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PRIVATE ENTERPRISE PROFILES

An Analysis of Competitive Advantage
for Developing Countries

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Summary and Introduction

Keene, Monk and Associates, Inc. (KMA) has developed an exclusive methodology to assess the existing competitive advantage of a single industry or a variety of key industries in a developing country. A key element in this methodology is a strategy to assess the most effective and efficient way in which to reduce artificial (man-made) barriers to increased prosperity as contrasted with those natural barriers such as limitations on natural resources and so on which are not so readily changed. At the same time this methodology provides the groundwork in support of a strategy for enhancing both natural and man-made elements that promote a single local industry's competetive advantage or the competitive advantage of an entire country.

The importance and usefulness of such a method of analysis as this presented here is based on the idea that most developing countries find themselves faced with a scarce resource environment and ever increasing competition from other countries in locating and securing markets for goods and services able to earn hard currency and to reduce costly reliance on non-essential imports.

Keene, Monk and Associates' PEP Methodology is able to provide important information for decision makers of three kinds:

First, the information is of critical importance to government officials in developing countries so that they can tailor government policies and practices to enhance, rather than thwart, existing or potential economic advantages. Moreover, the information is useful in targeting efforts at those specific industries most likely to provide the best results.

Second, corporation executives charged with the responsibility to enter, stay, expand, decline or close out of a given industry in a given country will find the information critical to their decision making process, and a key element in the exercise of their fiduciary responsibility to their share-holders.

Third, U.S. government officials who function in the capacity of providing foreign assistance to a developing country or who encourage bi-lateral trade will want an in-depth analysis of the most productive ways to use their position and influence as aid-givers to promote the potential prosperity of the client country, so that they target the recipients of the assistance judiciously.

The Private Enterprise Profile methodology developed and presented here involves the following major steps.

A review and analysis of readily available economic information about a specific country and its industries. This information is found in data bases maintained by a variety of national and international organizations with resources in Washington, D.C.

Telephone and personal interviews with key personnel of the U.S.-based headquarters staff of American corporations already located in the country under study. This information is collated to identify consensus or general trends and then supplemented by information from relevant U.S. government officials and experts from international organizations.

The next step in data gathering and analysis consists of personal interviews with key personnel in both local and international firms operating in the country under study. This information is supplemented by interviews with key government officials.

Once the previous steps have been completed in a PEP done for a specific country, the resulting data is foreseen to be organized into a concise and coherent body of information that provides an accurate profile of the relative strengths and weaknesses of various specific industries or of the country's economy as a whole with careful attention to those obstacles and limitations that have a negative effect.

On the basis of that information, the PEP Methodology provides the basis for making specific recommendations to aid in the identification and development of that country's existing or potential competitive advantages in the production and marketing of goods and services. These recommendations are foreseen to include steps to be taken to strengthen existing production and marketing strategies that are working well. Additionally, new strategies are suggested to strengthen, expand and diversify the economy even further. The recommendations include those measures that can be considered by the ministries of the country's government to facilitate and maximize the potential for increased prosperity.

An added and important potential value of the PEP is that it can be used to identify those developing countries (or selected industries within the countries) where major increases in private-sector foreign assistance are not likely to achieve worthwhile short term results. In a scarce resource environment, foreign assistance donors frequently must make difficult choices about how, when and where to allocate funds. Since such funds earmarked for the direct development of private enterprise are in short supply, a PEP can help to identify for the donor agency how the expenditure of such funds is most likely to effect rapid and substantial results in the short run. On the other hand, the PEP analysis can identify those countries where assistance needs to be focused more on the long range objectives of improving basic health and education as well as such elements of a basically viable infrastructure such as reasonably effective transportation and communication networks so that eventually private enterprise has the context in which it can produce significant gains.

I. Background and Development of the Methodology

The U.S. Agency for International Development (AID) issued a work order in 1984 to Keene, Monk and Associates, Inc. to "design a framework (including indicators) for preparing Private Enterprise Profiles (PEPs) and identify potential sources of information for use in actual (subsequent) preparation of the PEPs". The PEPs are intended to be of use to AID Missions (as well as other clients) in incorporating country-level private enterprise and economic information into policy dialogue and program development efforts. In particular, KMA was instructed to identify and define indicators of receptivity to, opportunities for, or barriers against private sector development in Less Developed Countries (LDCs), and to develop a preliminary guide to preparation of these indicators (and the components thereof), and to identify the necessary data sources so that country specific PEP studies could be undertaken quickly and economically if so desired with the advantage of a methodology already solidly developed.

KMA reviewed a variety of studies and reports already done and germane to this task. Next KMA organized this existing data into a format whereby key personnel in international firms could be interviewed to see if the research results to date were accurate and on target, from the point of view expressed in the private sector itself. The dynamics of the investment decision are the focus and starting point of this task. The results of this two step process provided a list of six key indicators that are elements of critical importance in a typical business plan. They are:

I. General Sales Potential, Ownership, and Access to Suppliers and Markets; (Bottom Line Profitability is the fundamental notion here)
II. Infrastructure;
III. Workforce;
IV. Insurance, Banking and Credit;
V. Stable and Convertible Currency;
VI. Political/Communal Stability and Access to the Bureaucracy.

The ascending order of over all importance in which these indicators are listed here was established by the consensus of the international business men and women interviewed in the course of developing this methodology but is presented here in advance for convenience sake.

Several components have been identified for each indicator, for a total of twenty-seven components that are able to be examined to determine overall receptivity and obstacles to new or continued private investment. Most of the components in and of themselves are not discoveries for those experienced in international business. What is new and particularly useful is that the narrative, the research questions and the summary tables presented here for the first time are designed to elucidate and underscore the practical consequenses of each component for the private investor. The ability of government agencies as well as businesspersons to have and use information organized from this business perspective should be of distinct benefit in discussions among government officials and with private sector leaders.

The Private Enterprise Profile methodology presented here is organized into four parts.

1. The Summary and Introduction
2. The Background and Development of Methodology section describes how the methodology was developed; Appendix A describes the survey component, and Appendix C consists of a selected literature review and bibliography.
3. The Guide to Preparation of Private Enterprise Profiles establishes an investment decision-based framework of indicators and components that comprise the environment for private enterprise investment. Research questions are presented for each indicator. This framework is followed by a section on data collection. Annotations of sources of data available in Washington, D.C. are presented as Appendix B.
4. Part Four is a discussion of additional issues regarding utilization of the Private Enterprise Profile.

By definition a PEP is an analytical study to be done on a specific country; such an empirical test of the methodology on a specific country is not presented here. This is the next logical and necessary step, but beyond the scope of this initial contract. The purpose of work presented here is to develop the basic methodology readily applicable to a wide range of countries and industrial sectors within countries. The methodology presented is logically appropriate, methodologically sound and is grounded in the context of the best available research to date. The actual PEP studies that put this general methodology to the test will result in further refinements to improve the effectiveness and usefulness of this methodology, bringing to light clearer evidence of the importance of the indicators on a country by country basis.

II. The Development of the PEP Methodology

To design the general "methodology" for developing Private Enterprise Profiles, the following tasks were performed by KMA:

A. identification and definition of indicators of receptivity to, opportunities for, or barriers against private sector development in Less Developed Countries (LDCs), and division of these indicators into their various components;
B. development of standard PEP research questions;
C. survey of U.S. corporate executives to validate the relative importance of the indicators and components;
D. development of a data collection guide; and
E. a test run of the methodology with reference to three countries, but limited to a detailed investigation of data bases available in Washington, D.C.

In completing Task A, the resources used included expertise in local and international economic development, interviews with persons actually involved in international business, and the literature on private foreign direct investment. A literature review and bibliography is included in Annex C of this report.

Critical to the success of the PEP Methodology as a tool is the ability to formulate a standard set of research questions to guide implementation by or for U.S.AID Missions or other interested parties. Thus, Task B was undertaken and completed.

While the indicators and their components were derived from various business research studies, and from a careful analysis of the dynamics of local economic development, there is no clear, consistent consensus among previous researchers as to the priority of one component over another in the investment decision. We have learned from our interviews that actual priorities fluctuate and are based on the impact of the component in question on the cost of the factor(s) critical to the investor's business and to profits, and these factors, of course, vary. In any event, we have verified general agreement on the importance of the components identified by asking executives of U.S. corporations with subsidiaries in LDCs to discuss their decision-making criteria, and their experience operating overseas. A copy of the telephone interview guide used is included in Annex A. The process for selecting sample companies is also described in Annex A.

The methodology or framework described in Chapter III is designed not only to enable the collection and interpretation of relevant factual data, but also to highlight in future PEPs the practical experience of individuals or corporations who work in the private sector environment of that country.

The Dynamics of the Investment Decision

The profile or model of the investment decision process that emerges from the interviews with businesspersons in this PEP Methodology research is a very dynamic, sometimes even fluid, one. Over and over again interviewed executives said "it depends" when asked which of the business indicators was of greater relative importance from their individual points of view, distilled from long and varied experience in international business.

The explanations of "it depends" suggest a conceptual model that can be visually represented by six concentric circles (like the circles visible in a cross section of a tree trunk) with profitable access to necessary resources, suppliers and markets as the key and central component, termed Indicator I.

The importance of the other surrounding circles which represent the supporting indicators is best understood in terms of how much they actually do support or impede the profitable access that constitutes the core indicator. Generally speaking, the next circle closest to the core center is infrastructure. And the key question regarding infrastructure is this: Do the sum total of facilitators and obstacles in the infrastructure negatively loom so large as to virtually extinguish profit potential, or are profit margins sufficient to incur the expenses for whatever is necessary to work within the constraints of the existing infrastructure?

In most cases the next closest ring surrounding both the core and infrastructure is the workforce. Are problems of workforce size, skill level and availability affected by the foreseeable savings in wages relative to foreseeable profit? If so, workforce is a facilitating support to investment; if the situation is otherwise, the workforce circle becomes a barrier that diminishes or even blocks out investment altogether.

The fourth ring is insurance, banks and credit while the fifth ring is stable and convertable currency and the final or outer ring is the stability of the community and the government as well as access to a reasonably reliable and cooperative bureaucracy for the basic minimum of cooperation needed so that private enterprise can function efficiently and profitably vis-a-vis government negotiations.

By looking at the dynamic interrelationships of the components in this way, it is clear that both in theory and practice the positive and negative elements of each indicator ring can either stimulate or impede investment and in some cases choke it off completely. If the sum total of any combination of communal, political, currency, financial, workforce and infrastructure problems reach a critical point whereby they effectively defeat profitable access to resources, supplies and viable markets, then the only reasonable decision is to curtail production and, if the situation does not improve well enough and soon enough, to abandon the enterprise.

The vital combination of indicators promoting business investment and growth will constantly vary as conditions change over time in one country. Moreover, it is clear that these conditions are different from one country to another. The resulting model is one where the sum total of existing obstacles, restraints and disincentives represented by any or all of the indicators must be kept within bounds that allow the positive elements (lack of obstacles; strong supporting elements and incentives) to sustain, strengthen, expand and diversify investment.

Therefore, at a given point in time actual circumstance can make the effect of one or more of the "lesser" indicators (represented by the outer circles) so prepotent in its consequences that it is in fact the single most important critical issue upon which business decisions with far reaching consequences are made.

The essentially dynamic (sometimes even fluid) nature of the business investment indicators and the changing quality of their interrelationships also has its practical limits from a business perspective. A frequent theme in the interviews with business executives was that (given reasonable profitability in resources, supplies and markets) almost any obstacle in the other indicators can be overcome provided that actual conditions are not subject to abrupt and extreme changes in a negative direction. Sharp and disturbing changes of this sort, if they occur at all, are seen most frequently in the indicators for political and communal stability, financial matters and currency regulations. These changes can rapidly throw the previous business equation off base and negate the previous reasonable expectations of profit and prosperity.

Several interviewed businessmen repeatedly pointed out that obstacles in any of the indicators are tolerable and able to be compensated for provided the elements of rapid and unexpected instability do not enter the picture. For example, if profits from the business are sufficient to overcome long range workforce and infrastructure difficulties, this situation constitutes no disincentive. However, in that same situation, if other abrupt changes were to occur, the whole formula falls apart. Some obvious examples are prolonged political and communal instability of the sort that seriously curtails or shuts down business operations. Other examples would be abrupt policy shifts in the government leading to expropriation (at least in effect) or drastic negative financial and currency situations. Or an abrupt negative shift from a pro-business government to the opposite can have a similar effect on private enterprise.

In effect, the more stable and predictable negative components of the business environment can be identified and coped with, and measures can be taken over the long term to deal effectively with workforce or infrastructure obstacles to improve the situations. Moreover, companies are generally most anxious to collaborate with one another and governments and to underwrite to some extent the effort to make these needed improvements. On the other hand, if too many shocks are absorbed from the three outer circles described above, the business climate in general will falter even though individual companies in isolated instances may be able to weather the adverse circumstances and survive. What is more, this kind of instability places a long-lasting negative reputation on that country as a reasonable location for prosperous private enterprise. In most such instances extraordinary efforts and concessions will be necessary to spark a reverse trend of attitude in the future.

This model is so clear cut and simplified that one is tempted to wonder why a PEP analysis is necessary. The answer is that the circles are simple but the interrelations of the components within each circle are complex, subtle and changing at all times. While businessmen are naturally reluctant to share the details of a well honed expertise in which they have proprietary interest, it is clear that the genius of international business lies in the ability to carefully identify the indicators and to weigh both their current and future effects on the business decision at hand. Since sizable international business enterprises generally take five years to "come on stream" the consequences of these skills in evaluation and forecasting are of immense importance.

In actual fact, the elements considered in business decisions that are identified and organized into the format of a PEP Methodology are widely held and put to good use. But several of the interviewed business executives, obviously adept at making these investment decisions correctly most of the time, found it altogether novel to think in terms of constructing an actual model and methodology of how to go about it, a methodology that could spell it out in an organized way and facilitate a more wide spread understanding of the underlying complexities of the process by which appropriate business decisions are made. Caught up in the day to day exigencies and details of successfully implementing the process they are less practiced at articulating a description of the process itself.

This wealth of international busines experience suggests that a PEP should follow this basic format presented below. In each PEP study the relative importance of each topic in the outline will only become evident as the work progresses.

Exhibit 1

BASIC OUTLINE FOR PRIVATE ENTERPRISE PROFILE

I. Recent history of Foreign Direct Investment in the Country

II. Current Economic Situation
   A. General Demographics
   B. Sectoral Contribution to GDP
   C. Inflation and Exchange Issues

III. Indicators of Investment Climate*
   A. Indicator #1, Definition of Components, Explanation of Relevance to Private Enterprise Success, Research Queston, Measures and Data Sources
      1. Status of each component of a major indicator
      2. Summary
   B. Indicator #2, etc...... Indicator #6

IV. Industry-specific Discussion**
   A. General trends
   B. Specific cases

V. Policy and Administrative Issues
   A. Policy
      1. Fiscal, Monetary, Budgetary
      2. Sectoral/Regional
      3. Communications
      4. Education
      5. Public Investment
      6. Others as identified
   B. Administration of Relevant Institutions
      1. Staffing
      2. Procedures
      3. Organizational

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*In order of relative importance, as derived from survey/interviews of private investors

**To be included only when there are enough resources to do so.

III. Guide to Future Preparation of Private Enterprise Profiles for Individual Countries

A. Overview

In deciding whether to invest in a given industry in a specific country, the business executive is most concerned with the potential profitability of that investment. Is the local or proximate market (for goods and services) big enough or "rich" enough to more than offset the costs of entering and operating in that market? Is the supply of raw materials of good or acceptable quality more reliable and/or less costly here than elsewhere? To answer that question, the executive examines the profit and cost elements common to his or her business/industry, in the country under consideration. Thus, he needs information on the following environments or "markets" of available resources:

Consumer population
Industrial/Commercial resources
Supporting infrastructure
Financial resources
Regulatory obstacles and facilitators

The indicators, and their components, that form the focus of the PEP methodology incorporate the variables in these environments: the table on the next page presents each environment and the variables therein. By researching the indicators for a particular country, KMA is able to identify the positive and negative factors in these environments and the resulting investment climate, and so have a basis for discussion with the host government and other key officials from government or private enterprise.

Exhibit 2

Environment	Factors	Relevant Indicator(s)
The Consumer Population	demographic: age, sex, education, location, discretionary income; tourist statistics: N, landings, expenditures import-substitution policies	General Sales Potential, Ownership, and Access to Supplies and Markets (GSPOM)
Industrial/ Commercial Resources	$ size, employee size by Standard Industrial Classification code; composition of imports; strength of business community	GSPOM (see above); Political/Communal Stability (PCS)
Supporting Infrastructure	labor market storage facilities, wholesale and retail outlets transportation and handling facilities availability of energy and other utilities adequacy of communications and information channels	Workforce (W); Infrastructure (I)
Financial Resources	credit and banking exchange controls inflation interest rates balance of payments	Stable and Convertible Currency (SCC); Insurance, Banking and Credit (IBC)
Regulatory Obstacles and Facilities	statute and regulations regarding private investment administrative procedures	GSPM; IBC; I; and PCS

The section that follows presents and defines Indicators and Components, Research Questions, Measures, and Data Gathering Procedures for each section of the Basic PEP format. They are presented in order of relative importance indicated by U.S. business executives in making their investment decisions.

B. Indicators, Components, Research Questions and Methods

This section focuses on Part III of the sample PEP outline attached as Exhibit 1: Parts I and II of the outline are designed to provide historical context and set the stage for the analysis, and should be self-explanatory, as similar sections generally appear in Country Development Strategy Statements (and/or documentation of multilateral lending institutions referred to in preparation of CDSSs). The discussions of each indicator is followed by a chart listing the indicators components, the significance of the components and the needed sources of information.

Indicator I: General Sales Potential, Ownership, and Access to Suppliers and Markets (GSPOM)

The chief concern of any businessperson, domestic or multinational, is profitability. The basic reason for this is his fiduciary responsibility to his company's shareholders. How long will it take to realize a profit? What special actions must be taken to retain profits? And how much profit will actually be seen in the end? This indicator is comprised of six components that have the greatest direct impact on profitability.

The components of this indicator -- market size, competition, protection against competing imports, forced forward linkages and export requirements, tax incentives, and ownership and licensing alternatives -- are the basics of the decision to invest and to remain in business in a country. Below each component is discussed in detail.

Market Size

Without a market for its goods and services, neither a local nor a multinational firm will invest in a country. How does a company determine

a) whether there is a market*, and b) whether that market is large enough to offset the costs of investment and operations? This is necessary to determine targets for internal and external investment promotion schemes that will be truly effective.

Both the consumer and the industrial/commercial markets must be considered, the latter not only as a source of consumers but also as a source of potential competitors. Some multinationals need special information about mineral reserves and regulations regarding their utilization as well.

For analytical purposes, the consumer market is made up of population demographics, and regulations affecting access to that market (trade, price and technology policy). While infrastructure and financial "factors" also affect access, they are discussed separately for clarity. Business people need to have a description of the population for preliminary indications of market segments, present and projected. Data disaggregated by sex and by age are needed for effective market analysis.

When used in formulas intended to project population growth, this information can be very useful. It should, however, be augmented by qualitative information on population education, location, and discretionary income. Knowledge of the structure of the population along these lines is important not only for market segmentation purposes, but also to denote market "richness." In analyzing census data on these variables, it is very important to document the definitions used by the census office. Some countries may have data that enable the researcher to estimate discretionary income, other situations may require that a sample survey be undertaken to do so. An alternative measure to discretionary income as an indicator of market "richness" is retail sales per inhabitant in a given location. There are a number of possible sources of such data, especially business associations, Central Bank or Ministry of Commerce.

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*Note: Obviously, data requirements will vary for analysis of markets for different products and services. What is presented here are the basics with which to build a specialized market study. If these are not available due to poor record keeping, then a major obstacle is in the way.

To make investments to enhance the multiplier effect of tourism, data on frequency of landings, numbers of people, and type and size of purchases are necessary. Some of this information is available from Immigration or Tourism Ministries or Port Authorities; other information must be derived from sample surveys.

Industrial/Commercial Factors

Information on the structure of host country industry and commerce is needed to determine markets for non-consumer goods and services, to determine the extent of competition, and to identify potential sub-contractors or joint-venturers. Data from the census, Central Bank, Government Ministries and business associations should be used to examine the following variables: distribution of firms by (international) Standard Industrial Classification (SIC), receipt size, and number of employees. Type and quantity of goods and services imported also indicate potential markets.

The statistical analyses noted above are of use for investment promotion targeting, and to the investor who wishes to produce locally for local consumption. To complete the picture, the investor also needs to know:

- whether the local market is protected by tariffs imposed under an import substitution policy;
- whether one can import intermediate goods (inputs) without being subject to tariffs;
- whether one can pay for them with fairly priced foreign exchange;
- whether one must export to be able to import;
- whether other country markets in the region will be open to one's products, if there are tariff barriers; and
- how much control (financial and managerial) one can have over production and profit.

The answers to these questions constitute the regulatory environment.

Import-substitution and related policies are implemented by customs, the Central Bank, and the relevant Ministry. While information on official exchange rates, tariff structures and subsidies is available from these sources, it is advisable also to communicate with investors to monitor their passage through the system, to determine areas subject to wide administrative discretion. It is important to get a fair picture of the scope of administrative discretion because investors, as they have repeatedly stated in various surveys and articles, can operate under almost any policy constraints as long as these constraints are predictable and allow a reasonable hope of reasonable profit in the end of the process.

Control over production and profit is tightly linked to the investor's original motivation to invest overseas, i.e., to tap or control markets and/or supplies. Investors scrutinize host country rules regarding ownership, licensing, joint ventures and subcontracting and technology transfer. Host country governments must be willing to have some flexibility in these regulations, to allow a range of options to be implemented (while pursuing their goal of harnessing productive resources for social and political, as well as economic, development) and to ·ize the implications of these regulations. For example, a host country with a legitimate interest in promoting labor-intensive technologies will need to devote attention to promoting exports of goods produced, at a higher per unit cost, with such technologies.

INDICATOR I: GENERAL SALES POTENTIAL, OWNERSHIP AND ACCESS TO SUPPLIERS AND MARKETS

Component	Component Significance	Research Questions	Sources
1-A. Protection against competing imports	Beneficial to subsidiary once established (especially high-tech and bulk item producers) because protects the market, however tends to increase cost of production Threat of import restrictions can actually induce consumer goods manufacturer to locate in-country	Do the costs of entry exceed benefits of protected market? Will country allow importation (use) of second-hand equipment, to lower protected production costs?	Host country statute and regulations
1-B. Forced Forward Linkages and Export Requirements	If implemented too quickly, can make exports uncompetitive Can limit investors' equity options	What are the local content requirements, and how are they enforced? (government purchasing, price-controls that credit value-added, granting of import licenses)	Host country regulations (Ministry Finance or Commerce)
		Is the permissable amount of equity ownership tied to extent of linkages? To the level of exports?	Local observers; relevant Ministries
		Are import licenses linked to foreign exchange earnings?	
		What subcontracting incentives exist?	Local observers; host country regulations
		What export incentives exist?	
1-C. Tax Incentives	At Margin of Investment decision	How stable and predictable (i.e. "real") are the tax concessions? NB: U.S. firms may not find it necessarily advantageous to pay lower taxes abroad but companies based elsewhere might	Local observers

INDICATOR I: <u>GENERAL SALES POTENTIAL, OWNERSHIP AND ACCESS TO SUPPLIERS AND MARKETS</u>, continued

Component	Component Significance	Research Questions	Sources
1-D. Ownership and licensing alternatives	Affects control over and profitability of potential investment	How much flexibility is there regarding issuance and sale of shares; type of management contracts?	Ministry officials
		What is the condition of patent and trademark legislation and its administration? (Is it arbitrary? What is the life of a patent?)	Local observers
		What kind of licensing restrictions may be imposed by investor? NB: U.S. firms cannot restrict exports by other than wholly-owned subsidiaries	Host country regulations
		Are there "use it or lose it" restrictions? Are there limits on royalty payments?	
1-E. Market Size	A substantial market can override many disincentives NB: Data requirements vary for analysis of markets for: • agricultural inputs • manufacturing inputs • consumer durables • consumer non-durables • services	What are the demographics? (location, sex, age, education, and income distribution of the population)	Host country census reports; National Accounts
		What public (capital) investment projects are contemplated or soon to be implemented, and what are the contracting possibilities?	Ministry of Planning; Multilateral lending institutions Central Bank
1-F. Competition	Estimate effort required to get large enough share of market to be profitable	How large is parastatal or trading company share? Do they get preferential access to resources?	Relevant Ministries; Official of Parastatals

INDICATOR I: GENERAL SALES POTENTIAL, OWNERSHIP AND ACCESS TO SUPPLIERS AND MARKETS, continued

Component	Component Significance	Research Questions	Sources
Competition, continued		How much private competition is there? (size, SIC and locational distribution of host country commercial and industrial enterprise)	Host country census reports
		Who are the foreign suppliers?	Industry representatives; heads of companies

Indicator II: Infrastructure

U.S. companies will often first consider investing in a country on the suggestion of a senior executive who has business contacts or other ties with that country. In these situations, one of the first tasks of the international manager is to determine the technical feasibility of the project in that country. Clearly, specific physical infrastructure requirements will vary depending on the exact nature of the investment being contemplated, however, it is helpful to know where the strengths and weaknesses of the various components are, how readily they might be brought up to par, and how they compare to other countries.

Infrastructure consists of the following components:

- transportation, storage and handling
- land
- utilities
- communications and information channels
- existing plant and distribution network capacity

The meaning of research questions regarding each component are discussed in turn below.

Transportation, Storage and Handling

Because they are generally partially subsidized, transportation and related facilities and operations can be priced so as to be competitive vis a vis other countries. Low transportation costs* can balance or even outweigh high production costs (incurred in a protected market), in the investment decision equation. The items to be considered in examining this component are: roads, port facilities, rail lines, air strips, riverways, and warehouse facilities. Both the physical condition and operating efficiency must be considered. Investors want to know:

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* determined as an interaction of price and operating efficiency

What is the quality, quantity, reliability and price of shipping, trucking, air freight, and warehousing for import and export of goods and materials?

Is the public transportation system such that workers can get to work on time?

Specifications and prices (fees) on transportation and related facilities can be obtained from industry publications (particularly shipping and ports management), the Ministry of Transport and World Bank appraisals. Operating efficiency and the availabilty of fuel, however, can only be determined by on-site inspection and experience.

Land

The availability of land is crucial to the ability to construct new plants and support facilities. Regulation of foreign ownership and of land management are better indicators of actual availability than are population densities and topographical maps. The place to start in assessing the status of this component is host country statute.

Utilities

Utilities consist of water, electricity, natural gas/coal/wood supplies, and sewerage and other effluent control. The consistent availability of these things in sufficient quantity and quality are uppermost in the mind of an investor whose production must be steady and of high quality; thus, the condition of a country's utilities affects its ability to attract and retain manufacturers of "high technology" products such as electronic components or pharmaceuticals. Research on utilities can be guided by the following questions:

What is and will be the cost (per million BTUs), reliability and level of generation of electric power?

What is and will be the cost, availability and purity of water?

What are the pollution control/environmental protection regulations and enforcement mechanisms?

Information with which to answer these questions can be obtained from World Bank appraisals, and the relevant host country Ministry, parastatal or contractor. If there are no recent utility appraisals available and in-country research is not feasible, some information may be obtained from Embassy commercial attachés, the U.N. Environment Program liaison in New York or the International Energy Agency in Paris. Trade sources are limited, particularly for the smaller countries. Other Washington, D.C.-based organizations which may have the information on smaller countries are the Planning and Development Collaborative (PADCO)*, and the Institute for Public Administration (IPA)*.

Communications and Information Channels

The degree and quality of access to information affects operations and profitability. Companies need ready access to market, financial and political news. Thus an executive will investigate the quality and number of telecommunications channels (in most places, this means telephones), and the regulations regarding private ownership and use. Generally such information is available from on-site observers, the relevant Ministry or parastatal, World Bank reports, and trade publications.

Existing Plant and Distribution Capacity

International businesses find it is usually less expensive to purchase and modify existing operations than it is to build new ones. Thus, the availability of potential acquisitions is an important factor in the investment decision. The following questions guide statistical and regulatory analysis of this component:

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* An AID contractor in urban development.

What is the location, size and type of industrial, wholesale and retail capacity?

What are the regulations regarding foreign acquisition?

This research must be done usually in-country, and it involves Chambers of Commerce and the relevant Government Ministries.

INDICATOR II: INFRASTRUCTURE

Component	Component Significance	Research Questions	Sources
II-A. Transportation, Storage and Handling • roads • port facilities • rail lines • air strips • warehouse facilities	Low transportation costs can balance or even outweigh high production costs	What is the quality/quantity reliability, and price of export shipping/trucking/air freight and warehousing facilities and fees?	Trade publications Ministry of Transport World Bank appraisal
		What is the condition of internal transportation (for material inputs and for workers)?	Ministry of Transport On-site observation
		What is the availability of fuel?	
II-B. Communications and Information Channels	The degree and quality of access to information affecting operations and profitability (marketing, financial transactions, data transmission, etc.)	What is the quality and number of telecommunications channels, equipment, and technicians?	Trade publications Relevant Ministry World Bank appraisals
		What are the regulations regarding private access and use?	
	Ability to compete	Can business get market information -- e.g. spot prices, futures prices, industry projections -- readily?	Local observers
		Is it possible to advertise efficiently?	Local observers
II-C. Utilities • water • electricity • natural gas/coal supplies • sewerage/other effluent control	Affects ability to manufacture "high tech" products	What is the cost (per million BTUs), reliability and level of generation of electric power?	Relevant Ministry or parastatal
		What is the cost, availability and purity of water?	World Bank appraisals
		What are the pollution control/environmental protection regulations and enforcement mechanisms?	UNEP liaison

INDICATOR II: **INFRASTRUCTURE**, continued

Component	Component Significance	Research Questions	Sources
II-D. Land	Ability to construct new plants	What are regulations regarding foreign ownership of land?	Host country statute/ regulations
II-E. Existing Plant and Distribution Capacity	Availability of potential acquisitions	What is the location, size and type of industrial or other capacity?	Relevant Ministry;
		How many wholesale and retail outlets are there?	Chamber of Commerce
		What are the regulations regarding foreign acquisitions?	Host country statute/ regulations

Indicator III: Workforce

Workforce is important enough to stand on its own as a key indicator in all industries even though it obviously assumes greater importance where labor intensive production is involved, or where a technically trained labor component is required. The core issue is as follows: Are the specific skills one needs available there at an acceptable price.

The components of "Workforce" are:

skill levels,
labor relations, and
productivity.

Essential labor market information is available for most countries from the International Labor Organization Statistical Yearbook. The factors of particular interest are: age and sex composition of the employed and unemployed labor force; occupational distribution of the employed and unemployed labor force; and wage rates for occupational categories. The business person also needs information on host country and/or trade union regulations/restrictions on benefits, hiring and firing, and settlement of disputes. The number and quality of training facilities in country or in the region are also important, because they go into the determination of training costs where technically trained labor is required.

The productivity of the labor force influences the investor's choice of technology, and the ability to make profit while paying the going wage rate. Commonly used measures of productivity are: annual average hours worked per week, and value-added by employees per monetary unit (e.g., $) of production payroll. Such records are kept by companies, unions, manufacturers' associations, and Ministries.

INDICATOR III: WORKFORCE

Component	Component Significance	Research Questions	Sources
III-A. Skill level	Affects training costs and productivity;	What is the distribution, by sex, of educational attainment, occupation (title/industry), and skills?	UNESCO Yearbook ILO Yearbook Ministry of Education Ministry of Labor On-site observation
	Has impact on choice of production technology; and		
	Has impact on investor confidence in local managers	Are there adequate local and regional training facilities? (ratio of programs to relevant population; relevance of programs; distribution of public expenditures on education)	Ministry of Education
III-B. Labor Relations	Have impact on operating expenses and freedom of management decision-making	What are the minimum wage/salary and benefit costs?	Host country regulations
		What are the regulations regarding hiring and firing of indigenous personnel?	Relevant Ministry
		How strong are the unions? (participating in decision-making; frequency of strikes/work stoppages; industrial health and safety requirements)	Union representatives; Ministry of Labor Chamber of Commerce
III-C. Productivity	Influences choice of technology, and ability to make profit while paying the going wage rate	What is the value-added by (manufacturing) employees per ($) of production payroll?	Ministry of Labor or Industry Manufacturers' Association Company records
		What are the annual average hours worked per week?	

Indicator IV: Insurance, Banking and Credit

The financial and non-financial costs of day-to-day operations are greatly influenced by the components of this indicator: condition of the local capital market; strength of the banking system and the ease of foreign investor access to it; strength of the local business community; and availability of guarantees or risk insurance. These components determine the ability to finance and protect business investment. Each is discussed in turn below.

Local capital market

The condition of the local capital market is important both in terms of the arrangement of the initial investment, and for financing on-going operations when necessary. The following research questions can be answered using information obtainable from the Central Bank, the Ministry of Finance, the Chamber of Commerce, and Business International Corporation reports:

- What is been the prime lending rate now and what is its recent history?
- Is medium and long-term financing available?
- Where docs most equity capital come from? (e.g., private individuals, money lenders, banks, non-bank intermediaries)
- Can shares be sold locally at a fair market price?
- What alternatives to capital are available as host country contributions to joint ventures? (e.g., contributions in-kind; resource rights, etc.)

This last item requires creative thinking, but often can mean the difference, because a host country stake in a venture is a form of political risk insurance.

An enterprise's ability to operate efficiently and effectively is greatly influenced its relationship to its banker(s). The following basic information on a country's banking system can reveal potential benefits and problems for both domestic and foreign investment:

Where are the banks located?

What facilities and services do the banks offer?

- automation
- collections
- import/export services

Is the use of foreign, as well as local, banks by foreign investors allowed?

Can foreign investors access local credit? Are there limits to how much? Is a parent company required to guarantee loans to its subsidiary?

What non-bank financial institutions are there? What are their sales and services? Do foreign investors have access to them? Is there a National Development Bank?

Local business strength

A strong business community in the host country increases the likelihood that desired policy or administrative changes will be implemented. The potential investor is also interested in the quality of potential joint ventures. In assessing the strength of the business community, one must ask:

What is the size, SIC, and locational distribution of local commerce and industry?

How profitable are local enterprises?

How many business organizations are there? What are their purposes, membership and activities?

Are investors allowed to acquire healthy businesses?

Does the government have policies to encourage business growth? (e.g., tax incentives, and incentives for public trading)

What provisions are there for formal private sectorparticipation in national decision-making?

Information of this sort may be obtained from local business leaders, and from census, labor organizations and Ministry officials.

INDICATOR IV: INSURANCE, BANKING AND CREDIT

Component	Component Significance	Research Questions	Sources
IV-A. Strength of the local business community	Ability to generate and ensure implementation of policy or administrative changes Quality of potential joint ventures	What is the size ($, employees), SIC and locational distribution of local commercial and industrial private enterprise?	National census
		How many business organizations are there? What are their purposes membership and activities?	Local business leaders; Ministry of Commerce/ Industry
		Does government have policies to encourage business growth?	
		What provisions are there in the constitution/procedures for private sector participation in national decision-making? What are some examples of business-government cooperation?	As above
		Are investors allowed to acquire healthy businesses?	
IV-B. Availability of guarantees or risk insurance	Protection of investment	Is there OPIC/FCIA exposure in the country?	OPIC
		Is there a (registered) foreign insurer available?	Ministry of Commerce/ Industry; Insurers
		Can investors take advantage of multilateral guarantees or on-lending programs through national development bank?	National Development Bank officer

INDICATOR IV: <u>INSURANCE, BANKING AND CREDIT</u>, continued

Component	Component Significance	Research Questions	Sources
IV-C. Condition of the local capital market	Ability to finance investment with minimum foreign exchange or political risk versus keeping money available to domestic enterprises	What is/has been the prime lending rate?	Central Bank
		Is medium- and long-term financing available?	Ministry of Finance; BIC "Financing Foreign Operations"
		Where does most equity capital come from? (private individuals, money-lenders, banks, non-bank intermediaries)	Ministry of Finance; Chamber of Commerce
		What alternatives to capital are available as host country contribution to joint ventures?	Ministry of Planning; Creativity
		Can shares be sold locally at a fair price?	
IV-D. Strength of and access to local banking system	Ability to operate profitably	Where are the banks located?	Ministry of Finance; Bank Officers
		What facilities and services do the banks have? ° automation - which functions? ° collections ° import/export service	Bank Officers
		Is the use of foreign, as well as local, banks by foreign investors allowed?	Investment Code

INDICATOR IV: INSURANCE, BANKING AND CREDIT, continued

Component	Component Significance	Research Questions	Sources
IV-D. Strength and access to local banking system, cont'd.	Ability to obtain credit at reasonable cost	Can foreign investors access local bank credit? Are there limits to how much? Is parent company required to guarantee loan to subsidiary?	Investment Code
		Are banking transactions taxed? To what extent?	Ministry of Finance
		What non-bank financial institutions are there? What are the roles/ services of these institutions? Do foreign investors have access? Is there a National Development Bank?	Ministry of Finance

Indicator V: Stable and Convertible Currency

This indicator is comprised of six components:

- Exchange Rate,
- Rate of Inflation,
- Exchange Controls,
- Reserves,
- Participation in Currency Area, and
- Balance of Payments Trends.

As will become clear, the components interact, and any modifications in monetary, fiscal or other policies must be considered with that fact in mind.

Exchange Rate

The exchange rate, or value of host country currency in terms of other countries' currency (U.S. $ is the standard reference) is important at three levels: first, at the level of factor input; second, at the level of the sales of exported goods; and finally, at the point where profits are to be transferred out of country. Thus, exchange rates affect the cost of the various inputs to a private enterprise, and the price that can be obtained for the output of goods and services. Companies use different accounting methods for different objectives. Some shift losses to countries where the tax rate is highest and shift gains to countries where tax rates are lowest, and all of this is done "at arm's length", which means taking advantage of existing legitimate loopholes. Some companies engage in currency trading or "hedging operations", to protect profits. The value of home country currency is a crucial factor in multinational enterprise operations, and the value of host country currency is equally important.

The host country can manipulate the value of its currency to serve internal political purposes, or as part of an import substitution* strategy which

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* Import substitution is a basket of policies designed to promote industrialization and improve the balance of payments of the host country. Import substitution relies heavily on protection of consumer and capital goods industries behind tariff and quota barriers.

discourages use of imported inputs by raising their costs. Overvalued currency can be a deterrent to investment because it means that local currency will be difficult (expensive) to come by for local operations, imported inputs will be expensive, and exported products will be less competitive. While companies can sometimes handle this problem by seeking host-country business or government participation in a joint venture, or by seeking input subsidies, sometimes such strategies are insufficient. For example, the relative paucity of private investment in many African countries is due, among other things, to persistently overvalued currencies.

How can one determine whether a currency is overvalued? The following are considered symptoms of overvalued currency:

- a wide gap between official and black market exchange rate, or an otherwise "tiered" exchange rate system;
- increased use of trade restrictions and payments restrictions; and/or
- a trend of slow growth and loss of market shares in traditional export markets that arises from a domestic rate of inflation that is greater than the world rate of inflation.

One can also plot trends in the nominal and actual (nominal adjusted for inflation) exchange rates over time. These symptoms and trends can be researched using data from the host country Central Bank, the International Monetary Fund, and reports by the Business International Corporation in its "Financing Foreign Operations" series.

Rate of Inflation

Inflation fuels speculation and debt, and dampens prospects for long-term investment by raising the price of money and creating financial uncertainty. Governments frequently react to an inflationary situation with (politically risky) price controls, tighter control of credit, and currency depreciation. Of immediate concern to private investors in such a situation are: the negative impact of inflation on accounts receivable; lengthened collection periods; and difficulty in evaluating the performance of the subsidiary. For purposes of planning, if the trend in the annual inflation rate is sharp, it is important to examine the extent of public sector debt and its contribution to GDP, as well as estimated future public capital expenditure. Data needed for such an analysis are available from host country Central Bank statistics; IMF reports; and World Bank tables.

Exchange controls

Exchange controls are usually enacted in the face of low or rapidly depleting reserves of foreign exchange. The imposition of exchange controls makes it difficult or impossible for a company to convert and repatriate its earnings. Some companies are willing to reinvest locally, when host country regulations do not prevent this (see Indicator 1: GSPOM). For most, however, the inability to repatriate earnings seriously conflicts with overall corporate strategy, and thus serves as an important constraint to investment. The ability of the company to take profits in kind, and the ability of the country to offer these alternatives, is an asset in such situations.

Many of the larger, and some of the smaller, U.S.-based multinational corporations are organized on a regional basis. For this reason, countries often are competing against their neighbors to attract foreign investors. To an investor, a country that is a member of a currency area -- such as the CFA in Western Africa -- is less of a risk than one that isn't. On the other hand, a country that participates in a currency area or other integration scheme can be limited in its ability to correct an import-substitution or export promotion policy (e.g., specific tariffs or subsidies) unilaterally. Terms of the integration scheme would likely be available from the Ministry of Trade or Finance.

It is instructive also to examine balance of payments trends, using Central Bank, Customs or other data, as they not only reflect the impact of productivity and monetary policies, but also can reveal potential markets for goods and services provided by foreign investors and their subsidiaries or licensees.

INDICATOR V: STABLE AND CONVERTIBLE CURRENCY

Component	Component Significance	Research Questions	Sources
V-A. Exchange Rate	*Ceteris paribus* consistently overvalued currency means that local currency will be difficult to come by for private enterprise; local imports will be expensive; and exported products will be less competitive Yet, to reduce their foreign exchange risk, companies will seek foreign participation	Are the symptoms of over-valued currency present? e.g.: ° increased use of trade and payments restrictions ° wide gap between official and black market exchange rate, or an otherwise "tiered" exchange rate system ° trend of slow growth and loss of market shares of traditional exports Must companies, in effect, buy high and sell low? What has been the trend in the nominal and actual exchange rate?	Central Bank Reports IMF Reports BIC Reports - "Financing Foreign Operations"
V-B. Rate of Inflation	High inflation, while favoring a debtor position, triggers the following problems: • accelerated depreciation of local currency • tighter capital controls and input restrictions • scarcer credit and higher borrowing costs • build up of accounts receivable (to investor/subsidiary) and lengthening of collection periods • price controls • difficulty in evaluating performance of foreign subsidiaries • increased political risk	What has been the rate of inflation? What have been the trends in the nominal, and the real, interest rate? What proportion of GDP is government spending? What are the trends in the public capital expenditure? What are the plans for public capital expenditure?	Central Bank Reports IMF Reports Exchange traders for large companies or banks World Bank tables; National plans; Central Bank Reports

INDICATOR V: STABLE AND CONVERTIBLE CURRENCY, continued

Component	Component Significance	Research Questions	Sources
V-C. Exchange Controls	Ability to repatriate earnings and other company funds	Are companies allowed to reinvest local currencies? Can local subsidiaries maintain foreign bank accounts?	
V-D. Reserves	Strong reserve position enables importation of technology, and reduces need for currency restrictions/exchange controls	What is the condition of reserves? Has the country requested "soft window" loans (SDRs)?	Central Bank IMF
V-E. Participation in currency area or other integration scheme	Participation in a currency area reduces uncertainty for the investor, but also limits the type of adoptive measures that may be undertaken by the individual governments	What are the terms of the currency area, trade zone, common market, etc.?	Ministry of Trade and/ or Finance; Documents establishing
V-F. Balance of Payments trends	Trend in Balance of Payments reflects productivity and monetary policies, as well as rate of exchange, and reveals receptivity to offers of investment in export industries	What are the trends in import/export value? volume? composition?	Central Bank and/or Customs administration

Indicator VI: Political/Communal Stability and Access to the Bureaucracy

Executives of multinational corporations very frequently mention the need for "stability" and "predictability" in discussing overseas investment. Some even go so far as to say that they can operate profitably under almost any policy circumstances, as long as these circumstances are reliable and not arbitrary or capricious. It is basically an issue of risk assessment. The greater the risk the higher the predictable return must be. To define this indicator in operational terms, it is composed of three components: adherence to national and international standards; implementation of investment regulations; and general political risk. By their nature, in contrast to the other indicators, a greater proportion of research on these components must be done in-country, rather than in Washington, D. C. Findings on all the components, because they reflect or refer to risk, should be considered in conjunction with the Insurance, Banking and Credit indicator.

In determining the extent of a country's adherence to national and international standards, the researcher needs answers to the following questions:

- What are the foreign investment approval criteria? (see also implementation component);
- Is the country signatory to ICSID*? What other avenues of commercial arbitration exist?
- Is the government signatory to patent conventions? (see also ownership, licensing and technology transfer issues under GSPOM Indicator);
- Does the country adhere to the Calvo Doctrine**? What assurances of equitable treatment are there?

Much of the information required is available from host-country statute, ICSID, and the Business International Corporation.

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* International Center for the Settlement of Investment Disputes

** A doctrine which stipulates that corporations cannot have recourse to home country legal jurisdiction.

Implementation of investment regulations is the second component. On-site observation and constructive discussion with would-be and actual investors is necessary to answer the following questions:

- How sensitive or vulnerable is the bureaucracy to elections?
- Is the bureaucracy staffed by nationals only or is there a high proportion of expatriates?
- How visible are the various bi-lateral aid programs in terms of revenue generated andthe resultant good will?
- How variable/discretionary are administrative procedures?
- What proportion of staff of relevant Ministries have experience dealing with private enterprise?
- Are there reporting requirements by which investors are to demonstrate that they are serving national interest, such as these may be articulated?

Patterns of capricious practices are more important than individual instances, because they reveal organizational weaknesses that can be rectified.

General political risk is a vague term, but is highly significant to those contemplating large, long-term investments, such as firms in the extractive or heavy manufacturing industries. The perceived level of risk has an impact on the insurance needs and rate of return required by the investor. The following research questions should help focus the investigation of political stability:

How stable is the government?
- What are the constitutional provisions for transition, and what is the actual history?
- What is the frequency of elections?
- What is the role of the military in promoting political stability?

How is power distributed?
- geographically? (can be indicated by location of public services)
- ethnically?
- by other criteria?

What is the condition of interethnic relations where this is relevant?

policy of pluralism, strategies for integration?

languages taught?

proportionate representation rules?

official religion?

frequency and duration of ethnic unrest?

Information needed to answer these questions is available from statute, news reports, planning offices, and community organizations.

INDICATOR VI: POLITICAL/COMMUNAL STABILITY AND ACCESS TO BUREAUCRACY

Component	Component Significance	Research Questions	Sources
VI-A. Implementation of Investment Regulations	Companies can operate under almost any regulatory regime, as long as it is internally coherent and predictable	How sensitive or vulnerable is the bureaucracy to elections?	On-site observers
		Is the bureaucracy staffed by nationals only or by colonial (or other) expatriates?	On-site observers
		How variable are administrative procedures?	On-site observers
		How visible is the U.S. aid program?	On-site observers
		What proportion of staff of relevant ministries have experience dealing with foreign-owned enterprise?	On-site observers
		Are there reporting requirements by which investors are to demonstrate that they are serving national interests, such as they may be articulated?	Host country regulations
VI-B. General Political Risk	Has impact on rate of return required, and on guarantees required	How stable is the government? ° What are constitutional provisions for transition, and what is actual history? ° What is the frequency of elections? ° How powerful is the military?	Statute Newspaper reports
		How is power distributed? ° geographically ° ethnically	Ministry of Planning and/or Office of President regarding census; decentralization or regional development programs

INDICATOR VI: POLITICAL/COMMUNAL STABILITY AND ACCESS TO BUREAUCRACY, continued

Component	Component Significance	Research Questions	Sources
VI-B. General Political Risk, continued		What is the condition of interethnic relations? ° policy of pluralism, strategies for integration? ° languages taught? ° representation rules? ° official "church"? ° frequency of ethnic riots?	Ministries, community representatives, news reports
VI-C. Adherence to national and international standards	Predictability/reduction of risk versus local control of means of production	What are the foreign investment approval criteria, and how uniformly are they applied? How efficient and effective is the process?	Investment code; local observers
		Is the country signatory to ICSID? What other avenues of commercial arbitration exist?	ICSID; OPIC
		Is the government signatory to patent conventions? To what extent have they been followed?	Business International Corp. (BIC), "Investment Licensing and Trade:; WIPO; statute; observers (e.g. engineering VPs of multinationals)
	Profitability versus local control of means of production	Does the country adhere to the Calvo Doctrine? What assurances of "equitable treatment" are there?	Investment code; observers

The Survey Technique and Results

The procedures for surveying the opinion of U.S. business executives regarding the relative importance of the PEP indicators were as follows.

Step 1

The fifty companies identified as a suitable and representative cross section of American firms with significant operations overseas received a written explanation of the purpose of the requested telephone interview as follows:

"This letter is a request for your participation in a survey for the U.S. Agency for International Development (USAID). The survey results will equip USAID with a method by which to compile an accurate and useful investment picture of foreign countries. That is important because one long-standing goal of the U.S. foreign assistance programs is to stimulate economic growth and development overseas by fostering more international business investment. The idea is to supplement and even supplant wherever possible the benefits of foreign assistance with the benefits of increased international business.

"The methodology will include survey information and will be used to gauge the relative suitability of various foreign countries for direct investment on the part of U.S. firms. The results, in the form of a private enterprise profile, will be a useful tool in discussions between U.S. government officials and their foreign counterparts working toward improvements in the investment climate.

"The methodology we produce must be sound and practical, so we ask the advice of seasoned and well experienced U.S. investors. You can help us arrive at the right questions to ask about foreign investment so that the answers are as practical as possible. Your firm is one of fifty firms to be surveyed by telephone interview because of significant investment experience in foreign countries. You are qualified to tell us what the key issues are from the vantage point of your first hand position and experience.

"We want to know how and why your company decided to make its foreign investments, or (where appropriate) why your company has decided _not_ to have such investments. We also need candid and specific comments regarding changes you would like to see in foreign countries where your company has operations. Some factors we think may be of concern to you are as follows: insurance, banking and credit; stable and convertible currency; equity and access to various markets; infrastructure; workforce; and political/communal stability. There are probably others that you can highlight for us. The purpose of getting your opinions on key issues and concerns is to ensure that our methods of measuring investment climate are rooted in actual experience of international business. Your responses will be confidential, and any opinions expressed will not be attributed.

"We will call you within the next two weeks. The telephone discussion we request should take about twenty minutes of your time. If one or more of your colleagues would be better able to discuss the kinds of questions noted above, please let your colleague know about our plans to call. Please let us know the name of that colleague as soon as possible so we will contact the appropriate individual.

"Thank you for your help in this effort to facilitate direct investment in developing countries. We look forward to our discussion with you."

Step 2

The telephone follow up contact proved to be a much more difficult and time consuming task than originally anticipated. There were a few outright refusals to take the time to cooperate, some stating lack of interest in a project of this kind, others simply stating that their schedules precluded participation. In the majority of interviews the only difficulty was being able to establish telephone contact for a sufficient length of time to discuss and rank the items in the survey. The executives contacted were those with international responsibilities and frequently their travel schedules created the need for repeated calls and delayed discussions.

Forty-seven discussions did occur and the cooperating executives were asked to rate components and rank indicators made up of those components. The following coding method was used by the interviewer to record the resulting data. The attempt to lengthen the interview long enough to request within-group rankings for each sub-component of an indicator proved to be too time consuming and somewhat irritating because of its repetitiveness and so it was dropped from the interview format. For the same reason, brevity, a number of detailed questions about the nature of the company's past performance overseas, their current problems and future plans were dropped because these questions came close to touching on information considered by the respondents to be proprietary and of value to actual or potential competitors. Since the few respondants who did entertain these questions provided only perfunctory answers of a very vague and general sort, the interviewer elected to confine the questions to the indicators and components as such.

CODING SHEET FOR TELEPHONE INTERVIEWS

Overall Ranking	Component	Rating Scale*
Re:	Insurance, Banking and Credit	
--	Strength of local business community	1 2 3 4 5
--	Adherence to national and international standards	1 2 3 4 5
--	Condition of the local capital market	1 2 3 4 5
--	Strength of and access to local banking system	1 2 3 4 5
Re:	Industry-Specific Infrastructure	
--	Transportation	1 2 3 4 5
--	Communications	1 2 3 4 5
--	Utilities	1 2 3 4 5
--	Land for contruction of facilities	1 2 3 4 5
--	Existing plant capacity	1 2 3 4 5
--	Wholesale and retail sales outlets, adequate distribution system	1 2 3 4 5
--	Other	1 2 3 4 5
Re:	Workforce	
--	Skill level availability	1 2 3 4 5
--	Labor relations	1 2 3 4 5
--	Work ethic and entrepreneurial ethic	1 2 3 4 5
--	Labor costs	1 2 3 4 5

Re: Markets, Sales and Supplies

--	Protection against competing imports	1	2	3	4	5
--	Forced forward linkages or export requirements	1	2	3	4	5
--	Tax incentives	1	2	3	4	5
--	Ownership and licensing alternatives	1	2	3	4	5
--	Market size	1	2	3	4	5
--	Competition	1	2	3	4	5
--	Information channels	1	2	3	4	5

Re: Currency - Stability and Convertability (Capital Flow Risks)

--	Exchange rate	1	2	3	4	5
--	Rate of inflation	1	2	3	4	5
--	Reserves	1	2	3	4	5
--	Participation in currency area	1	2	3	4	5
--	Balance of payments trends	1	2	3	4	5
--	Ability to convert/repatriate earnings	1	2	3	4	5
--	Blocked currency	1	2	3	4	5
--	Availability of local capital	1	2	3	4	5

Re: Government Regulations

--	Local ownership or control regulations	1	2	3	4	5
--	Restrictions on growth of foreign controlled business	1	2	3	4	5
--	Restrictions on foreign labor, requirement for local labor	1	2	3	4	5

Re: Political Risks

--	Nationalization, expropriation risk	1	2	3	4	5
--	Government instability re regulations and policies	1	2	3	4	5
--	Possibility of war, civil disturbance, social unrest	1	2	3	4	5
--	Ready access to bureaucracy for needed permissions	1	2	3	4	5

--	Other: ________________	1	2	3	4	5
--	Other: ________________	1	2	3	4	5
--	Other: ________________	1	2	3	4	5
--	Other: ________________	1	2	3	4	5
--	Other: ________________	1	2	3	4	5
--	Other: ________________	1	2	3	4	5

*5 = Very important in investment decision
4 = Somewhat or mostly important in investment decision
3 = Neutral in investment decision
2 = Somewhat or mostly unimportant in investment decision
1 = Unimportant in investment decision

Company ________________ **Respondent** ________________

Step 3

As anticipated, the interview data gathered from a cross section of industrial and business executives reflecting on long years of experience in a wide variety of foreign countries is of limited, but important usefulness. Because the survey referred to so many kinds of private enterprise experiences in so many different places in the world, in the aggregate the survey results yield only a profile of the priorities and concerns of U.S. executives doing business overseas in a wide variety of countries. As a result it does not (due to sub-sample size limitations) yield useful information about a selected country or a specific single industry in a number of countries. But it was not intended to do so. It was intended as a verification check on the completeness, appropriateness and relevancy of our list of indicatators and components to make sure that nothing important was omitted and that only things of importance were included in our list.

In view of its objective, this survey was a notable success. The respondents commented on its comprehensive range and the fact that it included all issues and concerns that they considered important.

Relative Overall Importance of Indicators from Telephone Survey Results

	Average of Assigned Ranks
Markets, Sales and Supplies	4.70
Protection against competing imports	
Forced forward linkages or export requirements	
Tax incentives	
Ownership and licensing alternatives	
Market size	
Competition	
Information channels	
Industry-Specific Infrastructure	4.26
Transportation	
Communications	
Utilities	
Land for contruction of facilities	
Existing plant capacity	
Wholesale and retail sales outlets, adequate distribution system	
Other	

Workforce 4.04

Skill level availability
Labor relations
Work ethic and entrepreneurial ethic
Labor costs

Insurance, Banking and Credit 3.83

Strength of local business community
Adherence to national and international standards
Condition of the local capital market
Strength of and access to local banking system

Currency - Stability and Convertability (Capital Flow Risks)

Exchange rate 3.49
Rate of inflation
Reserves
Participation in currency area
Balance of payments trends
Ability to convert/repatriate earnings
Blocked currency
Availability of local capital

Government Regulations/Political Risks 3.09

Local ownership or control regulations
Restrictions on growth of foreign controlled business
Restrictions on foreign labor, requirement for local labor
Nationalization, expropriation risk
Government instability re regulations and policies
Possibility of war, civil disturbance, social unrest
Ready access to bureaucracy for needed permissions

Meaning of Rank Assessments

5 = Very important in investment decision
4 = Somewhat or mostly important in investment decision
3 = Neutral in investment decision
2 = Somewhat or mostly unimportant in investment decision
1 = Unimportant in investment decision

Step 4

The Delphi exercise (described on page 56) was used as a limited test of the consistency and stability of the telephone survey results over the period of one month.

The Delphi Exercise

Ten of the telephone survey respondents were contacted a second time to determine the degree of consistency over time of the rankings previously assigned. These ten were randomly selected from the larger sample of 47 previously interviewed individuals.

The results are as follows and indicate a high degree of consistency in comparative rank and a slight elevation in the assigned importance of the indicators.

Indicator	Original Rank Assignment	Second Rank Assignment
I	4.70	5.00
II	4.26	4.80
III	4.04	4.70
IV	3.83	3.70
V	3.49	3.60
VI	3.09	3.30

This finding strongly suggests that, at least for this sample, the relative importance assigned to indicators is both stable and consistent.

However it should be noted that there is a whole other aspect to this issue of indicator strength. The issue is the dynamic aspect of the importance of individual indicators. At least a third of the interviewed business-persons pointed out that at different stages of the beginning and continuation of an investment various indicators take on added or diminished importance. The sequence and timing of these changes is a whole new area for further research.

Step 5

Since telephone interviews of thirty minutes or less yield only basic and somewhat limited information, ten executives were contacted and agreed to schedule longer in-depth interviews. As was the case with the Delphi exercise these more lengthy interviews yielded indicator ranking results consistent with those of the telephone survey. An important advantage of these face-to-face discussions was the opportunity for the executives to elaborate on additional areas of concern beyond those listed on the survey form. This information alerts us to the fact that a PEP interviewer should be alert to the possiblity that these additional items may be of concern to other eecutives contacted in the future. The list is as follows:

A general lack of safety in some developing countries
The competitive cost of capital from U.S. sources such as EXIM Bank, AID and commercial banks
A lack of confidence that U.S. Government officials overseas understand and solidly support U.S. business interests abroad suggesting that these officials need more experience in the private sector or compensatory training if such experience is not available
Poor medical care and hospital facilities in some developing countries

C. GUIDE FOR RESEARCH ON INDICATORS

In the previous section, the various indicators and the components therof were defined and research questions presented. The procedures for answering the questions - data gathering and analysis - are presented here. The first part of PEP research is getting basic descriptive and regulatory information; the second part is generating a ranking of the barriers to private sector development in that country. A summary of PEP data sources appears as Exhibit 3.

The process of gathering and analyzing statistical and regulatory information to answer the research questions presented earlier consists of the following steps:

1. Be sure to have defined measures and variables for each research question
2. Develop data recording and analysis formats
3. Record relevant statistical data from available Central Bank and census reports
4. Record relevant investment regulations and other statutes
5. Examine available World Bank, Business International Corporation, and U.S. Department of Commerce analyses
6. Determine further information needs in order to streamline and expedite in-country data collection
7. Examine Ministry and Chamber of Commerce and other business association documentation
8. Meet with U.S. Foreign Commercial Service Officer to get additional special studies, and insight into U.S. investor requirements and problems typically encountered
9. Develop preliminary assessment of the receptivity or obstacles regarding the components of the six PEP indicators (problem areas)

Summary of PEP Data Documentation Sources

PRINCIPAL SOURCES OF INFORMATION	LOCATION OF INFORMATION SOURCES	INDICATORS/COMPONENTS ADDRESSED BY EACH SOURCE
Host country census and national accounts	in-country; International Monetary Fund (IMF) Library	General sales potential, ownership and markets/market size; competition Insurance, Banking and Credit/ strength of the local business community
Host country Central Bank Reports	in-country; IMF Library	Stable and Convertible Currency/ all components Political & Communal Stability/ general political risk Insurance, Banking and Credit/ condition of the local capital market
Host country statute and regulations	Embassy; in-country (Office of President, parastatal organizations, and the various Ministeries, e.g. Commerce & Industry, Labor, Finance, or Transportation)	Infrastructure/land; existing plant & distribution capacity General Sales, Ownership and Markets/protection against competing imports; forced forward linkages; tax incentives; ownership and licensing alternatives Workforce/labor relations Political & Communal Stability/ general political risk; adherence to international and national standards Insurance, Banking and Credit/ strength of and access to the banking system
Local Observers	in-country	Infrastructure/Transportation, etc.; Communication & Information Political & Communal Stability/Implementation of Investment Regulations Workforce/skill level
Host country Chamber of Commerce	in-country	Insurance, Banking and Credit/ strength of the local business community; quality and availability of banking services General Sales, Ownership and Markets/ competition Infrastructure/existing plant & distribution capacity
International Labor Organization Statistical Yearbook	any U.S. reference library	Workforce/all components

The preliminary assessment of obstacles and receptivity (Step 9 above) requires laying out the research questions and the responses to them, by Indicator and components, and assigning a judgement of "strong", "neutral" or "weak" to the components, and then to the Indicators. These judgements will then serve as the basis for the ranking exercise described below.

Based on the above, the next step is to develop a questionnaire with which to obtain rankings of the problem areas from individuals involved in private sector development in that country. There are likely to be three such groups of people: executives of parent companies of local subsidiaries, local businesspeople and bankers, and local government officials.

The purpose of the ranking exercise is to verify or repudiate the initial assessment derived from statistical and regulatory analysis, and to reveal other details or nuances of the business environment to be investigated.

Use of Modified Delphi Exercise to Obtain Rankings of Barriers to Private Sector Growth and Investment in the Host Country

Barriers to investment need to be ranked for two reasons:

1. to identify the structural issues and concerns common to many cases contrasted to problems from unique "war stories" or ideosyncratic factors; and
2. to establish relative importance of the various indicators and components as a basis for priorities for policy dialogue and program design.

Delphi is suggested as a procedure for generating such a ranking because it is a technique for the systematic and non-adversarial utilization of expert opinion, in cases where hard data are unavailable or difficult to come by, and face-to-face interaction is either not feasible or undesirable. One of the original designers and users of the Delphi technique, Olaf Helmer, refers to its potential specifically in the study of socio-economic strategies for a developing country.

A Delphi exercise basically consists of presenting a group of respondents* with a series of statements or topics, such as PEP components, and asking them to assign these items a ranking vis-a-vis each other; this procedure can take several rounds, depending on the final number of items desired, and on the extent of disagreement. Weights are then assigned to the items, and multiplied** by their rankings to obtain a prioritized list of items such that it can be said that "Item B is two and one half times as important (to respondents) as Item E", etc. Whatever weighting and factoring system is used, it must be applied consistently.

Selection of Respondents

Using the Delphi exercise we suggest that three groups of people be tapped for their opinions regarding barriers to investment in a specific country identified through statistical and regulatory analysis. These groups are: 1) executives of parent companies of local subsidiaries; 2) local business people and bankers; and 3) local government officials from relevant ministries and parastatal organizations.

The first group, executives of parent companies of local subsidiaries, represent foreign investors. They may best be identified through a process of cross-referencing the Dun & Bradstreet Directory *America's Corporate Families and their International Affiliates****, starting with the list of "Multi-national Business Geographically" and going to the page number given for the listing in "Ultimate Parents - U.S." or "Ultimate Parents - Canada". An example of the results of such an exercise are presented in Exhibit 4.

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* respondents are usually people with an intense interest in the subject at hand, and are sometimes referred to as "stake holders"

** or factored in other ways

*** The *Who Owns Whom* directories, also published by Dun & Bradstreet, are somewhat more exhaustive and are available for more home countries, but only company names are provided. The Families and Affiliates volume provides detailed information on each company, including contact information, SIC code, size and structure.

A supplementary source of data on U.S. companies operating overseas is the three volume Directory of American Firms Operating if Foreign Countries, 10th Edition (1984, New York. Uniworld Business Publications).

The second group, host country business people and bankers, should be selected using whatever resources are at hand, such as the Chamber of Commerce. Ideally it should have as many members as the first group. Selection criteria should be as follows:

° the sample of executives of locally-owned businesses should represent the same industries as the executives in the first group, and preferably provide a range of company sizes reflective of the size distribution of host country businesses as a whole. Every major region of the country should be represented, if possible.

The bankers come in contact with "unsuccessful" investors as well as successful ones; they are thus very familiar with the impact of the environment and regulations on potential investment.

The opinions of the third group, host country government officials, are necessary in order to bring in the social and political development perspective. It is suggested that individuals serving in decision-making capacities in government agencies which have a private sector development function be selected to participate in the Delphi exercise.

IV. PEP Utilization Issues

A. National and Corporate Goals and Objectives

As agents of a development assistance donor, AID Missions are concerned with the broad economic, social and political goals and objectives (as articulated by the government) of the countries in which they are located. Transnational corporations generally do not question these goals, rather they take them for granted and focus their attention on the performance of the firm, whereby the benefits of efficient and profitable operation accrue to all concerned: those who relate to the firm directly through the purchase and sale of goods and services, including labor, and indirectly to the rest of society through the payment of taxes. The issues are: to what extent do the two sets of goals and objectives conflict? And to what extent do they overlap? The Private Enterprise Profile (PEP) is a tool used to determine what policies and programs can serve both the corporate good and the commonweal at the same time.

B. Importance of Industry Differences

A survey of 96 multinationals done in 1980, revealed that the views of particular multinationals depend heavily on the industrial sector in which their affiliates operate*. Indeed, corporate strategies will vary according to market, factor and operations requirements, and these are generally defined by sector. Generally speaking, sectoral variations in response can be traced to different factor requirements (land, labor, material, capital, time) and markets, and the _differential impact of policies on those factor requirements and markets_. Hence, companies involved in the extraction of material resources will have different reactions than pharmaceutical companies or food processing companies to policies designed to enhance the transfer of technology to the host

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* Frank, op cit, pp. 146-147

country. Export-equity linkages will have one meaning to a food and chemical production company, and yet another to a manufacturer of automotive components. Exhibit 5 summarizes distinctions found through our 1984 survey and the Frank 1980 survey.

Importance of Policy Coordination

This is not to suggest the PEPs must be done sector by sector to be effective, as client resource constraints will generally preclude such an approach; moreover, such an approach could be counter-productive. Rather, it is beneficial to determine beforehand which sectors are ripe for or have been targeted for growth, and to emphasize the requirements of only those sectors in the PEP. For example, if Country X has abundant mineral resources, and thus has a number of foreign investors in the extraction industry, the government could want to diversify its economic base. In the past, attempted import substitution policies have not had the intended effect. The government of Country X has therefore promulgated a law which stipulates that all foreign direct investors must create forward linkages that will increase the value-added in-country, or lose their equity positions and their import licenses. Most extractive companies could comply with this *if* there was ample time for them to create these linkages gradually, without straining their financial and technical resources, and if the ways and means of creating forward linkages are not circumscribed (i.e. they need to be free to subcontract and not be limited to a minority participation position in joint-ventures; to import inputs for indirect exports; to convert and repatriate export earnings, etc.). Further, if the point is to generate value-added exports, then investors must be free to choose a mix of processes and products that can be competitive in world markets. Thus, even in this simple example it becomes apparent that the straightforward objective of encouraging local processing for export faces a number of potential policy and administrative roadblocks that must be addressed if the policy is to have the intended result.

C. Uses of the PEP

Within the process of business decision making or government policy dialogue, and the processes of government program and project development, there are a number of uses for the PEP or adaptations of it. It can be used as:

- Country Development Strategy Statement material;

- Background for various foreign assistance strategies of change, e.g., policy dialogue, support for the private sector, techno- logy transfer, and institutional development; and

- a basis for coordination with the initiatives of other bilateral and multilateral donors.

The status of a PEP indicator is an impetus for policy dialogue when:

- the country compares unfavorably with its neighbors in that regard (such an assessment would require PEPs or equivalent information concerning the neighboring countries); or

- there is a trend toward disinvestment or reduced growth in investment, attributable to that indicator (the connection should be revealed during conduct of PEP); and

- change in components of that indicator is:
  a) within the power of the government or other institutional actor susceptible to government influence
  b) does not have a too high degree of conflict with political or public choice considerations

The PEP is designed so that economic information about the host country can be interpreted by AID from the perspective of a private investor. This perspective differs somewhat from that held by host country government officials. In particular, the need to make a profit, and for a concommitant predictability in the operating environment, are crucial points to get across to these officials, before specific measures can be effectively discussed and implemented.

The mission of government agencies is the achievement of certain social, political and economic objectives, wherein they perform certain functions while maximizing equity (variously defined) before efficiency (as Americans define it). Thus there can be a proliferation of agencies, <u>many of which have some impact on the private sector environment and none of which have the private sector environment as their primary responsibility</u>. This situation is sometimes handled by appointing an autonomous interagency commission or an investment council within a Prime Minister or President's Office. While such measures can serve to focus attention on problems of private investment, they cannot usually facilitate the implementaiton of policy recommendations (hence the research emphasis for some components on implementation of regulations). One reason for the proposed inclusion of a selected group of government officials in the researce described earlier is that it will provide the client with clues as to potential allies in the policy dialogue and implementation process, as well as reveal potential difficulties.

IV. LITERATURE REVIEW

The question of what attracts and retains foreign investment in a country has been a focus of investigation by economists and business researchers since the 1950's. A small portion of this research has examined the question of attraction of private direct foreign investment to Less Developed Countries, or the Third World. The U.S. Agency for International Development (USAID) and other bilateral foreign assistance agencies, particularly the Japanese, have supported efforts to expand private investment in the Third World since the mid-1960's.

Based on insights gained from Billerbeck and Yasugi (7) and the U.S. Business International Advisory Committee to the OECD (29), the indicators used in the methodology are designed to be reflective of general economic and sectoral policies, rather than of incentives designed to correct or off-set such policies at the margin of the investment decision.

The review that follows is organized by indicator, for brevity and convenience. The indicators are: Stable and Convertible Currency; Infrastructure; Political/Communal Stability and Access to the Bureaucracy; General Sales Potential, Ownership and Access to Suppliers and Markets; Workforce; and Insurance, Banking and Credit.

Stable and Convertible Currency

This indicator is comprised of the following components: exchange rate, exchange controls, reserves, balance of payments trends, participation in currency area, and the rate of inflation. A cogent analysis of these components and their meanings and interactions in a regional context is provided in World Bank (32). Balassa (3) discusses these components, and other aspects of monetary policy, in the context of inward- and outward-oriented economies, and their contribution to the success or failure of import substitution policies. Analyses of monetary and trade policies as part of development strategies for specific countries are provided in Balassa, et al (4). The constraining effects of exchange controls on exporters receives a good deal of attention in an AID 1982 report on the Dominican Republic (28). The strategies used by business to circumvent exchange policies are detailed in an article by Sesit (23). The interaction with home country currency is discussed in Auerbach (2).

Insurance, Banking and Credit

The components of this indicator are: strength of the local banking community, availability of guarantees or risk insurance, condition of the local capital market, and strength of and access to the local banking system. It is obvious that the stronger the business community, the better the attitude toward business is likely to be, as experience with host country business organizations attests. Frank (14) provides insight as to the importance of this component vis a vis the quality of potential suppliers and joint venturers. The importance of insurance is also discussed in Frank (14), and Cizauskas (11); general information on getting it is provided in U.S. Department of Commerce and OPIC publications, and details are provided in guidance published by the Business International Corporation (9). The predictability of FCIA coverage decisions has been questioned by small U.S. business (interview). The importance of the structure and health of local capital markets is discussed by Balassa (3), Bhatt and Roe (6), Business International Corporation (8), and an article by Behr (5). The need to license foreign insurers is discussed by CIGNA Corporation (10). The ability to sell shares locally at a fair price is an issue for some U.S. investors (interview). The importance of various aspects of the host country banking system is examined in detail by Business International Corporation (8). Taxation of financial transactions is discussed in Frank (14).

General Sales Potential, Ownership and Access to Suppliers and Markets

This indicator is somewhat of a catchall. Its components -- protection against competing imports, forced forward likages and export requirements, tax incentives, ownership and licensing alternatives, market size, and competition -- were derived from or substantiated by Department of Commerce publications, Frank (14), Daniels, et al (12), Hackett (15), Kindleberger (17), Orme (20), and Business International Corporation (9).

Political/Communal Stability and Access to the Bureaucracy

The Business and Industry Advisory Committee (29), Frank (14), Orme (20) and interviews with business people revealed considerable concern for "stability", "predictability" and "access to the right people" in closing deals and operating effectively in the host country. We have identified two components for this indicator -- implementation of investment regulations, and general political risk.

Workforce

Skill level, productivity, and labor relations -- the three components of this indicator -- have long been known to be of importance to investors, and are frequently emphasized in promotional literature, as well as in analyses of development status. Frank (14) in particular notes labor relations issues, especially pertaining to the ability to fire indigenous personnel for cause. Alexander Grant (1), in a study of U.S. domestic investment needs, emphasized productivity.

Infrastructure

Obviously, any lack of (physical) infrastructure is going to greatly increase investment costs. We have identified the following components of the indicator Infrastructure -- transportation, storage and handling; communications and information channels; utilities; land; existing plant capacity, and wholesale and retail outlets. Infrastructure as an attraction for investors is discussed in Daniels, et al (12) and is reflected in the World Bank's project portfolio, and its appraisal reports. The impact of the cost of electricity and of transportation is discussed in Frank (14), and in the Annual Reports of companies such as Reynolds Metals.

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