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PRESENTATION

on

THE APPLICABILITY OF THE SMALL BUSINESS INVESTMENT COMPANY MODEL

for

SOUTHERN AFRICA

AID/AFR/ONI/PBS
CONTRACT NO. AFR-0138-Z-00-000-00
TASK ORDER 20

by

JAMES F. HANSLEY
Consultant to

HARVEY & COMPANY, INC.
1910 K STREET, NW, SUITE 302
WASHINGTON, DC 20006

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EXECUTIVE SUMMARY

Introduction

James F. Hansley was engaged by Harvey & Company, Inc., a contractor to the U.S. Agency for International Development, to investigate the feasibility of establishing and implementing a small business investment company for Southern Africa which would be capitalized in the range of $10 to $20 million; and to assess the applicability of the Minority Enterprise Small Business Investment Company (MESBIC) approach to financing Small Minority Enterprises (SMEs) in Southern Africa. For purposes of this paper, Southern Africa is described as: Botswana, Lesotho, Malawi, Namibia, South Africa, Swaziland, and Zimbabwe. The consultant was asked to explore the strengths, benefits and potential objective goals while outlining the problems associated with the MESBIC approach.

In undertaking this consultancy, the author drew upon his experience as one of the principals in the development of the MESBIC industry, to wit: a) as the founder of one of the pioneer MESBICs started in 1969, a company of which the consultant was the chief executive office and chief operating officer for thirteen years; b) as one of the founders of the American Association of MESBICs, a not-for-profit trade association established to represent the interests of MESBICs; and c) as national President of the MESBIC trade association and contributor to the initial legislation passed by the U.S. Congress in 1972 giving statutory authority to the MESBIC program, and the 1976 legislation extending additional benefits.

The Public/Private Partnership

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

The Southern African Region

The countries in the Southern African region which are the subject of this paper are very different in many respects, which suggests that venture investment strategies should be tailored to the specific conditions as they vary from country to country. A profile of each country is presented in a later section of this paper, however some data on individual countries are provided below:

Key Economic Factors and Other Data: 1990

	Population (millions)	Gross Domestic Product US$ millions	GDP per capita US $	Land Area sq km
Botswana	1.2	2,726	2,428	582,000
Lesotho	1.8	459	873	30,355
Malawi	8.9	2,058	231	118,484
Namibia	1.7	1,818	1,119	824,292
South Africa	38.0	102,400	2,671	1,221,037
Swaziland	0.8	704	902	17,363
Zimbabwe	9.5	6,200	659	390,759

Because of the underdevelopment of substantial segments of the population in each of the countries in the region, the simple observation is that the type of effort contemplated in this paper is needed in every country. The specific form that assistance should take can best be addressed after analysis and study of various factors, including:

a) a survey and documentation of existing business enterprises in each country

b) demographics, economic trends, and market conditions in each country

c) the extent to which efforts similar to those contemplated herein are already underway

d) impediments to economic development of a structural nature

e) policies of government that encourage business and economic development and those that hamper such development

f) agreements between countries which favor certain types of business activity over others

Assisting the Management of Client Firms

The venture investment company, in this setting, must be prepared to provide extensive business and management training and assistance. It may be expected that most of the firms financed in the region will have short performance histories as well as relatively inexperienced management teams. This function of assisting the client's management is very important to ensure the success of the investee firm and the receipt of the expected returns to the venture firm. The assistance may best be provided by an entity which is an affiliate of the venture firm so as to ensure the quality of the assistance.

Exiting the Investment

It is unlikely that the venture investor will find much opportunity for exiting investments through public offerings, in the region, but will be forced to rely on other innovative means, such as: sales to other participants in the venture, the structuring of puts and calls, use of an employee stockholders ownership trust (ESOT) for the gradual purchase of the venture firm's holdings, etc.

Potential Funding Sources

An investment officer at the Southern Africa Desk at the International Finance Corporation (IFC) commented on several venture capital projects which IFC is presently involved with in the Southern African region. They include the 10% shareholder ownership in a venture capital company in Zimbabwe, lines of credit which have been extended to 5 banks in Zimbabwe, an investment in a development bank in Malawi, and the financing of a leasing and finance company in Malawi.

Recommendations:

1. that because of the sizeable geographic area which the subject project is proposed to cover that consideration be given to allowing the financial institution to fund other venture funders in the region.

2. that the various governments in the region be encouraged to consider establishing programs similar to the regular SBIC and the 301(d)SBIC programs. Both programs have experienced administrative and regulatory problems of one kind or another; however, in the main, it is conceded that both programs have been an enormously successful investment by the U.S. Government when viewed from the vantage point of a cost/benefit analysis.

Mesbic Development-Nascent State

The first Mesbic type investment fund was started in 1968 by the Arcata National Corporation (ANC), a major corporation based in Palo Alto, CA. In late 1967, Robert Dehlendorf, President and Chief Executive Officer of ANC, was considering ways to improve the economic conditions of minorities and the impoverished in the Palo Alto and San Francisco communities. During that period Mr. Dehlendorf was a member of the National Advisory Council for Minority Enterprise which acted as a source of knowledge, information and advice on developments in the fields of economic and social life which affect minority business enterprise.

The death of Dr. Martin Luther King in 1968 supplied the sense of urgency that resulted in Mr. Dehlendorf asking his board of directors to approve a proposal to start an investment company to aid minority businesses, and to fund the effort with $150,000 for the first year, and thereafter to invest roughly two percent (2%) of ANC's net profit or about $150,000 for each of the succeeding 5 years. The directors approved the proposal in May 1968 authorizing the chartering of a company called Arcata Investment Company, (hereinafter called the "AIC"). The management of AIC filed an application with the U.S. Small Business Administration (SBA) to be licensed as a small business investment company under the rules of the Small Business Investment Act of 1958.

Project Enterprise

Mr. Dehlendorf's initiative caught the attention of the Executive Administrative in Washington, DC and on November 6, 1969 "Project Enterprise" was declared by Executive Order as President Nixon's first major program to aid the economic development of minorities. President Nixon selected Secretary of Commerce, Maurice Stans, as the administration official responsible for promoting and implementing the Project Enterprise program. Secretary Stans viewed AIC as the perfect prototype around which to build the Project Enterprise program, and decided to seek the commitment of 18 major corporations to pledge $150,000 each to form Mesbics in various cities. Mr. Stans envisioned a target of 100 Mesbics being established by June 1970 and eventually 500 Mesbics generating over one billion dollars of minority business investments.

In response to the Secretary's request for major corporations to sponsor Mesbics, several corporations and a university responded by early 1970, they are: Standard Oil of Indiana, General Motors, University Computing Company, Rutgers University, R.J. Reynolds Tobacco Company, and General Foods. All of the original sponsors of Mesbics formed companies which were initially capitalized at $150,000. Those early Mesbics were administered under the rules of the Small Business Investment Act of 1958 which gave them the authority to sell $2 of their debentures to the U.S. Small Business Administration for each $1 of private capital.

Mesbic Trade Association-AAMESBIC

The managements of the pioneering Mesbic companies, saw major fallacies in the way the U.S. Government was promoting the development of minority investment companies and a small group of individuals agreed to form a not-for-profit trade organization to seek a stronger commitment from the Federal Government for the Mesbic initiative and to provide for the further development of the industry on a sounder business basis. In December 1971, the founding convention for a national trade association was held in Dallas, Texas. Over forty persons attended the meeting as representatives of Mesbics, government agencies, and other interested parties. The assembly adopted a resolution calling for the chartering of a company called the American Association of Minority Enterprise Small Business Investment Companies (AAMESBIC). The major goals articulated at the meeting were:

-that the organization seek funding from the office of Minority Business Enterprise to establish a Washington, DC office to represent the interests of member Mesbics

-that the organization propose that the U.S. Congress pass legislation giving Mesbics statutory authority, separate and apart from the 1958 legislation authorizing the general small business investment company program

-that the President of the United States and Secretary Stans be advised of the need to promote the establishment of larger Mesbic companies

Mesbic Legislative Initiatives

In a message on October 13, 1971, entitled "Expansion of the Minority Enterprise Program," President Nixon noted both the potential and the limitations of Mesbics:

....."Mesbics have the potential of becoming sophisticated investment companies, knowledgeable in the peculiar problems of minority business investment, and able to bring sound business principles and practices to their tasks. Seeking a fair return on investment, Mesbics can act effectively to raise the success prospects of portfolio companies.

Despite the proven values of the Mesbic mechanism, it labors under burdens which endanger further development. The cost of administering minority business investments and the risk of early loss are both very high. Moreover, the short term success pattern of minority businesses has not been sufficiently encouraging to enable them to attract equity investments in normal competitive markets. But the recent successes of minority enterprises have shown that they can compete if they are given enough equity assistance to carry them through this early period."

The purpose of the President's message was to urge Congress to restructure SBA financing of Mesbics so they could operate on a fiscally sound basis. In urging prompt action on the Minority Enterprise Small Business Act of 1972 (the "Act") the President went on to state:

"The immediate impact of this legislation would be to materially restructure the Mesbic program and to stimulate increased private investment and gifts to Mesbics, resulting in greatly increased capital for minority business enterprises, at startlingly small Federal cost.

The legislation would: lower the high cost of starting the investment program of Mesbics; allow Mesbics to take advantage of full SBA financing; enable Mesbics to invest more in equity securities and to reduce interest rates to portfolio companies; and provide special incentives to existing, smaller Mesbics which have pioneered the program.

In the Act, I am proposing a fairer partnership between the private and public sectors--a partnership that would yield enabling capital for minority enterprise. It equitably extends our free enterprise system by making it work for all Americans."

The Act (S.2227) was referred to the Committee on Banking, Housing and Urban Affairs in the Senate, and to the Banking and Currency Committee (H.R. 17632) in the House of Representatives.

Legislative Purpose

The purpose of the legislation was to correct major deficiencies in the way Mesbics were conceived and structured up to that time, for example:

a) Mesbics, prior to the passage of the Act in 1972, were not legislatively mandated but were created by a Presidential "Executive Order";

b) The legislation proposed that Mesbics be authorized, for the first time, to sell preferred stock to the SBA, thereby improving the debt/equity ratio of individual companies;

c) The legislation proposed increasing the leveraging power of Mesbics, by authorizing Mesbics to sell preferred stock and debentures to the SBA in an amount of 3 times the Mesbics' private capital, as compared to the authority of regular SBICs which were entitled to leverage equal to 2 times their private capital;

d) The legislation proposed a subsidy equal to three percent (3%) of borrowings by Mesbics from the SBA.

In summarizing the major features of the legislation, a congressional report stated:

"The purpose of this bill is to give legislative authority to a program of providing long-term credit and equity capital to present or potential businessmen whose participation in the free enterprise system is hampered because of social or economic disadvantage....

The heart of the Act is contained in its paragraphs dealing with the means by which SBA may provide matching funds or "leveraging" to these limited SBICs. The Mesbics now in existence have found it almost impossible to render the sort of management counsel needed by disadvantaged businesses without incurring substantial operating deficits. This bill would attack that problem by allowing SBA to subsidize for a limited period the interest rate charged on debentures issued by Mesbics and also by authorizing SBA to purchase preferred stock issued by such Mesbics. These two provisions would dramatically cut the cost of debt service for special SBICs."

Senator John Tower of Texas, a sponsor of the legislation in the Senate, in comments before that body on September 13, 1972 stated:

"The need has long been recognized in our country for the formation of capital in disadvantaged minority communities. The Act is one of the means recommended by the President to the Congress to facilitate capital formation in the minority community generally, and I think that this self-help approach to curing poverty and unemployment in the minority community is very deserving of support by the Congress..."

The aforementioned legislation was passed by Congress and signed into law by the President in October 1972, and subsequently another bill was signed into law in June 1976 which gave Mesbics the authority to increase their leverage of private capital from 3:1 to 4:1.

Leverage Incentive

One of the unique features of the Mesbic program is the partnership that was created between the Federal Government and the private sector by the authority which permits SBA to match private capital on a 4:1 basis, including the ability of Mesbics to use one tier of its leverageable dollars to sell to the SBA its non-voting preferred stock. The debentures which the SBA is authorized to purchase from Mesbics, have a term of ten (10) years, and a cost equal to the cost of money to the Federal Treasury, less three percent. The preferred shares which SBA is authorized to purchase from Mesbics carry a cost of three percent (3%). As a result of the 1972 and 1976 legislation, private citizens are offered an attractive incentive by the Federal Government to engage in venture capital investing, for the benefit of firms which are owned by persons whose participation in the free enterprise system is hampered by social or economic disadvantages. These innovative incentives which occurred in the early 70' served as a catalyst to cause venture capital, in an institutional setting, to flow into minority communities for the first time in the United States. Scores of new and substantially larger Mesbics were licensed by the SBA soon after the passage of the legislation, in large part due to the improved leveraging and the decreased cost of capital.

Illustrated below, in Figure 1, is the representation of the capital section of a Mesbic balance sheet, capitalized at $1 million in private capital, and assuming the total authority of SBA's leveraging.

Figure I

SBA Debenture, Subordinated 5%	$3,000,000
SBA Preferred, 3% Cumulative, Par Value $10; authorized 150,000 shares; issued and outstanding 100,000 shares	1,000,000
Common stock, Par Value $1; authorized 1,000,000 shares; issued and outstanding 1,000,000 shares	1,000,000
Total Capital	$5,000,000

Legislative Intent

At the time the Mesbic legislation of 1972 was enacted, Congress believed there was an "institutional gap" in the financing community that made it impossible for minority small business persons to meet their needs for equity capital and long-term credit. The prevailing perception among minority business persons was that banks, regular SBICs and other financial institutions generally practiced discrimination against black business persons particularly. At that time no national and objective study had been performed to document patterns of discrimination against black owned business concerns. Nevertheless, Congress declared that the purpose of the 1972 Act was to:

"---improve and stimulate the national economy in general and the socially and economically disadvantaged business segment thereof in particular by establishing a program to stimulate and supplement the flow of private equity capital and long-term loan funds which minority owned small business concerns need for the sound financing of their business operations and for their growth, expansion, and modernization, and which are not available in adequate supply---."

The Act authorized the creation of Mesbics, regulated and licensed by SBA, and (officially designated by the SBA as "301(d)SBICs"), to achieve the above. Federal funds were provided to 301(d)SBICs to encourage them to form and to grow. The Congress anticipated that the loans would be relatively temporary, would act primarily as a catalyst in starting the program, and would be replaced by private financing once the Government had taken the first steps.

301(d)SBICs are privately operated investment companies and may be owned by a) individuals, b) banks, with certain limitations, c) and corporations. 301(d)SBICs are authorized to make equity investments in small business concerns which are owned or controlled by persons deemed to be socially or economically disadvantaged. A 301(d)SBIC may not ordinarily assume control of a business--generally, ownership of fifty percent (50%) or more of its outstanding voting securities, except under circumstances where temporary control is reasonably necessary for the protection of the 301(d)SBICs investment. 301(d)SBICs may also make long-term loans for periods up to 20 years at interest rates not to exceed 15 percent or the maximum rates permitted by the laws of the States in which they operate, whichever is lower.

301(d)SBICs Meeting Congressional Interest?

In October 1978 approximately six years after the first piece of Mesbic legislation was passed by the U.S. Congress, the Chairman of the Small Business Committee of the House of Representatives asked representatives of the American Association of Mesbics to report on the extent to which the industry could justify the continued Federal support of the Mesbic program. In reporting to the Committee, the trade association referred to a comprehensive survey which was completed by the U.S. Commerce

Department of black owned firms. The survey counted a total of 163,000 black owned firms which had total receipts of $4.5 billion, or less than $30,000 in receipts per business. Of the total number of black owned firms, 125,000 had no paid employees. In that same year the receipts for all business concerns was $1.7 trillion. Therefore, black owned firms had sales which represented less than three-tenths of one percent (0.3%) of the sales of all businesses. If the sales of black owned firms had begun to approximate the representation of blacks in the population, sales of black owned firms would have been in the neighborhood of $187 billion.

In 1972, the U.S. Commerce Department conducted another survey of black owned firm and concluded that the revenues of black owned firms had increased to $7.2 billion and the number of black owned firms had increased to 195,000. While the executives of the Mesbic trade association were careful not to take singular credit for the improvement in the statistics for black owned firms, they felt that the Mesbic industry had some part to play in those gains.

In addition, it was pointed out to the Committee that since the first Mesbic type organization was founded by Arcata National Corporation in 1968, that as of June 1978 there were eighty four (84) licensed Mesbics outstanding, with total private capital of $50 million and SBA borrowings outstanding of $65 million. 301(d)SBICs provided $13.6 million in financing to 146 firms in calender year 1976. For the nine months of calender year 1977, 301(d)SBICs provided $17.6 million in financing to 148 firms.

Current Structure and Operations of the 301(d)SBIC Industry

The SBA reports in its Directory of Operating 301(d) SBICs, that as of June 30, 1991 there were 132 operating 301(d)SBICs with private capital totalling $210 million and with $347 million of SBA leverage outstanding. The latest operating report of 301(d)SBICs which is published by the SBA is dated April 1990 and contains statistical data for the calender year ended 1989. The report contains information on 122 301(d)SBICs. Those companies recorded a return on equity of 8.0%--the second highest rate of return ever.

Total 301(d)SBIC income was $14.1 million for Fiscal Year 1989 (equal to net investment income of $11.4 million plus gain on the sale of securities of $2.7 million.) Reporting 301(d)SBICs showed net investment profit of $11.4 million from total investment income of $56.8 million less $45.4 million of expenses and taxes. The largest investment income items were interest from portfolio loans and debt securities ($46.7 million) and interest on invested idle funds ($6.3 million). The largest expense items were interest on long-term debt ($12.6 million), salaries ($8.3 million), and financial costs ($4.9 million). On the equity side, 301(d)SBICs showed a $2.7 million realized gain on the sale of securities from $11.9 million of security sales less $9.2 million for the cost of the securities sold and taxes.

For the year, 77 Section 301(d)SBICs showed gains and 45 showed losses. Four 301(d)SBICs had net income of more than $1 million, and five 301(d)SBICs lost more than $250,000, but no 301(d)SBIC lost more than $500,000.

301(d)SBICs-Net Income-Fiscal Year 1989

Net Income Size	Number of 301(d)SBICs	Total Net Income
(500,000)to (100,000)	14	($3,178,159)
(99,999) to 0	31	($1,085,077)
0 to 50,000	24	$577,886
50,001 to 100,000	25	$1,797,641
100,001 to 500,000	19	$4,034,028
500,001 to 1,000,000	5	$3,321,242
1,000,001 to 3,700,000	4	$8,609,969
Totals	122	$14,077,530

Reporting 301(d)SBICs had total assets of $592 million with portfolio securities comprising 70 percent of total assets, current maturities comprising 10 percent of total assets, and cash and invested idle funds comprising 16 percent of total assets. Seventy-seven percent of the 301(d)SBIC's portfolio securities were straight debt loans, while the remaining twenty-three percent of the 301(d)SBIC's portfolio had equity features. Eleven 301(d)SBICs with total assets over $10 million accounted for $222 million (38 percent) of reported total assets.

Total liabilities were 37 percent of total assets. The largest liability line items were notes and debentures payable to SBA (53 percent of liabilities) and current maturities of long-term debt (11 percent of liabilities). In addition, all other current liabilities made up 28 percent of total liabilities.

Reporting 301(d)SBIC's capital was composed entirely of paid-in stock and surplus ($190.7 million) and 3% preferred stock issued to SBA ($192.7 million). Both unrealized gain on securities held and undistributed realized earnings were negative by more than $5 million.

Reporting 301(d)SBICs paid $8.4 million in dividends and $1.8 million in taxes during Fiscal Year 1989.

SBA Report-301(d)SBICs-Quarter I & II Fiscal Year 1989

The SBA reported in its SBIC Digest, dated April 1989, as follows: From October to December 1989, Section 301(d)SBICs made 406 financing for $37.6 million as 372 different small businesses were financed by 77 different 301(d) SBICs. In the second fiscal quarter, 301(d)SBICs made 388 financing for $42.6 million as 357 small businesses were financed by 70 different 301(d)SBICs.

	Number of 301(d)s Making Financing	Number of Financed Small Bus.	Number of Financing	Dollar Amount Financing (in millions)
1988				
Q I	69	366	403	$39.3
Q II	67	337	369	$33.8
Q III	62	299	319	$25.8
Q IV	77	372	406	$37.6
			-----	------
YEAR	104	1,241	1,497	$136.5
1989				
Q I	70	357	388	$42.6

First financing made up 51 percent of the number of financing and 71 percent of the dollar amount of financing over the last two quarters. The majority of 301(d)SBIC financing over the past five years have been first financing. During the last two quarters, the average dollar size of first financing was $117,000 and the average size of continuing financing was $76,000.

As in recent years, Section 301(d)SBICs made mostly straight debt financing during the last two quarters as 76 percent of the dollar amount of financing and 88 percent of the number of financing by 301(d)SBICs were in the form of straight debt financing with no equity features. The average size of a debt financing by 301(d)SBICs during the last two quarters was $88,000 with an average interest rate of 14.11 percent in the first quarter and 14.65 percent in the second quarter. The average size of an equity-type financing was $195,000 with an average interest rate on the debt portion of debt with equity features of 12.88% in the first quarter and 13.76% in the second quarter.

The SBA also reported that in the calender year 1988, the Middle Atlantic region received three times more 301(d)SBIC financing dollars than any other region of the country. The States of New York ($60 million), California ($21 million), Michigan ($8 million), and New Jersey ($7 million), each region received at least $7 million in 301(d)SBIC financing during the calender year.

The retail trade industry received the most 301(d)SBIC dollars disbursed during 1988--28 percent. The transportation, communications, and utilities industries received 27 percent, the service industry received 15 percent, and the construction industry and the manufacturing industry each received 9 percent. Sixty-one percent of the dollars provided by 301(d)SBICs were used for working capital, sixteen percent were used to acquire an existing business, and ten percent were used to refund an existing obligation with an non-SBIC lender. Small businesses financed by 301(d)SBICs during 1988 had average employment of 14 people and median employment of 5 people; average revenue of $1,114,000 and median revenue of $338,000; average total assets of $582,000 and median total assets of $221,000.

As indicated earlier, the SBA reported in its directory of 301(d)SBICs that, as of June 30, 1991, the 301(d)SBIC industry was represented by 132 companies with $210 million in private capital and with $347 million of SBA leverage dollars. A distribution of those resources are as indicated below, according to 301(d)SBIC asset size.

Total Capital Resources by Size Class
at June 30, 1991
Dollars in millions

Capital Resources Size Class	Number of SBICs	Total Private Capital	Total Leverage From SBA	Total Capital Resources
Size 1-up to $2mm	46	$ 40.7	$ 21.0	$ 61.7
Size 2-$2mm to $5mm	61	69.2	130.6	199.8
Size 3-$5mm to $10mm	15	31.7	69.6	101.3
Size 4-$10mm & up	10	68.9	126.2	195.1
Totals	132	$210.5	$347.4	$557.9

Although the average size 301(d)SBIC, with respect to private capital, is $1.6 million, the five largest 301(d) companies, with respect to private capitalization are, as follows:

Dollars in millions

	Private Capital	Leverage from SBA	Investment Policy
Medallion Funding Corp. New York, NY	$11.2	$21.7	Transportation
Equico Capital Corp. New York, NY	10.6	10.3	Diversified
Allied Financial Svcs. Washington, DC	9.4	26.0	Diversified
Capital Dimensions Minneapolis, MN	7.3	13.0	Diversified
Transportation Capital New York, NY	6.6	10.1	Diversified

Distinction Between Loan-and Equity Oriented 301(d)SBICs

Venture financiers use a variety of ways to finance individual small businesses: loans, equity financing, or a combination of both.

When a 301(d)SBIC loans money, it is interested in obtaining interest income and is less concerned with the profitability or growth of the borrowing firm. This is in contrast to both an equity investor or a combined equity and loan arrangement.

Loan Oriented 301(d)SBICs

The loan oriented 301(d)SBICs are typically firms which are capitalized at the lower end of the investment spectrum and are highly dependent upon a near-term income stream to support the cash flow needs of the venture firms; and are careful to ensure that their investments are fully collateralized. The operations of these firms take on characteristics which are similar to the SBA's primary loan program, as authorized by Section 7(a) of the Small Business Act. Under the 7(a) program, SBA generally makes direct or guaranteed loans to small businesses to finance plant construction, conversion, or expansion; to purchase equipment, facilities, machinery, supplies, and materials; and to supply working capital. Many small business persons who accept 301(d)SBIC financing are unfamiliar with the SBA 7(a) program or believe that it takes SBA an inordinately longer time to execute a financing than a 301(d)SBIC. Although the maximum term of a 301(d)SBIC loan is 20 years, compared to generally 10 years under the 7(a) guarantee loan program, experience indicates that both types of loans are approved for an average term of about 7 years. Loan interest rates under the SBA 7(a) guarantee loan program are more favorable than those offered by loan-oriented 301(d)SBICs. Recent studies indicate that loan interest rates charged by 301(d)SBICs are about 2.5% higher than rates charged by the SBA under its 7(a) guaranteed loan program.

Equity Oriented 301(d)SBICs

Those 301(d)SBICs that primarily provide equity financing, or debt financing with equity kickers, to small businesses are extremely selective, investing in larger firms that have significant growth and profit potential. The venture firms tend to be larger in capitalization size and are not as dependent on interest income from direct investments to meet the cash flow needs of the venture firm. Of all requests for financing, only about 1% of those requests for financing are consummated. In general, the equity oriented investors tend to lean toward the qualitative side of the investment spectrum, to wit:

-they tend to look for companies which are profitable, have proven management, strong proprietary products or services and can grow rapidly to a size where public ownership of their securities is both desirable and feasible.

-they prefer to invest in companies which have broad markets for their products or services and can grow rapidly to a size where public ownership of their securities is both desirable and feasible.

-their basic philosophy is to seek capital gains with established companies that have evidenced a growth potential. By providing long-term equity funds, they are able to assist a company in growth to a point where its principals can achieve their goals through a public offering, sale of the company, or repurchase of the 301(d)SBIC equity ownership.

Cost of Capital

One of the most serious management issues faced by equity investors in a venture firm is establishing policies concerning the appropriate rate of return to expect for common stock investors in the venture firm. This process is often complicated by persons who are a part of the decision process who bring overarching political, social and other concerns, as over and against financial and economic criteria. It is generally conceded among professionals in the venture business that common stock equity in venture firms, such as 301(d) companies is entitled to a return of at least 25% after taxes. 301(d)SBICs in order to satisfy the requirements of common equity investors, and at the same time to lower the cost of investment to investee firms, have employed innovative methods such as substituting public funds as private capital, lobbying the U.S. Congress to lower the cost of funds borrowed from the SBA; and by securing legislation enabling the sale of 3% preferred stock to the SBA. A measure of the risks attendant to venture capital investors can be gauged by looking at the returns of all licensed SBICs over a five year period. (See Table below).

Percentage Return on Capital
for all SBICs
Total Population over 350
Grouped by Private Capital Size

Year Ending	Up to $300,000	$300,000 to $1 million	1 to 5 million $	above $5 million
3/31/67	3.0%	1.3%	2.1%	5.3%
3/31/68	1.1%	4.2%	7.6%	7.5%
3/31/69	1.4%	6.0%	11.1%	12.4%
3/31/70	1.4%	3.1%	5.0%	2.0%
3/31/71	(0.2%)	1.7%	1.8%	(9.1%)

Source: U.S. Small Business Administration

The statistics shown above suggest that improper investment strategies were being employed across the SBIC industry in the years for which the numbers were provided.

Investment Policy and Procedures

Excerpts are provided in this section from the policy and procedures manual of a small 301(d)SBIC. The policy document was dated September 9, 1972. The 301(d)SBIC which in this section be referred to as the "Company." The policy and procedure statements demonstrate how one firm approached the management issues with which it was confronted, as follows:

A. Authority

The authority to make investment decisions shall be vested in the Board of Director. The Board shall be permitted to have discretion in determining what investment to make among those permissible under applicable laws and regulations. The Board shall have the responsibility for the establishment of policies, operating procedures and overall planning.

B. Policy

1. The Company shall principally make financing of the junior debt type, with warrants allowing participation in the common stock of the portfolio firms. The debt instrument shall typically carry an interest rate ranging from 9% to 15%. The overall after tax, common stock, return to the company, including the conversion feature, shall be 20% to 30% depending on the degree of perceived risk.

2. The investment strategy shall be designed to provide common stock investors with an investment program which adheres to the following objectives:

a) conservation of principal
b) reasonable cash income return
c) profits without undue risks

3. The Company shall continuously observe the general regional and national economic and monetary policy trends to detect signals of adversity and shall adjust investment policy to meet the trends.

4. The Company shall continuously monitor new progress of its portfolio clients to detect at an early stage new cash needs, deviations from projections in sales and profitability, major changes in prices of raw materials and supplies, labor costs, and other critical factors.

5. Equities in portfolio companies shall be sold if favorable market opportunities present themselves.

C. Application Procedure

1. The applicant for financing will make contact with the Company, either in person or through a representative. At the time of the initial meeting, the applicant will be given business plan outlines to assist him in the preparation of an investment proposal.

2. Continuing discussions and analysis will take place between management and the applicant. During this period, credit reports, personal history data, industry analysis and related data will be compiled.

3. Once the proposal has been prepared in writing, management will decide whether or not it will recommend to the Executive Committee that the proposed financing be consummated. Management will include in its recommendations the financing plan it deems most appropriate. Those proposals thought to be unsound will be declined without review by the Executive Committee.

4. Once the Executive Committee has the proposed financing materials, it will recommend that a) the venture be financed; or b) that the venture be declined for financing; or c) that management compile additional information which would enable the Committee to render a decision.

5. Once a decision is made by the Board of Directors, and if that decision is affirmative, then management shall be directed to prepare, in cooperation with legal counsel, the documents necessary to accomplish the decided upon financing arrangements, subject to the approval of the Board of Directors.

6. Once an investment is made, management shall arrange for continuing surveillance and management assistance to the investee firm.

D. Evaluating the People

1. Integrity and Reliability: The management will check the applicant's background and history to make an assessment about the applicant's integrity and reliability. If anything disreputable is uncovered, management will consider this information along with all of the other data to consider. Likewise, if the applicant attempts to hid or fails to mention a

significant part of his past, such as being fired from a job, for cause, management may conclude that the applicant is not trustworthy enough to warrant a business relationship with the Company.

Except for obvious cases of dishonesty and deception, making evaluations in this area is very difficult. It is easy to review the past record, but quite another thing to predict how the applicant will act in the future. Management will take into account that those qualities of stubbornness and strong-mindedness that are necessary for success as a business person may have been the reason for a person's clash with a former employer. Similarly, the very qualities that have made a man beyond reproach in the past may make it hard for him to accept losses and defeats should his venture run into trouble.

2. Abilities and Demonstrated Competence

Management will assess the applicant's areas of competence. Technical ability is of concern, but also important is an awareness of business operations and the ability to manage a growing organization. All to often, the ideal entrepreneur is not the ideal manager for the business once it becomes a rapidly growing concern.

Management will give preference to a group which represents a management team approach, which brings to the enterprise various complementary skills and disciplines. The importance of an awareness of the critical functional areas of business: technology, marketing, accounting controls, cost controls, finance, planning, personnel development, etc.,-is crucial to the success of an enterprise.

3. Attitudes and Ambitions

It will be important to Company management and the applicant that their goals and methods are mutually compatible. Factors of "body chemistry" and personality are of primary importance. If management feels that it cannot work with an applicant, then there will be strong reservations about a joint business relationship. There must be a continuing working relationship between management and the applicant/businessman regardless of whether the venture is a success or a failure.

E. Evaluating the Venture Itself

The management will pay particular attention, in the evaluation stage, to the completeness of a proposal. The proposal should place special emphasis on the profit motive, cost control and marketing. Major areas of the business which are not discussed in detail will indicate to management that the businessman is inexperienced in those areas or is unconcerned about them. Management will look favorably on proposals, while being realistic, which offer above average growth prospects. The proposal should evidence the unique characteristics of the venture that make it more likely to succeed. They may be: special skills, technical advances, a market name, a proprietary product, etc. The businessman should discuss his own strengths and weaknesses and indicate possible solutions for weaknesses.

The businessman should seek funding well in advance of his actual needs. The lack of such foresight may suggest to management weaknesses in the areas of budgeting and resource allocation. At the time of presentation of the proposal, the businessman is advised to have specialists to attend the meeting to lend their moral and technical support in areas in which the businessman does not feel completely capable.

F. Legal Fees Associated with Consummating Deals

All legal fees and closing costs associated with the consummation of financing shall be borne by the client concern. During the stages of investigation and negotiation, management will suggest changes in the proposal that will make the deal more attractive to the businessman and the Company. In all but the most straight forward situations, the actual deal that emerges will be quite different from the proposal as first presented.

The negotiations will center around creating a financing that will satisfy both the applicant's need for capital and management's desire to protect its investment, and to make a capital gain on the equity portion of the financing.

Aside from the actual amounts of money involved, the three primary negotiable factors in a deal are:

a) percentage of equity available to investor
b) debt covenants and the amount of security offered to the investor
c) interest rates and conversion privileges

G. Control of Small Business Concerns

The Small Business Investment Act does not contemplate that investment companies shall operate business enterprises or function as holding companies exercising control over such enterprises. However, in new business situations, particularly where there is the absence of a strong track record on the part of the applicant, and in order for the Company to protect its investment, the Company may assume temporary control of a small business concern pursuant to the appropriate SBA regulation.

Country Profiles

BOTSWANA

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

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

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

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

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

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

Two American companies, Colgate Palmolive and H. J. Heinz, are active in food processing and toiletries production. Another recent venture was the initiation of a brick making plant by Interkiln Corp. of Houston, Texas, a financing in which the Overseas Private Investment Corporation participated.

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

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

LESOTHO

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

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

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

Tourism: Although the number of tourists, mostly from South Africa, increased 43 percent from 1983 to 1987, Lesotho's tourist industry is small and largely underdeveloped. Maseur, the capital city, has several excellent hotels with both conference and casino facilities, but quality accommodations elsewhere in the country are presently limited. The Lesotho Government has placed high priority on expanding the tourist industry and hopes that the construction of lakes and access roads in connection with the Highlands Water Project will stimulate tourism and attract potential investors. Tourist attractions to be developed include water sports, lodge construction, mountain climbing, skiing and fishing.

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

MALAWI

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

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

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

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

NAMIBIA

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

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

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

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

Colonial history bequeathed Namibia three different agricultural sectors: about 4,000 large commercial ranches, almost all white-owned; 20,000 African stock-raising households, compressed into central and southern reserves; and 120,000 black families practicing mixed farming on just 5% of the viable farmland in the far north. At the time of Namibia's independence about 50% of the country's commercial farms were owned by absentee landlords; the possible re-distribution of such land was an important political issue. In mid-1991 a national land reform conference resolved that abandoned and under-utilized land would be re-allocated and that ownership of several farms by one person would not be permitted. In 1990, following independence, Namibia signed the Lame Convention, agreeing to supply an EC quota of 10,500 tons of beef in 1991 and 1992, rising to 13,000 tons in 1993. Some 84% of commercial beef production had previously been exported to South Africa. The Lame Convention agreement gives Africa, Caribbean, and Pacific countries preferential access to European Community markets.

Potentially, Namibia has one of the richest fisheries in the world and the fishing industry was formerly second in exporting to mining, which plays a dominant role in Namibia's economy.

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

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

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

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

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

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

REPUBLIC OF SOUTH AFRICA

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

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

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

The total population of the Republic of South Africa as of the March 1985 census was 23.4 million. The ethnic composition of the population was: Africans 15.2 million (65.0%); Europeans 4.6 million (19.7%); Coloureds 2.8 million (12.0%); and Asians .8 million (3.4%). These figures excluded the independent homelands of Transkei, Bophuthatswana, Venda and Ciskei. The total population of the whole region in 1985, including the independent homelands, was unofficially estimated to be 33.5 million, with an ethnic breakdown as follows: Africans 24.9 million (74.3%); Europeans 4.9 million (14.6%); Coloureds 2.9 million (8.7%); and Asians .9 million (2.7%). The population of the region, including the independent homelands, is estimated to be growing at the rate of 2.5% per year, and the population of the region is estimated to be 38.9 million in 1991.

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

In recent years, government economic policy makers have conceded that past policies contributed to structural problems that have hampered South Africa's economic performance in the last decade. Chief among these are persistent inflation (estimated to be in the range of 15 percent in 1990), low domestic savings rates, the use of scarce capital to replace labor, and stagnation of production, employment and productivity.

An important problem remains, the education system, based on apartheid, which deliberately failed to prepare Black South Africans to meet the needs of the economy, leaving a severe shortage of skilled workers. Economic policies are now being put into place to address these problems, but the process will be difficult and slow with respect to achieving substantial improvement.

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

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

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

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

Sanctions: The U.S. sanctions imposed under Title III of the Comprehensive Anti-Apartheid Act of 1986 (CAAA) and the Rangel double-taxation amendment were lifted by President Bush on July 10, 1991, once the South African Government met the conditions set forth in the statute. Other U.S. sanctions remain. The 1985 Gramm Amendment prohibits U.S. support for new IMF funding for South Africa. The U.S. maintains a ban on all exports to the South African military and the police. There are some 140 sanctions having been imposed at the state and local level on U.S. companies doing business with South Africa.

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

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

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

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

Investment Incentives and Performance Requirements: The South African economy is highly centralized. There are four principal metropolitan areas, namely the Pretoria - Witwatersrand - Vereeniging area, the Cape Peninsula, Port Elizabeth and the Durban - Pinetown area.

The Pretoria -Witwatersrand - Vereeniging (PWV) area is of particular significance in the wider South African context. It covers an area of 23,000 sq. km. (8,800 sq. mi) or 1.3 percent of South Africa's total land surface, comprises 30 percent of South Africa's total population and produces nearly 40 percent of its gross domestic product.

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

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

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

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

In accordance with the decentralization policy the following corporations serve the needs of the various geographically defined areas:

a) In South Africa, the Industrial Development Corporation (IDC) and the Small Business Development Corporation (SDBC) are the corporations involved in the promotion and financing of development schemes.

b) In the self governing states, the Corporation for Economic Development (CED) together with the various development corporations are the institutions involved with development in these areas. These corporations are:

The KaNgwane Economic Development Corporation, The KwaNdebele National Development Corporation, The KwaZulu Finance and Investment Corporation, The Lebowa Development Corporation, The QwaQwa Development Corporation, and, The Shangaan-Tsonga Development Corporation.

In the independent states: The Transkei Development Corporation or the Department of Industry, Commerce and Tourism, The Bophuthatswana Department of Economic Affairs or the Bophuthatswana National Development Corporation, The Venda Industrial Development Board or the Venda Development Corporation, and the Ciskei Industrial Development Board or the Ciskei Peoples Development Bank.

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

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

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

On a more positive note, recent discussions and cooperation between Black trade unions, business and government could lead to a healthier industrial relations climate. Most significantly, those parties are trying to reach agreement on amendments to South Africa's anti-union Labor Relations Act, which would remove a major focus of anti-government and anti-employer dissatisfaction.

In addition, while trade unions will continue to be major players on the country's political stage, the recent unbanning of political organizations creates the possibility that workers may begin to vent political demands through those groups rather than on the shop floor. Nevertheless, strikes are up in 1990, with one private analyst attributing it to workers' rising expectations created by a liberalized political climate. If true, workers are by and large expressing those expectations in local disputes over shop floor issues, but nationwide mass stayaways can still occur.

Opportunities for U.S. Firms: South Africa's highly industrialized market economy is the most viable and productive on the continent. The improved political climate offers further opportunities for U.S. suppliers. More American firms are inquiring about export opportunities, and visits are increasing. The most promising sectors for U.S. exporters are computers, software and peripherals; aircraft and associated avionics; mining equipment, services and technology; industrial process control equipment; medical equipment; residential and industrial security equipment; quality clothing and children's clothing; and cosmetics and toiletries.

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

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

Black business' primary business organization is the National African Federated Chamber of Commerce and Industry (NAFCOC). This organization is an umbrella organization consisting of seventeen affiliates scattered around the country. NAFCOC's primary role is to lobby the South African Government and the white business community for changes in South African law and business practices that will help place Black business on a more equal footing with their White counterparts. Other organizations representing or assisting Blacks in South Africa are: Soweto Chamber of Commerce, the American Chamber of Commerce in South Africa, the African Bank, Get Ahead Foundation, the Small Business Development Corporation, South Africa Black Enterprise, the Black Forum, and the South African Bus and Taxi Association.

SWAZILAND

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

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

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

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

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

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

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

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

ZIMBABWE

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

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

Zimbabwe is a member of both the Southern African Development Coordination Conference (SADCC) and the Preferential Trade Agreement for Eastern and Southern Africa (PTA). Both organizations are committed to increased trade and investment among member states. SADCC members are Angola, Botswana, Lesotho, Malawi, Mozambique, Namibia, Swaziland, Tanzania, Zambia, and Zimbabwe. PTA members include Burundi, the Comoros, Djobouti, Ethopis, Kenya, Lesotho, Malawi, Mauritius, Mozambique, Rwanda, Somalia, Swaziland, Tanzania, Uganda, Zambia, and Zimbabwe.

Trade with the U.S.: Trade between the U.S. and Zimbabwe increased from US$160 million in 1988 to over US$220 million in 1989. Major Zimbabwean exports to the U.S. were ferrochrome, nickel, tobacco, and sugar. The major exports from the U.S. were aircraft, aircraft parts, earthmoving equipment, and data-processing equipment. The U.S. was Zimbabwe's third leading trade partner in 1989 after South Africa and the United Kingdom. U.S. products are highly regarded in Zimbabwe, but the chronic lack of foreign currency has limited sales opportunities for the last few years. Importers very often must settle for what is available through barter deals or commodity import programs.

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

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

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

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

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

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

New Developments: The government took steps to encourage additional U.S. investment by signing an agreement with OPIC on June 20. Several major projects under consideration by the government. These include:

- A $100 million rehabilitation and expansion of the Zimbabwe Iron and Steel Company (Zisco)
- Upgrading and digitalization of the telephone and telecommunications system
- Modernization of the Harare Airport
- Development of Zimbabwe's extensive chromium and platinum reserves
- Development of a 900 ton-per-day, $200 million fertilizer plant

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