PN-AAJ-311
ISN 73524

International Science and Technology Institute, Inc.

Headquarters 1129 20th Street, N.W. Washington, D.C. 20036
202/785-0831 • Telex 272785 ISTI UR • FAX 202/223-3865

WORKING CONSTRAINTS INVOLVED IN CONDUCTING FINANCIAL MARKETS ASSESSMENTS AND DEVELOPING FINANCIAL FACILITIES IN LDC'S

PART I

Prepared for

Agency for International Development
AFR/MDI
Contract No. AFR-0438-C-00-5037-00
Task No. 38

Prepared by

International Science and Technology Institute, Inc. (ISTI)
1129 20th Street, N.W.
Washington, D.C. 20036

July 15, 1988

U.S. and Overseas Offices

Arlington, Virginia • Lewes, Delaware • Guatemala City, Guatemala • Cairo, Egypt • Jakarta, Indonesia
Rabat, Morocco • Dakar, Senegal

Working Constraints Involved in Conducting Financial Markets Assessments and Developing Financial Facilities in LDC's

Part I

Prepared for

Agency for International Development
AFR/MDI
Contract No. AFR-0438-C-00-5037-00
Task No. 38

Prepared by

Tamara J. Duggleby,
Financial Consultant

International Science and Technology Institute, Inc. (ISTI)
1129 20th Street, N.W.
Washington, D.C. 20036

July 15, 1988

TABLE OF CONTENTS

	Page
I. BACKGROUND	1
A. The Policy Environment	2
B. Lack of Infrastructure for Business Development and Operation	4
1. Business Advisory Services	4
2. Infrastructure	5
C. Financial Sector Constraints	5
D. Market Factors	7
E. Logistics	9
F. Design Factors	10
1. Structure of the Financial Vehicle	10
2. Terms of the Financing Package	11
3. Provision of Foreign Exchange Financing	11
4. Equity Funds	11
5. Guarantees	11
6. Project Eligibility Criteria	11
7. Management and Administrative Structure	12
8. Oversight Mechanism	12
9. Independent Audits	12
10. Built in Checkpoints in Financial Structure	12
11. Market Rates	13
12. Cost of Funds	13
13. Provision of Business Advisory Assistance	14
14. Dollar Denominated Costs of Technical Advisors	14
15. Coordination with Other Donor Lines and Technical Assistance Programs	14

I. BACKGROUND

The ultimate success of the private sector in a developing country rests upon its ability to create and to access development financing. To generate a permanent and sustaining process for financing private sector development, capital required for expansion or restructuring of local industrial and agricultural enterprises must be effectively mobilized from within the country, and leveraged with outside debt and equity financing where necessary.

Working in coordination with other donor agencies, AID/Washington and the AID Missions have begun to evolve Private Sector Strategies for developing countries under bilateral agreements, in part to improve the functioning and efficiency of financial markets. The Africa Bureau (AFR/MDI) and AID Missions have been particularly active in this regard.

A key component of each Private Sector Strategy developed in Africa has been a Financial Markets Assessment. These are typically carried out in country by a multi-disciplinary team to determine (1) how formal and informal financial markets function to mobilize savings and investment capital and channel it toward productive investments, and (2) how market efficiency might be improved through specific interventions (policy reforms, capital markets institutions, training and technical assistance).

Results of a number of recent Financial Markets Assessments, conducted in East, West and Southern Africa, have revealed working constraints affecting AID/Washington and AID Missions, in conducting realistic assessments and developing financial markets institutions responsive to local needs for debt and equity financing and related services. The purpose of Part I of this Working Paper is to examine the principal constraints involved in the process of market assessment and project development, based upon lessons learned from financial markets assessments recently conducted under AID contracts in the following countries: Madagascar, Kenya, Botswana, Guinea and Zimbabwe/SADCC Region.

Part II of this paper, to be delivered separately according to the Scope of Work dated (7/6/88), will highlight the organizational and structural characteristics of financial markets facilities which have been launched in selected LDC's outside Africa, including examples in Jamaica, Sri Lanka and Morocco. Financial interventions in the latter three countries will be discussed as examples of what can be accomplished in improving functioning of financial markets, through use of Title I Section 108 counterpart funds for local project financing.

The constraints to financial market development identified in Part I of this paper occur in six (6) categories. These are (1) restrictive policies, (2) lack of infrastructure for business development and operation, (3) financial sector constraints (regulations and institutional capacity), (4) market factors, (5) logistics and (6) design factors. Principal constraints in each of these areas are discussed by category below.

A. The Policy Environment

Restrictive credit and monetary policies, which often limit the scope of financial markets activity and market options of users of capital, are among the most pervasive constraints in development of financial institutions which are responsive to local investment needs in less developed countries. Growth of financial markets in many LDC's is constrained, for example, by credit ceilings imposed by Central Banks, often under the IMF restructuring programs which limit the amount of debt financing which can be extended to local businesses through the commercial banking sector.

Interest rate structures imposed by national or regional credit policies often do not permit sufficient spreads to make lending to higher risk sectors requiring medium to long term project financing attractive, resulting in prevalence of short term lending to commercial activities. Some countries, notably those like Guinea which are just entering the West African Franc Zone, lack central credit policies and regulations for operation of rediscounting facilities. This has hindered the growth of diversified financial services, and deepening of capital ownership in local industry.

Medium and long term credit is in limited supply in most African countries. Heavy outstanding parastatal debt, combined with IMF negotiated credit ceilings, have substantially reduced the financing available to the private sector. Local and offshore investors planning to develop investment or banking institutions serving local business, are often faced with the requirement of negotiating the lifting of credit ceilings, as a condition for launching facilities serving needs for debt and equity financing.

Most start ups or expansions require some foreign exchange financing, for offshore sourced equipment, intermediate goods and spare parts. In the majority of African countries, foreign exchange availability is limited. Access to and use of foreign exchange is often subject to stringent monetary controls, and there is significant competition for foreign exchange between existing businesses seeking to finance imported inputs, and project loans.

Although monetary policies have shifted in a number of African countries to permit purchase of foreign exchange under auctions and Open General Licensing Systems, actual availability vs. demand continues to constrain local business growth in African markets.

Specific prohibitions against the maintenance of retention accounts, for payment in foreign exchange for necessary imported inputs, has restricted the growth of export industries in some countries (notable examples are Zimbabwe and Madagascar), or forced financial planners to devise means of providing access to such facilities through Central Banks and other channels.

Limited overall availability of sources of foreign exchange financing has forced design teams for recent financial institutions projects to look to alternative sources. These have included Commodity Import Programs (CIP's), donor agency foreign exchange contributions to established investment funds, and other vehicles.

Restrictive import and export policies have limited growth opportunities for local businesses producing for the local and export markets, and consequently, the project market for financial institutions offering a variety of debt and equity instruments. Progress achieved in the process of privatization of state owned enterprises - and the nature of the "process" by which privatization is taking place - have retarded the deepening of local capital ownership and formation of institutions encouraging it.

Illustrative examples are countries which are conducting the divestiture of productive assets of state owned enterprises using a "transactional" process, offering potentially profitable industries and agribusiness enterprises for sale to large European or American firms which will purchase majority interest and/or take a management contract. Divestitures which result are deals made with one financial or technical partner. The pattern of assets sell off discourages the development of a more mature local capital market, with vehicles permitting the small investor to purchase equity in divestitures.

Burdensome and unclear investment codes serve as a deterrent to investment in many countries. Certain key sectors are still reserved exclusively for the state. In cases where codes have been revised to invite private sector participation (manufacturing, banking, insurance) regulations are offen not sufficiently clear to assure that basic investor requirements will be met, and that rights will be protected (e.g. repatriation of dividends, non-nationalization of private businesses).

Other factors slow or discourage the investment process in many African countries. Lack of qualified government staff to conduct detailed analyses of investment feasibility studies, the nature of project eligibility criteria (emphasis upon number of jobs created rather than targeted growth sectors), and discretionary application of code incentives, tend to discourage start ups and expansions and slow demand for new financial products for project financing.

Finally, complex and onerous business licensing procedures create delays and added expenses in processing investment approvals, which discourage new investors and often render smaller scale and higher risk projects infeasible. Most African markets do not offer business services which can provide local and foreign businesses with assistance in dealing with the legal and administrative requirements of getting investment approvals and licenses.

B. Lack of Infrastructure for Business Development and Operation

1. Business Advisory Services

In many developing African countries, professional advisory services required by business start ups and expansions are limited, and those which are available are sometimes of dubious quality. Prospective investors and established businesses must rely almost entirely upon their own resources to generate and to analyze market information, to deal with a myriad of regulations and legal requirements and administrative procedures, and solve their logistical problems.

Business Advisory Services are often lacking or poorly coordinated to meet the needs of smaller scale businesses and new start ups, for technical assistance with marketing, development of entrepreneurial skills in business planning, export market development, and management. Quality technical services for conducting of market and feasibility studies are lacking, and where they are available, they are often not affordable by local businesses.

In countries where liberalization of the economy is opening up new opportunities in local and export markets, small management consulting firms and legal and accounting practices are beginning to emerge to serve the local business market. Their prospective clientele will in many cases be the small to medium scale enterprises which cannot pay the full costs of all services required to prepare a full business plan and supporting financials. Too little attention has been given within financial institutions project design, to factoring into market lending rates a sufficient spread to partially cover costs of such local contract services.

In all but a very few countries, there is no effective, functioning investment promotion center which can serve to (1) assist local and foreign investors in identifying sound investment projects, (2) facilitate the investment approval and licensing processes, (3) serve as a clearinghouse for market information and investment projects studies, and (4) continually update market needs and match investor resources to emerging opportunities. A notable existing example is the Centre National de Promotion des Investissements Prives (CNPIP) in Guinea, AID funded to work with local and foreign

investors to develop feasible investment projects in the agri-business sector, and assist their packaging and financing. Due to lack of legal infrastructure, and precedents for private investment in this country, the Centre has encountered a slow start up in generation of joint ventures between Guinean and foreign investors.

2. Infrastructure

Investors in start ups and expansions in African countries are bringing their projects on line in markets served by poor or obsolete infrastructure. In many areas, communications are limited to non-existent. Roads and transportation are poor and unreliable, and private businesses must operate their own generators to assure adequate supplies of electricity. Inputs availability cannot always be assured, due to lack of established supply and distribution networks.

Local and foreign businessmen are often hampered by lack of an adequate legal framework permitting development and expansion of business. This problem is complicated as noted, by unclear Investment Codes, as well as by lack of definitive codes assuring land tenure and leasehold property rights in some countries. Legal frameworks are lacking in some countries which would permit traders, transporters and farmers associations to better organize and improve their functioning in markets which are newly opening up, as a result of policy reform and economic liberalization.

C. Financial Sector Constraints

Financial services in most African markets have traditionally been geared to meeting the needs of established customers, drawn largely from the commerce and export sectors. As noted in Section I.A., both development and commercial banks have been called upon in recent years to finance the short and medium term needs of parastatal enterprises. Much of this lending has represented a drain upon both available credit for longer term private sector project lending, and bank staff resources in credit appraisal.

Due to the nature of traditional commercial lending in African markets, which has been predominantly short term and risk averse, commercial banks have not for the most part developed adequate expertise in development finance. Development finance as a specialized field does not fit within the parameters of commercial banking.

In response to all of these factors, commercial banks have not typically developed the capability of conducting project and credit analysis for small to medium scale production and service enterprises. Further, interest rate structures centrally imposed in

many African financial markets, do not provide sufficient spreads to enable banking institutions to provide the additional servicing required for such non-traditional markets.

Imposed credit ceilings, low rates of savings mobilization, and lack of medium to long term resources in the market, have severely restricted the amount of credit available for start ups and expansions. In nearly every market in which AID has conducted Financial Markets Analysis for private sector strategy development, equity is in particularly short supply (risk, share or venture capital). This is due in part to the shallowness of local capital markets, a function of lack of vehicles to attract and channel small investor capital to productive investments, and to some extent lack of liquid capital within the local business market.

The lack of equity financing for start ups and expansions, and limited capacity of local investors to mobilize it, are two of the most difficult constraints in the development of financial markets institutions in African LDC's. Sponsors proposing projects for financing cannot typically mount sufficient equity to secure the commercial financing package at debt/equity ratios of 70/30 minimum.

The equity gap generally requires local currency financing, and Title I PL480 funding is increasingly being considered for financial assistance to local businesses under Section 106/108. Under the Food Security Act of 1985, proceeds of PL480 local commodity sales can be made available in the form of loans to be used as equity, made through local financial intermediaries. Due to uncertainty as to the near future supplies of U.S. exportable grains and pricing of grain shipments, it is not clear how much assistance can realistically be made available through this channel in the next two years.

Critical considerations in appraising and designing both credit and equity vehicles, are the nature of the sources of available or mobilizable equity, and the degree to which the local investor market is organized to identify and channel capital toward productive investments. Are the parties holding investable capital largely traders, or is there a well developed based of risk capital investors in country, willing to invest in local production and service industries? It is often the case in Africa that investors have come from the commercial markets, with a well developed knowledge of trade circuits and the means for making high margins on quick turnover transactions, but very little knowledge and experience with risk investments (identifying, analyzing and managing them).

A related question which must be asked is whether offshore sources of risk capital are realistic, given the relative degree of risk (political, commercial) and the stage of development of the local

investor market. The size and liquidity of the local savings base, and efficiency of vehicles for mobilizing it, are related factors.

Design, development and negotiation of a financial institution responsive to local project needs for term financing or equity, generally require a protracted period of time (at least one to two years, if the facility is new to the country). At the same time, local project financing needs are usually immediate, as businesses are responding to new opportunities arising now through the reform of state run economies and market systems.

The immediacy of the capital needs, the relative lack of development finance experience among local banks, and the need for considerable organizational and skills development among local investors, often require that the financial institutions assessment team develop an interim solution. This may be a credit or equity facility housed within an existing financial institution, but managed separately to insure integrity of the fund, sound financial management and direction of financing to target sectors of the economy.

The interim facility can, with close monitoring and oversight by an independent board of donor and host country private sector officials, become the base for testing the depth and quality of the project and entrepreneur markets, and set the stage for spin off of a permanent development financing institution, run on a commercial basis. The interim solution also provides lead time needed to assist local investor groups in organizing local capital and developing an equity investment program directed toward high profit potential projects in the local market.

D. Market Factors

One of the critical factors in the feasibility determination for a new financial markets institution is the size and quality of the annual project market for term or equity financing. In developing countries in Africa, the size of this market is typically limited due to several factors. These include: (1) lack of capacity among local entrepreneurs to develop and implement risk oriented investment projects, (2) closure of certain sectors of the economy due to state run monopolies on imports and production, (3) limited domestic markets as a function of low household incomes and purchasing power, (4) limited export markets due to monetary policies and lack of competitiveness in processed exports, and (5) lack of banking capacity to conduct project analysis and after loan servicing, particularly for small to medium scale businesses.

The quality of the local project market is typically determined by the variety and soundness of projects brought forth by entrepreneurs. It is also determined by the extent to which local businessmen are responding to real markets, not sectors where the

significant market shares have been absorbed by existing businesses, and with projects with good prospects for generating foreign exchange.

Characteristics of the market for locally produced products and services bear directly upon the viability and size of the market for financial services. Local consumer markets in a number of African countries are limited because of low average incomes, limited agricultural productivity and low producer prices, and reduced overall buying power. Currency convertibility, the extent to which protection is available vs. imports, and availability of foreign exchange, make production for the local market more feasible. The availability of intermediate goods and/or necessity to import, also affect feasibility of serving the local market.

International markets, types of products where the country is competitive and location of those markets, affect considerably the size of the market for debt and equity financing. Overvalued currencies make export projects significantly less attractive.

The presence and functioning of regional markets, pricing policies and currency valuation can expand or severely limit the real market opportunities for local business, and size of the annual market for sound projects. This is particularly true where the prices and currency values have generated regional black markets competing with local business.

Financial markets facilities of all kinds are typically constrained by limited size of the project market going in, because of predictably high fall out rates among local projects. This is particularly true among small to medium scale businesses. Due to a combination of factors, including poor technical advice at the local level, lack of project analysis capability among the local entrepreneurs, and lack of managerial capability, project success rates in securing debt and equity financing are often low.

Project market analyses from a sampling of six African countries for which AID recently conducted financial markets analysis for local financial facilities, indicate that the average success rate for projects proposed for financing, in getting from viable ideas through to actual financing, is between 15% and 30%. In some less developed private sectors, with significantly underdeveloped capital markets, rates of as low as 1 in 10 projects among small to medium scale enterprises, make it through the first screening to actually reach loan application stage.

The quality and capability of the entrepreneurs entering the project financing market, is an equally important consideration in determining feasibility of a proposed financial markets institution, based upon market factors. As noted, where the entrepreneurship is coming from (commercial markets as opposed to risk

investment sectors) significantly affects the soundness of projects proposed, and local business capacity to implement and run sound, value added businesses.

In many African markets, local businessmen lack basic expertise in business planning and forecasting, marketing, finance, technology choice/utilization and production processes. This is particularly true among small to medium scale enterprises, and informal sector businesses. Often local business advisory services are as noted, poorly coordinated or adapted to meeting the needs of these markets.

The low average capacity to bring equity to risk investments is a key factor in analyzing and designing responsive financial markets facilities for local business in African countries. Often this is the only resource counted toward the entrepreneur's contribution to an otherwise sound project, against standard debt/equity requirements. Too little attention is given to other positive investment resources which local entrepreneurs bring to the market, such as their knowledge of local product markets, business and technical expertise, land, and understanding of the local business market, resources which could be developed into effective investor vehicles.

E. Logistics

Several logistical considerations must be built into the design of financial markets facilities for local business in developing countries. These include: (1) agreement on the basic short term and long term objectives for creating the facility, (2) creation of management structure which will assure sound start up, and at the same time build long term local management capacity, and (3) maintenance of sufficient flexibility to make needed changes in the facility's design, project selection criteria and other factors to keep it responsive to the market.

From the beginning, both private and public sector participants must be in agreement on the basic objective of setting up a financial markets institution. In markets which require development financing facilities (often debt and equity), and for which a proposed facility is completely new to the market, the ultimate objective will generally be the setting up of a permanent facility to fill gaps in the market. As previously discussed, formation and negotiation of a permanent facility often takes time (as much as two years or more), and longer term debt and equity needs are often immediate.

In view of this, a short to medium term objective may be established. This will often be development of an interim vehicle to get started, and to test the depth and quality of the local project market. While the interim facility is being set up and

operated, negotiations can begin for establishment of a permanent, autonomous facility based upon operational and market experience.

Given the relative lack of development financing experience in most African markets, and the dubious quality of business advisory services which supplement bank credit reviews, most newly emerging debt and equity facilities for the local business market will require recruitment of an experienced development banker, generally expatriate. At the same time, this banking specialist must work as a facility manager and a long term technical advisor, to train local counterparts to take over management responsibility for the facility in average three to five years. Continuing outside technical assistance is generally needed, on a short term basis, to assist with special management and technical problems.

Flexibility in design, implementation and day to day operation is a particularly important logistic for newly emerging debt and equity facilities in African LDC's. This should extend from flexibility to consider high potential, value added projects which fall outside the parameters of regular project selection criteria, to conducting of periodic reviews of financing parameters to make sure that the facility and its objective are a good fit with the requirements of the market.

F. Design Factors

The following design factors have been culled from lessons learned by financial institutions design teams which have recently developed, proposed or implemented financial markets facilities, for providing equity and other financing to local business in African countries. These factors represent a cross section of working constraints, and solutions built into project design. Principal constraints discussed here include: (1) facility structure, (2) financing terms, (3) project eligibility criteria, (4) management and administration, (5) oversight, (6) business advisory assistance and (7) donor coordination.

1. Structure of the Financial Vehicle

Structuring of the debt or equity vehicle should respond to the evident needs for financial services, projected size of the annual project market, capacity of the existing financial market to administer financial projects envisioned, and the presence and nature of complimentary financing facilities (World Bank, IFC, other international and private facilities). In general, new financial facilities should respond to evident gaps in the market (longer term financing, equity), and at the same time, do so with complimentarity with other lending institutions (for example, guarantees on a shared risk basis for credits extended by other lending institutions).

2. Terms of the Financing Package

Minimum sizes project should be set, so that efficient use is made of limited staff at facility start up, and many small projects are not received. Maximum limits should be set for project financing equity participation. Setting of maximums will encourage the building of local equity and tend to increase project quality, through greater project investment by the entrepreneur.

3. Provision of Foreign Exchange Financing

As noted, virtually every value added project will require foreign exchange as well as local equity financing. To date, there has been a constant need to access donor foreign exchange lines, due to the limited availability of foreign exchange in many African markets, and the competition for it between existing enterprises needing inputs and project loans.

Design and development of any financial markets facility must address the alternatives for providing access to foreign exchange denominated finance. These include in addition to donor lines, CIP type facilities and donor contributed foreign exchange to established privately run facilities, once their market and capacity to serve it have been demonstrated.

4. Equity Funds

Given the fact that entrepreneurs in most of these markets are mounting projects with an anticipated variable cash flow during the first several years of operation, equity funds made available to project sponsors or third party investors should be made available on flexible terms. If equity is provided on a term debt basis, it should be with the requirement that there will be sufficient project earnings to pay dividends, which could be used to retire the equity loan. Otherwise, borrowers should find other sources of retiring the debt.

5. Guarantees

Guarantees made by a newly emerging financial institution on debt financing made available by other institutions, should be made on a risk sharing basis, between the facility and the other financial institution. Guarantees should be made based upon the same project criteria as those used for provision of debt or equity financing by the new institution.

6. Project Eligibility Criteria

Eligibility criteria should be set for (1) borrowers, (2) investment projects and (3) eligible costs, which will generally be those requiring medium to long term financing. Such criteria should be

continually revised to reflect the realities of the market, portfolio performance, and other factors.

7. Management and Administrative Structure

As discussed above, the management of a financial markets institution serving local business needs for debt and equity financing, must be structured to generate capable management by a qualified development finance specialist. This could be a local banker seconded to manage a private sector investment fund within an existing banking institution, provided with an experienced development banking specialist as long term advisor. A second alternative would be recruitment of an outside fund manager, under a contract providing that he would train a local counterpart manager to take over fund management within a specified period and upon reaching a certain designated level of local competency. As noted, continued outside technical assistance may be needed on a short term basis, to assist local staff in working with special problems in credit analysis and servicing.

8. Oversight Mechanism

To assure that funds are properly managed and used as intended in facility design, an Oversight Committee should be established, independent of the financial institution created or that under which it is autonomously managed. Such an Oversight Committee should be made up of representatives from donor agencies participating in the financial facility, the host financial institution, and members of the local private sector. It should function to monitor and evaluate the performance of the new financial facility, approve applications after concurrence by the Facility Manager and Technical Advisor, and assure sound management.

An appropriate role for AID Missions would be as participant on an Oversight Committee. In general, Missions will not have the technical skills and experience to take part in the review of projects prior to management recommendation for application approval.

9. Independent Audits

Periodic financial and management audits should be done by an international accounting firm, to assure independent monitoring and documentation of the application of operating procedures and sound financial practices.

10. Built in Checkpoints in Financial Structure

The proposed financial structure of any facility designed to serve the debt or equity financing needs of local business, will contain some concessionary elements which are targeted to achieve specific objectives (often provision of counterpart funds available for on

lending to local businesses in the form of loans to be used as equity, at concessional terms to the country). Concessional elements should be controlled and limited, in terms of scope, level and time.

The financial structure should have built in check points which require periodic examination to determine the continued viability of the financial institution concept. These should facilitate modification of the concept (such as acceleration or deceleration of the size of the fund, or its termination), depending upon performance.

Flexibility in acceleration or deceleration of size of funds will be particularly important in markets where the facility is new, and where demand is going to be variable, as a function of the number of new projects coming on line as a liberalizing economy opens new business opportunities. In markets where the private sector is just beginning to re-emerge in response to policy and market reforms (i.e., Guinea, Madagascar), it will be difficult to determine exactly how many and what type of projects will be presented for financing, until the funds have been made available for investment, announcements have been made, and local businesses have begun to present demands for debt and equity financing packages.

11. Market Rates

To enable the debt or equity financing facility to serve the project market with optimal allocative efficiency, and avoid subsidization of marginal projects, market rates should prevail. Rates should be set based upon the actual anticipated costs of doing business in the target market, taking into consideration needs for sufficient spreads (loan interest margins) to cover overhead and profit requirements, bad loan reserves and a margin for building additional equity in the fund. In some cases, loan interest margins will have to cover as well technical assistance required by the clients, and deliverable through the financial institution, or outside business assistance resources.

12. Cost of Funds

Most financial markets institutions providing debt and equity financing to local businesses in African markets, will as noted have to realize sufficient spreads to pay overheads, bad debt reserves and the costs of that portion of the business advisory services which businesses cannot afford to pay. This will require sourcing funds at a lower cost. Such sources include PL480 local currency funds in the form of low interest, long term loans made available to the Government, and other donor lines at concessional rates.

13. Provision of Business Advisory Assistance

New financial markets facilities serving local business needs could use part of the spread to contract services assisting the preparation and documentation of projects (feasibility studies, management advice). Contracting should be done with local financial management and management consulting services to the maximum extent possible, to help them develop local capability to serve business needs.

Eventually, such interest paid subsidies should be phased out, bringing local businesses to the point where they are paying the full costs of business assistance. By limiting the time period in which a portion of the spread (loan interest margin) covers business assistance costs, the financial facility would be forced to improve its operating efficiency to develop a management unit within that is capable of delivering some of these services, and absorbing the related costs in the operating spread.

14. Dollar Denominated Costs of Technical Advisors

Costs of fielding both Long Term Advisors and Short Term Technical Advisors should be financed from a separate funding. This may be drawn from foreign exchange sources, including those funds made available under special technical assistance and training projects developed by AID Missions with foreign currency denominated funding, or foreign exchange availability under Title I for special uses in private sector development.

15. Coordination with Other Donor Lines and Technical Assistance Programs

Coordination with World Bank, IFC and other lines of local currency and foreign exchange financing, will be absolutely essential for developing a more efficient financial package for African businesses. If well structured, a new financial markets facility providing debt or equity financing could eventually become the conduit for administering multiple donor lines and related fee for service advisory services. As a permanent facility, the financial markets institution could also become the vehicle for presenting and maintaining a more consistent set of guidelines and project selection criteria to potential borrowers.

Attachment

DOCUMENTS SURVEYED

AS PART OF FINANCIAL MARKETS INSTITUTIONS

WORKING PAPER

1. Investment Climate Assessment, Republic of Guinea, Equator Advisory Services, Limited, March, 1986.

2. A Private Sector Development Strategy for Madagascar, with Business Climate Update, Tamara J. Duggleby, Team Leader and Sandra Goshgarian, for USAID/ Madagascar and International Science and Technology Institute, Inc., June, 1988.

3. Private Sector Investment Fund for Madagascar, Equator Advisory Services, December, 1985.

4. Private Enterprise Development Project, Project Paper, USAID/Kenya, April, 1987.

5. Southern Africa Regional Program, Program Assistance, Initial Proposal (PAIP) for a SADCC/AID Export Revolving Fund, International Science and Technology Institute, Inc. for USAID/Zimbabwe, February, 1988.

6. AID Evaluation Summary, IQC for Parastatal Studies, Restructuring and Divestiture, REDSO/ESA, March, 1988.

7. Private Sector Strategy Study for USAID/ Botswana, International Science and Technology Institute, March, 1988.