intermediation services in making contacts for specific deals, as long as ISSC can fully finance such services out of the earnings from its services.

In order to carry out this activity, the ANDE-ISSC subcontract, described above, will call for ISSC to contract a U.S. firm after A.I.D. approval. The latter contract will include the following: an estimated 12 person-months of expert assistance plus support staff to set up the investment network ($192,000); six person-months of technical assistance to the ISSC in the second year ($96,000) and approximately 20 round trips of potential investors to and from Ecuador ($40,000).

3. <u>Venture Capital Pool and Investment Credit</u>

In addition to directly providing financial packaging services as described in Activity No. 1, ISSC will promote the establishment of a Sucre-denominated venture capital pool in Ecuador. Fewer and fewer foreign investors are willing to subject their hard-currency assets to exchange convertibility and other risks in Ecuador. The same attitude applies to many other soft-currency countries. Foreign investors will sometimes put up hard currency in their own countries to finance external aspects of a joint venture (such as expansion of a foreign distribution system), and the more sophisticated may be willing to guarantee soft-currency debt through an offshore deposit. And they are naturally willing to make the technology and other non-monetary inputs which are usually the main benefits of foreign investment to local partners. However most will expect local partners to come up with needed local currency equity and debt for joint ventures.

Even when foreign partners are willing to contribute hard currency to a deal, local capital participation (debt and equity) is considered a necessary factor for success given the unlikelihood that outside investors will wish to operate without Ecuadorean co-investors.

- <u>Venture Capital Pool</u>. The availability of this local equity capital is, however, currently constrained by the lack of an institution specifically geared to raising Ecuadorean equity capital. A source of capital, because it provides a way of spreading risk and of achieving a more workable balance between debt and equity in the structuring of a corporate entity, provides a powerful mechanism for investment promotion.

Few deals which the Component will promote are likely to be financially sound enough at the outset to be able to sell shares to the general public or even to individual Ecuadorean investors. Further, no effective mechanism exists in Ecuador to raise any kind of equity, much less risk capital. Also, the Component-promoted and other Ecuadorean ventures could benefit greatly from professional intervention on their boards. Finally, foreign investors are likely to highly value deals in

103

which a professionally-run co-investor takes an equity position alongside a local enterprise.

From many local investors' viewpoints there is also a need for a new investment vehicle. First, those who have taken their capital out of Ecuador and put it into dollar deposits are finding that the yields are falling. Second, many, while not needing direct investment in their own enterprises, do realize the value of having connections with a "window on foreign technology". Third, particularly among those who cannot take an active role supervising their investments, there is a great need for honest, professional investment management. Fourth, those whose investment alternative is to put more money into existing family businesses which require their personal intervention seek alternative investments which do not require so much attention. Finally, some, particularly foreign-owned banks, are now holding heavy amount of sucre debt which might benefit by conversion, at least partly, into equity capital.

These factors support the conclusion that Component activities in particular and Ecuadorean companies in general could greatly benefit from the establishment of an Ecuadorean sucre-denominated venture capital pool (VCP). In Mission, files are a general description of venture capital in developing countries (<u>Promoting Venture Capital Operations in the Developing World</u>, IFC, December 1983) and a special study of the venture capital experience in Brazil, the developing country closest to Ecuador with a venture capital industry (Ricardo B. Leonardos, <u>Sociedades da Capital da Risco: Capitalizacao da Pequena e Mediana Empresa,</u> 1984). There are also expositions on venture capital in the USA and US venture capital companies' experience abroad. Finally, the Mission commissioned a feasibility study of establishing a VCP in Ecuador, the conclusion of which was positive. Discussions with specific potential investors are planned for late May 1986. In addition, A.I.D. has invited IFC to consider an investment in VCP.

A.I.D. participation in the promotion of a VCP is warranted given that it involves essentially the catalyzing of a transfer of technology (in this case, a new investment finance mechanism) with potentially significant development results. In view of the underdeveloped state of financial markets in Ecuador, the creation of VCP in Ecuador in the foreseeable future is not expected without A.I.D. participation in its promotion.

The ISSC sub-contract will support the work of a VCP promotor for about one year ($100,000). The principal activities of this phase will include:

- o Legal studies to identify and consider incorporation options;
- o Presentations and discussions with prospective investors;
- o Establishment of VCP operating principles, parameters and procedures;
- o Securing of preliminary commitments;
- o Incorporation and board formation;
- o Securing of formal commitments; and
- o Staff recruitment.

The promoter will collaborate with other staff of ISSC in carrying out the above activities and in providing continuing support to the pool in its start-up phase.

Possibly, VCP local investors will wish to contract ISSC as pool manager (general partner in US terms). This would have the advantage of reducing VCP management expenses from about 6% of capital (at $ 2.5 million capitalization) to about 3%, and internationally more acceptable ratio. More important, it would make available to VCP deal identification, analysis and foreign connection abilities. However, the feasibility study indicates that local investors may mistrust ISSC's management of VCP, believing that it might favor deals on which it is earning especially high fees for performing other services. The best solution is to let the relation between ISSC and VCP develop naturally, making now the conservative budget assumption that the managements will be separate.

At the outset, some AID budget support to set up VCP's infrastructure will be required, which will be financed with local currency ($50,000 equivalent). As it develops a portfolio of investments, VCP will begin earning sufficient revenues to cover its operating costs and provide an attractive return to investors.

The Feasibility Study indicates A.I.D. equality participation in VCP vital for two reasons:

- Although the ultimate goal of VCP is to raise capital equivalent to $5 million, it is unlikely that there will be enough locally available even to reach the initial minimum operating level of $2.5 million without A.I.D. participation.
- Potential local investors see AID's contribution to VCP as more than capital. First, they look for technology inputs, not only during organization but also over LOP. Second, they see A.I.D. as a channel to foreign connections through other Component activities and other projects, such as that on capital markets. Finally, they see A.I.D's providing honesty and full reporting important because no investor will hold a controlling share.

Investors do not see loan participation as providing these benefits, even if the risky nature and initial low positive cash flow of any venture capital pool made accepting major loans prudent. Therefore, A.I.D. will make a grant from local-currency resources to a local, related non-profit private sector institution with which A.I.D. already has relations and expects to provide further support. This institution will use the funds to purchase VCP shares. Eventually, dividends and capital gains will benefit the institution, and board participation will benefit both it and VCP. A candidate for this role is the Graduate Management School. The Mission has also requested an expression of interest from PRE, which can make direct equity investments.

The Grant-investment will be $1 million equivalent, 20% of the eventual $5 million VCP capitalization and 40% of its initial level. Counterpart investment will initially be $1.5 million, rising to $4 million equivalent.

VCP will be restricted to making minority investments, most likely no more than 25% of the total equity in any single investment project. In addition, an absolute limit on the value of VCP participation per investment will be set depending on the results of studies carried out in the promotional phase. As in the case of ISSC, VCP will not restrict itself to investments in foreign joint-venture agribusiness export deals. However, from the investment figures discussed above, it is likely that at least one-fourth of its investments would be in this area. A.I.D. will make such a target, expressed in VCP's investment strategy statement (but not a legal restriction) a condition of the grant-investment.

To provide more detail on probable VCP operations, Annex VI contains an excerpt from the IFC appraisal of a Brazilian VCP. It is relevant because IFC's participation plays a role similar to that of A.I.D's, the pool's operations area has about the same population as Ecuador, the sizes of the pools are similar, management costs are about the same as those of VCP (the feasibility study did not have access to this appraisal), the Cruzeiro rate at the time of the appraisal had the same value as does the Sucre now and has even more in stability, and, most important, the Brazilian pool has been successful over the intervening three years. A 1985 annual report is on file at the Mission.

D. . I.D. (PRE) INVESTMENT-PROMOTION PRINCIPLES

PRE contracted a consulting firm, SRI, to identify a number of fundamental principles which should underline all investment promotion efforts.

- Before promotional programs are developed, an honest examination of the host country's investment climate assets and liabilities should be undertaken.

- Investment Promotion agencies should be involved in the development and review of investment policy.

- Investment promotion activities should be tailored to a host country's national character and objectives.

- Investment promotion activities should be staffed by highly-motivated, private enterprise-oriented individuals with business experience (directly) or at least by academic training) and excellent communications skills.

- Promotion program goals should be as specific as possible in order to increase the likelihood of effective design and execution.

- Initially, investment promotion activities should be characterized by modest programs and expectations.

- The promotion of indigenous investment should be a fundamental objective of investment promotion activities.

- Promotion agencies should develop and nurture domestic constituencies in support of private sector initiatives.

- Promotion programs should be tested, reviewed, and adjusted regularly as changes in the market place and the host country environment warrant.

- Investment promotion programs should be allowed sufficient time to work.

102

APPENDIX H

EMPLOYMENT BY CATEGORY

AND GROWTH TRENDS

This appendix does not attempt to do more than provide conceptual distinctions between the subsectors discussed. The distinction between urban and rural follows the FAP definition, which treats only Gaborone, Francistown, Selibe-Phikwe, Jwaneng and Lobatse as urban. It is important to note that "rural", thus includes such considerable towns as Kanye and Mahalapye.

Rural non-agriculture excludes only agricultural and livestock production and, for the purposes of this discussion, at least, would include such integrated activities as vegetable raising and packaging.

The informal sector includes firms in which the owner is poor and usually works alongside employees (if any) with little or no distinguishing management role. Such firms tend to have less than five employees and capitalization, excluding land and buildings, of less than P20,000.

The following table presents the latest available national employment figures.

ESTIMATED TOTAL NUMBER OF EMPLOYEES [1] BY SECTOR, 1985-86 [2]

SECTOR/ECON. ACTIVITY	NUMBER	PERCENT	% CHANGE 85/6
Formal Sector			
Private/parastatal			
Commerce	20800	7	14
Construction	13700	4	18
Manufacturing	11700	4	16
Mining & Quarrying	7600	2	4
Finance & Bus. Service	7400	2	9
Other Private/Parastatal	17700	6	2
Sub-total	78900	61 [3]	10
Government			
Central, Non-education	30200	10	14
Central, Education	11100	4	9
Local	9400	3	7
Sub-total	50700	16	11
Sub-tot. Formal Sector	129600	41	11
Informal Sector			
Trad. agri.	142900	45	NA
Rural non-farm	30700	10	NA
Urban	13000	4	NA
Sub-tot. Informal Sec.	186600	59	NA
Total Employees	316200	100	NA

Notes: 1. Formal-sector figures exclude working proprietors, unpaid family workers and BDF members.
2. Sources: Formal sector - "1986 Employment Surveys, Preliminary Results, June 1987" (figures for September 1986); informal sector - "Labor Force Survey 1985."
3. Private 22%, parastatal 3%.

The figures for rural non-farm informal employment are probably not very accurate. Experience in other similar countries confirms this and, further, indicates that the urban informal-sector figures are either strongly understated or imply an opportunity for employment expansion. Elsewhere, in fact, the above two subsectors typically account for 40-60% of total employment rather than the 14% which the table shows.

110