UNITED NATIONS
ECONOMIC and SOCIAL COUNCIL

49218

Distr.
LIMITED

E/CN.14/INR/184
20 October 1970

Original : ENGLISH

ECONOMIC COMMISSION FOR AFRICA

DOCUMENTS OFFICE
FILE COPY
NOT TO BE TAKEN OUT

INVESTMENT CLIMATE IN AFRICA

M70-2565

INVESTMENT CLIMATE IN AFRICA

A discussion of Africa's Investment Climate (IC) brings to mind an American humorist's apothegm about the vagaries of the weather. To paraphrase he said that everyone talks about the weather but no one does anything about it. There is an unhappy kinship between that pithy maxim and polemics involving Africa's IC. As a United Nations analysis of the Investment Laws and Regulations in Africa observed: "There is abundant literature and controversy on the question of creating an adequate climate for foreign investments" (underscoring supplied).

These comments were made in 1965. And as recently as November 1969 a poll of foreign business interests revealed an unabated discontent with the business environment in many of the African nations. Some eighteen operational friction areas were cited. (See page 36 and 37)

Apparently in the interim neither the African Governments nor that class[1/] of foreign industrialists intimately concerned with IC has developed a static free "communications" channel -- one which could tackle and satisfactorily resolve mutual conflicts and misunderstandings which obviously still exist. It is not the interest of this paper to add redundancy and controversy to the IC issues. Rather its objectives are constructively thereefold:

1. Define Investment Climate

2. Identify the principal classes of risk capital[1/] sources chiefly concerned with or affected by IC

3. Most important (in this writer's opinion), to offer four proposals designed to remove the criticisms which foreign investors, rightly or wrongly, level against the African IC.

1. Defining Investment Climate

For most if not all risk capital entrepreneurs, present and future political, economic and business environmental trends within a given country (or for that matter contiguous nations) constitute the principal ingredients of investment climate.

Oddly enough, a reading of assorted analytical literature and foreign - attended business seminar summaries discussing the problems endemic to IC's reveal that foreign investors are not unanimous in their concepts of what constitutes a salutary investment climate.

1/ Described on pages 5 and 7.

Examples to support the foregoing remarks are cited:

1. "Capital investment is considered only if there are sufficient sales. Company executives weigh investment incentives and preferential tariffs as key aspects of investment climate... The availability of labour and raw materials is of secondary importance".

2. "Hence, investment climate in Africa is determined basically by factors which affect the profit expectations of potential investors".

3. "An important aspect of the whole problem of investment climate in Africa is the size of markets".

4. "One single dominant fear of the foreign investor is nationalization. Others are low returns and inability to remit capital and profit. This is usually termed investment climite".

5. "In making financing plans for investment in developing African countries, the potential investor must take fiscal incentives into account. Tax considerations feature prominently in cash flow".

6. "The rules concerning foreign investments encompass a wide range. To a foreign investor, regulations concerning administrative procedures, tax incentives, rules relating to employment of nationals are all important".

7. "The use of domestic banking funds for industrial investment is being increasingly restricted... the desire of authorities to restrict the use of domestic funds by expatriate controlled companies"(underscoring supplied).

It is possible, of course, that subsequent Government regulation amendments or those under current study as applied to foreign risk capital investments may diminish or remove specific objections to IC's voiced by alien entrepreneurs.

The prerequisite to define IC was emphasized by Standford Research Institute (USA) in its comprehensive study "International Private Investment - A Guide to Prospectus Preparation". SRI commented: "To assist the potential investor in his understanding of the investment climate, the prospectus should cover incentives and conditions offered by the State and national government to encourage the establishment of new business enterprises, including those applicable to foreign investors" (underscoring supplied).

The aforementioned samplings affirm the view that individual foreign risk capital investors, assess IC's in terms of their specific corporate objectives. And these obviously are not parallel.

Distilling the IC deterrents as enunciated by the referenced sources appears to yield one common denominator insofar as risk capital entrepreneurs are concerned. Succinctly stated it is jeopardy to profit generation and recapture of total capital investment should nationalization occur.

The restraints noted on pages 27 and 28 plus those discussed in the writer's four proposals to improve the investment climate seem to fall into the following categories:

1. Geographic market/sales potentials
2. Government regulations which fetter foreign corporate managements from exercising sound administrative, fiscal and operational judgements
3. Imprecise or ambiguous investment laws and policies concerning tax exemptions, repatriation of earnings, tariff allowances and nationalization.
4. Political/nationalization trends in much evidence during 1970.

To add validity and force to the preceding items it is pertinent to quote from the United Nations Investment Laws and Regulation document which stated:

> "It may be suggested that in this age of the written word, investment laws need to be expressed in one easily assessible and understandable legal instrument. There is an urgent need therefore for African countries acting at a continental level or at sub-regional levels to get together or co-ordinate their legal practices, procedures and provisions....."

In the light of divergent, similar or overlapping dissatisfaction openly expressed or hinted at by foreign risk capital sources with respect to total corporate fiscal requisites the problem of succinctly and lucidly defining investment climate is a thorny one indeed. The reader may justifiably ask- why bother; let each investor settle the issue consonant with his own needs. But by doing so the efforts of all those determined to improve the investment climate for risk capital entepreneurs may be significantly dissipated. Without question, African officials charged with the responsibility to attract foreign investments could be and are thus confronted with a host of divergent instead of consolidated complaints. Moreover such disagreement by foreign investors as to the meaning of IC tends to destroy effective "communications" with African officials thereby arresting sincere efforts to introduce remedial measures.

Thus, it seems worthwhile to construct an IC definition which may be meaningful to a cross-section of risk capital entrepreneurs and responsive to varying their investment objectives.

A suggested IC definition may be this:

The foreseeable political, economic, legal and social currents which acting singly or collectively foster or discourage prospects for acceptable long-term profitability and equitable recovery of initial and reinvested risk capital commitments.

2. Capital Sources

Loans and Credits

The World Bank, International Development Association (IDA) and foreign governments are the principal sources of long-term loans and credits. Their decisions to grant fiscal accommodations to developing nations for building infrastructure facilities e.g. harbours, telecommunications, roads, railways, electric power generation and distribution systems etc., are probably not influenced by any country's investment climate.

Profitability to the lenders is obviously not a consideration in the granting of this form of capital.

Undeniably, there is a positive linkage between such funds advances and a country's IC. Prospective industrial entrepreneurs will tend to veer toward those countries which have reasonable or prospective programmes for essential infrastructure services as opposed to those not so blessed.

Assuming the validity of the preceding observation, further references to such sources of capital with respect to IC's are terminated.

Risk Capital Sources

In the sense of this paper, risk capital is defined as the total amount of monies necessary to establish and then support an industrial or services enterprise until profitability is assured. The funds may be in the form of: (1) interest bearing loans (debt/bonds) secured by the company's fixed assets e.g. machinery, equipment, buildings, land, etc., and; (2) the owners' money contributions for start-up working capital and other uses against which loans are not generally obtainable. The latter funds in financial nomenclature are referred to as "equity" capital and are represented by shares of stock in the enterprise.

Both forms of corporate capital - bonds and stock - are exposed to the profit risks distinctive to the undertaking. Interest payments on the bonds must be generated by earnings, paid on schedule and complete retirement of the debt must also be honoured at the obligation's maturity date.

In exchange for their capital risk investment and management contribution, shareholders (owners) expect dividend payments in a ratio commensurate with recorded earnings. The amount of periodic dividend is generally referred to as the pay-out ratio. Well managed companies operating in a conducive environment

for annual profit growth usually follow a conservative practice of ploughing back earnings in excess of dividends for additions and improvements to plant, machinery, equipment, expanded merchandising programmes and new product development.

The risk capital as defined may be provided by such organizations as:

Class 1 - International Finance (IFC), a World Bank affiliate; African Development Bank; the newly established SIFIDA - a consortium of international banks; etc.

Class 2 - Private risk capital combines such as MIDA (USA), ADELA (which operates in South America), domestic industrial development banks and foreign based multinational corporations either without or with indigenous partners as joint ventures.

Although IFC grants loans and equity capital to 'approved' industrial and services ventures its standards of investment acceptance seemingly are governed primarily by the proposed undertaking's "prospects of profits to the host country, in terms of higher national and per capita income". Such financed establishments ranging from hotels to fertilizer plants without question contribute to a nation's financial and economic well being. And it may be assumed, perhaps incorrectly, that some onerous aspects of IC criticized by private risk capital entrepreneurs may be relaxed or even removed for IFC and similar politically oriented capital granting agencies.

Class 2 risk capital sources with the possible exception of IFC are perhaps more acutely concerned with IC in terms of widely publicized encumbrances to earnings and invested capital repatriation risks should nationalization occur than other capital sources mentioned.

Class 3 - for the purposes of this paper are the well entrenched manufacturing assembly, export/import firms operating in Africa prior and/or subsequent to the independence dates for the various countries. These would include United Africa Company, a Unilever subsidiary; East Asiatic Company of Denmark; Philips of Netherlands; Fiat; Pechiney; Union Carbide; CFAO; SCOA; etc.

The subsequent remark may well raise the ire of these managements. But it is the writer's view that these and similar organizations with extensive market penetration, background of expertise in coping with "real life" unfavourable political, operational and economic problems (to them)are presumed to have polished techniques for surmounting "restrains" embodied in the IC's of individual nations. In effect their managements have developed the prized "know-how" to function under an adverse climate and still generate adequate (or satisfactory) earnings for shareholders. It may very well be therefore that IC is of minor consequence to their astute managements.

This brief summarization and description of risk capital sources suggests that "restraints, constraints, incentives and disincentives", the generously used provocative terms integral to IC dialogues, are problems confronted primarily by Class 2 contributors. Obviously the door is ajar for contrary points of view from Class 1 and 3 members.

Some Vignettes from Investment Climate Literature to Ponder

1.- Competition among Foreign Entrepreneurial Interests for Position in African Nations

Source: Robert F. Meagher, The Fletcher School of Law and Diplomacy, Medford, Massachusetts, USA

"Another problem in the development of regional programmes relates to the relationship of AID to other aid donors. For the most part the US provides a minority of aid in the non-emphasis countries where regional projects will be stressed. Thus the success of such programming will probably depend heavily on the support of the principal donor in the area. There is therefore a need for co-ordination of programmes on the part of donors. In most of the development emphasis countries (1) co-ordination is provided by consultative groups under the leadership of the World Bank or stabilization groups headed by the IMF. Such is not the case in the other countries. Possible sources of conflict include differing policy objectives and market competition. For example, the US opposes the French/European Economic Community concept of an Eurafrica bloc and prefers global trading. In addition tied aid under AID supported "projects will mean the penetration by Americans of traditional French and British markets" (underscoring supplied).

(1) Morocco, Tunisia, Nigeria, Congo (Kinshasa), Ghana, Ethiopia, Liberia, Kenya, Uganda and Tanzania.

Query: To what extent (is it measurable) is an African country's IC massaged or molded by competitive foreign political and adjunct fiscal involvements designed to insure or carve out markets for constitutents? Note the Zambia - Fiat "deal" referred to under the subject Nationalization. (Page 33).

2.- Need to Improve Government Image

Pearson Report ("Partners in Development", page 106) comments:

"The poor image of developing countries in business circles (foreign) is also the result of the cumbersome administrative procedures and inefficient decision-making process which companies often encounter when planning an investment in such a country (Africa).... we feel that many governments could even now streamline their procedures considerably".

Comment: Writer's proposal No. 1 attached is designed to remove this obstacle. An abridged version of this proposal appears in ECA's September issue of African Target.

3. Create Viable Machinery for Repatriation of Capital Investment

Pearson Report (page 106) observes:

"There are other ways of improving the relationship between governments and foreign companies and forestalling disruptive and costly conflicts between them. In particular, developing countries and international corporations alike could make specific provision, when initially negotiating the terms of investment agreements ..... for mutual reconsideration of those terms after a minimum period of years and for adequate compensation and freedom to repatriate such compensation of no accord can be reached at that time".

Comment: Writer's proposal No. 4 - Nationalization outlines a mutual pact for smooth and mutually satisfactory procedures for phasing out a company whose properties and business have been partially or fully nationalized.

4. Foreign Corporate Fiscal Disclosures to Improve Harmony with African Governments

Pearson Report (page 111) suggests:

"Company Laws could often be improved so as to require a greater degree of financial disclosure both for domestic and foreign enterprise. This would reduce distrust, help to protect minority stockholders, and foster the development of a local capital market (where applicable)".

Comment: The writer considers this suggestion is most vital and has described the ramifications and benefits of "fiscal disclosure" to both the foreign company and the African governments. (Proposal No. 4 - Nationalization and Proposal No. 3 entitled: Create a Viable Financial "Communications" Understanding with African Officials.

These comments are prefatory for introducing the four proposals to improve the Investment Climate in Africa.

Four Skeletal Proposals to Alleviate Foreign Investors' Concern about the Purported Clouded Investment Environment in Various African Nations

Proposal 1 (Published - abridged - in the September 1970 issue of ECA's African Target)

Each country create a politically independent agency, commission or group of qualified personnel whose authority and responsibilities should be at least three-fold as described below:

A recurrent statement made by African Governments is the paucity of skilled managerial and technical personnel. The writer suggests that cadre of experts to train the "group" in the techniques of feasibility study construction employed by corporate investment analysis could be obtained from foreign sources contemplating investment in the specific African country.

1. Analyse existing investment codes, overall tax laws and other relevant data and submit to a designated Ministry realistic recommendations to abate foreign investors' reservations of its Investment Climate.

2. Provide positive co-operation of officials of a proposed new company throughout the critical stages from formation to the period of optimum operations.

3. Render continuing counsel and advisory direction to the established company confronted with local or national political policies which may be inimical to or adversely affect managerial harmony between the company and the intimately related political entities.

To be operationally effective, this group should derive its functional authority (subsequently described) from the Minister directly involved in soliciting foreign investments. Should more than one Ministry be involved, then an incisive clean communications link or madus operandi should be structured between or among the Ministries.

The cognizant Ministry, it is envisioned, would delegate to the group such further authority to execute the following priority functions on behalf of the new enterprise:

1. Provide expediting assistance in the filing of various documents necessary to obtain economic sanction for the undertaking. Such co-operation is most vital to the in-coming enterprise during the stages of proposal consideration or formation. The urgency of this collaboration is emphasized by the following excerpt from the "Investment Law of Africa" paper by A.M. Akiwumi, Regional Adviser on Economic Co-operation, February 1969(ECA). He comments: "The potential investor applies to qualify for economic benefits by completing forms giving a variety of information on financial,

economic, technical and legal matters... some cause delay and raise unnecessary obstacles due in the main, to the fact that decision-making tends to shift from one forum to another until a final decision is reached" (underscoring supplied).

2. Obtain approval for the necessary documents, licenses, plant design, plant site location, etc., from various governmental tiers including municipalities which may be necessary for the "approved" company to install and complete all infrastructure for the proposed facilities.

3. Arrange or help to establish and maintain personal contacts with officials of Government, business interests, Chambers of Commerce, sources of banking facilities, labour unions, etc., essential to the continuing financial welfare of the company.

4. Applying the delegated authority - with tact - intercede in any governmental agency or muncipality to bilaterally resolve those problems which may adversely affect company operations, hence its level of manufacturing, sales or administrative costs.

5. Obtain current basic statistical background data necessary for economic and industry analysts to prepare "realistic" project or feasibility studies on behalf of private investors or organizations such as the Economic Commission for Africa. These data would include such vital operational and capital cost inputs as existing regular and overtime wage rates, labour union policies relating to vacations, sick benefits, pensions, etc., availability and cost of suitable land, proximity of raw materials, if local, electric, gas and water rates, and other pertinent data which may exert an impact on production costs and capital investment estimating.

The "publicized" awareness by foreign investors that a viable and functional group has been created and empowered to render such progressive services would unquestionably generate:

(1) a healthy atmosphere of confidence toward Governments at all levels and;

(2) a similar sense of security for the ultimate success for the proposed undertaking.

Assuming concrete and positive performance by the group, it would be stimulating to contemplate the manifold benefits which could accrue to the host country. For example, a relatively smooth phasing-in of a new enterprise would serve as a powerful magnet to attract other capital sources deliberating investments in that country. These could include "satellite" enterprises e.g. those producing materials or components for an established company. It could operate as a potent competitive plus factor in encouraging capital inflow in

those circumstances where the country site by itself - other factors being relatively equal - was being weighed by the foreign capital interests. And with such industry drawing power, a gradual build-up of the national economic and social benefits to the host country should be a viable expectancy.

In the light of today's parochial or skeptical attitude toward such progressive planning, expressed publicly and privately, the suggested proposal may be characterized by many as "wishful thinking or an impossible dream". Perhaps so, but industrial history throughout the world sparkles with myriad examples of entrepreneurial dreams - coupled of course with determination and tenacity - becoming realities.

And on this level of constructive thinking, it is most illuminating to know that almost fifty per cent of the African countries have, in fact, recognized the need to provide foreign investors with some forms of installation assistance by creating "Investment Commissions".

As the United Nations' "Investment Laws and Regulations in Africa" study dated 1965 comments: "A new 'development' machinery, the Investment Commission has been created by about half of the independent countries of Africa.... Most of the Investment Commissions are created by Investment Codes and, therefore, are statutory bodies established for special purposes. Their main function is to promote investment projects in offering technical and commericial facilities". In most countries which have instituted Investment Commissions, members are drawn not only from the ministries but also from other fields. Directors of banks, commissioners of customs and taxation and presidents of Chambers of Commerce are also included (underscoring supplied).

The above underscored items are the bases for provocative commentary below which the writer hopes will be accepted in the same spirit of sincerity in which it is offered.

1. The Commissions as reported are composed of representatives from various government agencies and business organizations. While this cross-section membership undoubtedly offers well balanced expertise in the mechanics of government, it may also generate sharply divided points of view and interests with respect to the new company. Such disagreements are the foci for serious time delays in coalescing final decisions.

2. Commission members are probably intensively preoccupied with daily official duties and responsibilities to their primary organizations. It is reasonable to assume therefore, that the time needed to structure mutually acceptable problem solutions may be restricted thereby creating inordinate delays in the decision making process. The validity of this point is affirmed by the prior extract. It is also worthwhile to note that at least one country, there may be others, has imposed a decision time limit on its officials

empowered to approve or reject a foreign investment application. Somali, in its Foreign Investment Laws effective June 1968, Article 5 titled Procedures and Conditions for Registration provides that: "Within sixty days from the date of receipt of a request to invest foreign capital, the Ministry of Planning and Co-ordination shall communicate to the applicant the decision of the Committee on Foreign Investments". Time limits are also provided for in instances of requests for capital expansion.

3. The "offering of technical and commercial facilities" probably falls far short for the practical phasing-in assistance required by the in-coming company. Moreover, unless the offering of technical and commercial facilities is firmly and vigorously supported by the group under its proposed authority, the quality of the "assistance" may be ineffective in the "real life" environment.

Other possible constraints which militate against or are road blocks to a smooth functioning Commission might be these:

Irregular frequency of meetings, insufficient attendance for a quorum or majority to vote on pending matters involving an applicant, interpretation of the Country's Investment Laws, prolonged absence from the Country of a key official whose Ministry must rule on a particularly vital or sticky issue, and disputes between Ministries as to which one is empowered to render final decisions on issues hanging in balance.

Suggested Personnel Structure of the Group

1. The Government decides which of its Ministries is to be exclusively responsible for encouraging foreign investments. The cognizant Minister is thereupon empowered to establish the Group, and define its specific authority and responsibilities.

2. The Minister staffs the Group with qualified personnel drawn from such existing departments as Customs, Taxation, Legal, Finance, Technical, and others whose professional skills and experience will contribute to processing, analysing, and finalizing applications for the Minister's final approval.

3. The Minister will appoint a deputy or "managing director" who will bring to the Minister a fully balanced analysis of each application or problem which requires the Minister's final approval.

4. The managing director will be responsible for the daily operations of the Group and will also participate in policy planning.

5. The Group will function on a full-time basis with salary scales established by the Minister.

6. Representatives of prospective or established companies will initially consult with the managing director to examine or resolve problems confronting them.

7. The managing director or staff members will be empowered to consult with counterparts in other Ministries or government agencies whose advice or co-operation is needed to speedily process an application or resolve a problem. Other Ministries and agencies will be directed by the Government to provide full co-operation to such requests.

Proposal 2 Postpone all Tax Liability for Foreign and Joint Venture Companies until initial invested capital has been recovered (Published in the June 1970 issue of ECA's African Target)

African governments, in their aggressive and competitive efforts to attract or increase foreign capital commitments, have created a virtual maze of tax concessions and "holidays". The inducements apply to reported profits, customs duties, tariff exemptions, real estate, turnover sales, establishment costs, licensing fees, consumption of locally purchased materials etc.

The writer submits that the ultimate purpose of these various tax concessions although not spelled out but implicit in the Investment Codes is to permit a new company to recoup its initial capital investment - within the tax holiday on earnings time period. And as subsequently described, the Investment Codes for debatable reasons, favour very large establishments and penalize those defined as small, medium or large - in terms of granted time for the tax concessions.

Undeniably, recovery of initial capital investment is an eagerly sought goal considering the range of risks endemic in the investment environment of many African countries. At that point in time (complete recovery of capital investment) the company is in a relatively riskless position. And it may be assumed that management can then execute subsequent operations with a higher degree of confidence that target goals will be achieved.

But whether these tax incentives are in fact the prime considerations in swaying a foreign investor's decision to establish its operations in one country or another is a highly controversial issue - one not pertinent to this discussion.

International economic research organizations, lawyers knowledgeable in African Investment Laws and Regulations and other agencies dedicated to improve the Investment Climate in Africa seemingly are in unanimous agreement that African countries should initiate positive steps to harmonize their "tax holiday" policies. Two citations in support of the above comment are pertinent.

A. Source: Investment Laws and Regulations, United Nations 1965

"It appears that tax laws ... so far have little relation to needs of future economic development. 'Tax holidays' and other concessions tend to create a spirit of deliberate competitiveness on the part of capital importing countries in Africa. The result is an artificial situation where tax holidays are geared towards attracting investors away from one's neighbours. There is thus a need to harmonize tax policies with a view to channelling investments in selected areas and obtaining revenues for defined public purposes" (underscoring supplied).

B. Source: Lester B. Pearson Report (Partners in Development 1969)

"Tax concessions extended by developing countries are sometimes a useful way of temporarily shielding foreign companies from the full impact of an antiquated tax system, thereby providing governments with time to revise the basic structure. But only in a few cases do they seem to draw an investment opportunity to the attention of a foreign company, and they are generally reported to be of very modest importance in the final investment decision. On the other hand, they restrict the growth of the host country's tax base, sometimes quite seriously. Accordingly, we would recommend that general tax concessions to attract foreign companies be used sparingly. In any event, developing countries should seek to stop the competition in tax concessions by international co-operation".

Obviously, the 1965 United Nations' advice to "harmonize" tax policies and the 1969 Pearson recommendation that African countries "Seek to stop the competition in tax concessions ..." have gone unheeded in the four year span despite the valued judgements of these two sincere and authoritative critics (underscoring supplied).

It is beyond the scope of this tract to examine or detail the myriad reasons why harmonization concepts have not as yet been initiated on a broad front. The writer respectfully observes, however, that constructive criticism of actions to be meaningful should be followed up by carefully considered proposals to cure or at least remedy the diagnosed ailments. Neither of the referenced directives - and probably for justifiable reasons - offer African government officials skeletal alternatives for this controversial issue.

The proposal as subsequently outlined is an effort to fill this void. Admittedly, it represents what appears to be a radical departure from existing tax philosphies. It may therefore germinate prickly weeds or hopefully, velvety flowers of fiscal opinion. Final judgement, it is suggested, should be reserved until an analysis of the rationale for the proposal has been read.

Proposal

1. Income tax on earnings and all other concessions for all foreign financed companies - regardless of establishment size - be postponed until the total amount of "initial capital investment" has been recovered.

2. Government and foreign investors concur on a pre-commitment definition of "initial capital investment". It is strongly recommended that the definition include all debt and equity capital - including working capital - required to support the company from start of production until the cash break-even point has been reached.

   The justification to including working capital requirements for the crucial start-up cash drain period is offered in the Criteria paper previously prepared by the writer for ECA. Excerpts are included in this paper;

   Also

   A mutually acceptable initial capital investment definition would contribute to improving IC as related to nationalization risks. The rationale for this observation is developed under the section entitled nationalization.

3. Agreement be confirmed prior to financial commitment for all accounting procedures and nomenclature with respect to provisions and rates for depreciation, depletion, amortization, contingency reserves and other operating costs which may affect the level of earnings before and after capital recovery. In effect, an understanding is reached for a clear-cut definition of "pre-tax earnings".

4. Following recovery of "initial capital investment" as defined, the foreign controlled or joint venture company - then in a relatively non-risk position - accepts an equitable sharing of pre-tax earnings.

5. The Government set an earnings tax rate applicable to foreign financed establishments.

6. The rate of return on investment acceptable by the foreign campanies should reflect the risk free position 'guaranteed' by the African Government. The companies in exchange should be expected to accept a lower return on investment than that demanded for investments with a very high risk potential.

7. The Government's percentage share of pre-tax earnings should be at a rate adequate to satisfy its requirements for "national economic benefits" to be derived from such undertakings.

Comments to Items 4 and 6

Inducements for profit reinvestment

The Pearson report in discussing tax concessions extended by developing nations recommends "that developing countries structure their tax system to encourage profit reinvestment by foreign companies". The report adds: "Profit reinvestment is a form of foreign capital which is more readily attracted by tax incentives than new capital, and positive incentives to reinvest are greatly to be preferred to penalties for remitting. The latter tend to be counter-productive by discouraging new capital inflow".

And on the same issue, United Nations' Investment Laws and Regulations study remarks: "The question whether it is to the advantage of the developing countries to forfeit tax revenues to stimulate additional investment has rarely been raised". Ibid: "Very few codes (investment) contain special privileges on reinvestments. Somalia's law on foreign investments makes special provision for reinvestment. Reinvested profits as capital are exempted from income tax up to 25 per cent".

The writer is in full accord with the Pearson recommendation and believes that the principles of Items 4 and 6, if adopted by African Governments and foreign investors, could open the door to favourable reinvestment consideration.

Rationale

As previously mentioned, the competitive tax holiday laws and concessions of African countries when stripped of legal legerdemain do acknowledge in a limited way the intent, concept and principle of providing tax exemptions and concessions until a company has recouped its initial capital investment.

For reasons which may lack economic or social benefit justification, tax postponements for as long as fifteen years are granted establishments which require "exceptionally large investment". It would be the unusual enterprise which could not completely recover full pay-back 1/ of initial capital investment well before the expiration of the extended tax concession period. Of course, completely unforeseen problems, e.g. political disturbance, prolonged delays in receiving production equipment, abrogation of allowable profit rates, etc., would shrink pay-back cash flows and thereby extend the time period for recovery of initial capital investment.

1/ The significance of pay-back period and its relationship to tax holidays on earnings is described briefly in the Criteria paper previously referred to and included in this tract. As a reminder, pay-back period represents the number of years required for annual cash flow earnings to fully return a company's predetermined "capital investment" in a plant or undertaking. As later discussed, realistic pay-back time policies if adopted by African Governments may also tend to lessen foreign investors' fears of substantial capital investment loss in the event nationalization of the enterprise is decreed by the Government.

In the writer's judgement, cash flow estimates which indicate 15 years or more for pay-back - considering the myriad risks - would probably dampen foreign investors interests (class 2) in the proposed undertaking - unless there were subtle inducements other than long-term profitability in the offing.

In sharp contrast, foreign financed companies defined as small, medium and large - in terms of capital investment - are allowed only from three to ten years for pay-back recovery.

Size alone of the financial commitment should not be the yardstick for granting variable tax concessions. In fact, small to large firms - the "under-privileged" - may face acute production phasing-in problems more difficult to surmount because they may lack the power of financial muscle and even a benevolent political endorsement perhaps enjoyed by "very large enterprises".

One of the many examples of tax exemption preferential treatment for "very large establishments" is illustrated by the Investment Code of Dahomey. It grants extended tax postponement for companies "which require a long period of installation before attaining full operational capacity". The underscored privilege is most significant. In effect, the Dahomey Government legally and financially acknowledges that annual pay-back cannot start until a company has begun to generate assured cash flow profits - generally realizable at "full operational capacity".

But, as stated, "under-privileged" companies are also confronted with identical or similar operational problems - in relation to size of capital investment and type of product to be manufactured or assembled - which delay the target date for continuous cash flow earnings. Why then should this group or class of companies be penalized with abbrevated pay-back time periods.

Following are some additional samples of tax holiday discrimination between the "very large enterprises" and the "under-privileged" - the writer's euphemism for small, medium and large ventures:

Congo (Brazzaville) - (Regime C) "enterprises whose establishment involves exceptionally large investments are given long-term preferential treatments which should not exceed twenty years". Regime A - "preferential treatment ... cannot be accorded for more than ten years".

Dahomey - Regime C - "the benefits (tax) ... may not exceed twenty-five years ... for very large enterprises which require a long period of installation before attaining full operational capacity". Regime A - "The maximum duration for all exemptions is five years".

Ghana - "An 'approved' enterprise is entitled to exemption for a period of five years or more, not exceeding ten, beginning from the date of production from the payment of income tax".

Niger - Regime B - "Exemption is granted ... on industrial and commercial income during the first ten years of operation ..."
Regime C - "The same exemptions agreements can be concluded for ten or twenty years".

What fiscal, political or socio-economic reasoning supports this imbalance, or bluntly stated, the inequity in tax treatment between the "under-privileged" and the "very large enterprises".

The answer seems to stem in part from the various Governments' philosophy that only very large establishments contribute to the flow of national economic benefits. This ideology is clearly expressed in the language of several Investment Codes which define establishments entitled to the extended tax holiday and concessions. Excerpts follow:

"which are of prime importance to the economy"

"the favoured treatment is progressive to the importance of size of investment in relation to the development of the country"

"companies of exceptional importance"

"particular importance for the execution of the economic and social development plan"

Other obvious and controversial questions - addressed to Government economists better qualified than the writer to answer - are these:

Will not prospective foreign financed "under-privileged" companies generate national economic benefits too despite the differential in size of capital investment? And if they do, however small, why disqualify such firms from tax postponement privileges in terms of elapsed time to recover initial capital investment?

Were this discrimination "brief" to be submitted to a jury for a verdict of equity, the Investment Code of Algeria (1965) as related to expropriation of foreign capital would be incisive testimony for the prosecution. As of that year the Code read: (Extract from United Nations Investment Laws and Regulations)

"that no expropriation can take place before the amortization of the invested capital has been assured".

Obviously, the Algerian Government, for one, approved the principle of complete pay-back of invested capital as a vital inducement for foreign capital infusion into the industrial economy.

The doctrince of tax holidays and inequities, when examined in the light of endemic risks to invested capital, may also tend to slow down the timing and amount of tax revenues expected from the foreign financed company.

It might be expected that such companies in their urgency to recoup initial invested capital would employ "accounting" expensing procedures which could create and extend a non-profit position until the very last day of the holiday grant. (But see recommendations to obviate this problem in Proposal 1). Were the restraints against capital recovery, as recommended, removed, it is indeed possible that profit goals would be "reached" in time periods earlier than the arbitrary limits now imposed.

To test the validity of this postulation, it might be worthwhile for Government fiscal experts to compare the tax flow from "under-privileged" and "very large" privately financed establishments now in a production stage.

Nationalization

As tersely expressed by United Nations' review of "African Investment Laws Regulations 1965".

> "The main factor responsible for the resistance of private capital in developing countries has been the "fear of nationalization". The provisions relating to repatriation of capital and profits in the investment laws of Africa reflect two main tendencies: one group of countries have placed no restrictions in remittance of profits and capital except the procedural requirement of permission for exchange. Another group ... have provided in their laws certain conditions before capital can be transferred".

This climate of apprehension is understandable considering real or imagined uncertainties surrounding the stability or continuity of certain incumbent governments. And this concern is further deepened by the language ambiguity of Investment Codes which may hinder negotiations leading to mutual agreement on the definition and amount of "invested capital" subject to repatriation - the event that nationalization becomes a reality. Not to be overlooked either is the fact that the latter underscored privilege above could be delayed were foreign exchange not available at the time of settlement. One may ask what is the significance of the relationship or interaction between fear of nationalization and the recommended postponement of tax holidays or earnings. And would a diminution of this "restraint" materially improve the Investment Climate.

Oversimplifying the answers, the writer submits that a foreign company facing nationalization proceedings is anxious:

(1) To recoup "initial capital investment"; plus additional infusions made necessary in order for it to achieve profitable operations and;

(2) To receive an acceptable interest return on total invested capital assuming profit margins to the consummation date of nationalization failed to meet allowed profit expectations.

In this frame of reference, it may be assumed that a company granted a tax postponment on earnings until "initial capital investment" as defined has been recovered - through pay-back - should face nationalization proceedings with confidence for an equitable settlement of its justifiable claims. And a more positive assessment of the investment environment for a country adopting suggested Proposal 4 as subsequently detailed should be anticipated.

Beneficial effects of Proposal 2

1. With respect to tax holidays and concessions, all countries adopting the proposal would be on equal competitive footing.

2. Competition for foreign capital - which cannot be eliminated under any circumstances - would depend on investment environment elements such as political hospitality, extent of extractive industries, labour skills, infrastructure availability, intra-inter country marketing areas, transportation and communications facilities, existing competition from established trading organizations, etc. In fact, these attractions (or detractions) may be more meaningful to foreign investors than the debatable competitive "inducements" of tax holidays and concessions.

3. Because companies would be allowed to recover capital investment within realistic time periods, tax revenues to Governments could be anticipated at an earlier date than under present conditions.

4. Fear of nationalization would be moderated. (See Proposal 4).

5. Possible requests for tax holiday and concession time extensions arising from inordinate delays in start-up production, etc. - which prolong tax revenue payments to Governments might be diminished.

6. Freedom from all tax "book-keeping" within the capital recovery period would permit companies to establish efficient accounting administrative procedures to process the multiplicity 1/ of taxes payable following the expiration of the tax concession periods. This aspect is of vital importance to those companies which plan marketing operations in two or more contiguous countries.

7. Reinvestment of profits within the country would be favourably considered.

8. The proposal would pave the way for communities of countries with similar economic and trade objectives to initiate "harmonization" of tax holiday and concessions programmes.

1/ Description of taxable corporate operations subject to tax holidays: profits, production, leasing fees, land, mining and forestry, products manufactured for exports, sales turnover, patents, domestic indirect taxes, consumption taxes for locally purchased materials, turnover taxes and municipality taxes. The foregoing do not include tariff concessions as described on page 21 for imported capital equipment and spare parts.

And in conclusion, legislative section to adopt this proposal should not engender internal governmental controversy. In actuality, taxes are not being forfeited, but as suggested (Item 3), tax payments to governments might flow earlier than under present taxing policies.

Proposal 3: Create a Viable Financial "Communications" Understanding with African Officials

A pre-marital obligation of prospective investors and host country officials is to develop a mutual understanding and evaluation of the variable fiscal elements which comprise an investment climate in any African nation. Yet it seems this obvious caveat may not have rung loud and clear for numbers of foreign corporate officials.

Many have not hesitated publicly or privately to catalogue their grievances toward the "real life" corporate operating environment in African nations. Whether these complaints are altogether justifiable or whether in fact foreign entrepreneurs are also at fault is examined in this chapter.

But in the final analysis, the paramount issues are those "restraints" which could jeopardize initial and subsequent capital investment and long-term profit potentials.

The latter fiscal factors are probably the key considerations which strongly influence private investors' (Class 2) go no-go commitment decisions or, an established company's positive or negative attitude toward reinvestment of accumulated earnings. And if the project has merit as mirrored by feasibility study estimates, then it is incumbent on foreign executives to present crystal clear capital investment programmes and projected production schedules for the proposed establishment. By doing so, latent areas of misunderstanding with cognizant African fiscal officials may be significantly reduced or even eliminated. Ancillary and undoubtedly helpful too would be a forthright disclosure of myriad difficulties - apart from Investment Code regulations - which invariably increase actual capital investment over feasibility study estimates and tend to diminish anticipated profitability rates.

These remarks are amplified by the following observations.

Observations

A possible basis for initial friction may be an indifference or even neglect by the foreign sponsors to establish a lucid financial "communications" exchange with companion African fiscal officials.

Skilled business managers, regardless of country origin, will confirm that initial stages of corporate formation and subsequent production on a profitable basis - are beset with exasperating difficulties however sophisticated the pre-production planning. And in developing nations the

critical problems of estimating initial capital investment (including working capital), time and rate of profitability are enormously enlarged. These data, as remarked, are the green or red signals for decision making.

Observations

And perhaps inadvertently overlooked by foreign businessmen may be this pertinent circumstance. African fiscal officials - in the brief period of their country's independence - may not have experienced the financial nightmare of finalizing the amount of capital investment for and then profitably operating a sizable enterprise in their respective countries.

If this assumption is bilaterally acceptable, foreign executives then have the opportunity to familiarize cognizant African fiscal officials with "real life" problems in establishing an enterprise and concurrently to create an harmonious negotiations climate.

It is of prime importance that readers gain an insight into several of the fiscal headaches associated with finalizing capital investment and estimating profitability potentials. These are now briefly discussed.

In part, some problems stem from the imprecise language of Investment Codes - specifically those involving tariff exemptions, tax holidays and concessions.

Capital Investment Costing Problems

These cover a broad spectrum of uncertainties due, in part, to upward price changes which invariably occur in the inordinate time lag between feasibility study estimates and actuals at the time of commitment. Major items subject to increments would include the following: land, machinery and equipment, shipping, insurance, in-land transportation, plant and infrastructure construction, added costs due to slowness in receiving production equipment, extended interest on construction loans arising from delays in plant completion and the possible need from "gratuities".

Tariff Exemptions Impact on Capital Equipment Costs

This is undoubtedly a sensitive subject with African officials - one fraught with economic and political controversy. Rather than become entangled in the mosaic of issues, the writer confines his observations to tariff exemption language of certain countries - as applied to imports of machinery, equipment and spare parts.

In each case, because language rules are indefinite, landed costs for production equipment are open-end book-keeping accounts which militate against the foreign company in firming total capital investment. To illustrate this point, attention is first directed to the underscored language of the subsequent excerpted tariff exemption samples and second, to questions related to the underscoring.

Selected Excepts from Tariff Exemption Laws (Source: Business International)

1. Total or partial refund of import duties and fiscal levies on raw materials and equipment needed for installation.

2. Exemption for import duties on materials, equipment and tools needed for installation.

3. Reduced rates of custom duties on materials.

4. Reduced rates of import duties for negotiated period.

5. Total or partial exemption, etc. for five years following date of initial production.

6. Exemption for five years from duties on essential material and spare parts - not found locally.

7. Complete or partial exemption up to three years.....

8. Total or partial exemption from or refund ... but not on replacements if obtainable from local industry.

9. Certain industrial equipment and raw materials may be imported tax-free for a limited period.

10. Total exemption for some industrial goods
(Underscoring supplied for subsequent questions).

Sample Questions Directed at Tariff Exemption Regulations

Note: Questions listed numerically as described on page

1. Partial Refund

Who or what determines whether the refund is to be total or partial.

What appeal mechanics are made available by the Government.

What time element is involved between payment of duty and refund.

2. Needed for Installation

What is the definition of "installation" period.

Why is exemption limited to installation period.

Who determines the actual completion date of installation considering the multitude of problems involved in achieving optimum production.

It is possible that tools, jigs, fixtures, etc., necessary to achieve efficient production may be required after "installation".

3. Reduced Rates

Are complete schedules disclosing these rates for the range of capital equipment, raw materials, supplies, components, etc. available in schedules for pre-investment inspection.

4. Negotiated Period

Are governmental officials familiar with the technical aspects of the undertakings active participants in such negotiations.

5. Initial Production

What is the definition of initial production.

Is the entrepreneur privileged to dictate when in his judgment "initial production" has been achieved.

Is he permitted to fix the date when cash break-even point has been reached.

6 & 8. Replacements Available Locally

Is it not possible that local replacements while similar will not perform in the parent machine as consistently as the imported item.

Is it not possible that local pressure might be applied to compel local purchase.

7. Up to Three Years

What is the reasoning behind this restrictive time limitation.

9. May be Imported for a Limited Period

Does not this language impose a severe range of uncertainties on a prospective entrepreneur particularly with the ukase of limited period.

10. Some Industrial Goods

Is there not a solid base for concern as to definition of Industrial Goods and with the limitation of the word "some".

Hopefully, the African reader will agree that the absence of precise tariff exemption rates and definitions as applied to imports of manufacturing equipment and accessories militate against capital investment determination. The present policies as related to raw materials for production also create production cost uncertainties.

Equity and Working Capital Requirements

These funds represent the entrepreneur's direct risks in total capital investment. As such, the subject deserves critical analytical treatment. The following chapter, an extract from the writer's paper titled: Suggested Capital Investment/Profit Criteria for Project Studies is a guideline to estimate working capital needs. It also high-lights "real life" problems which must be assessed in forecasting cash requirements.

Working capital for the start-up company, apart from funds which may be borrowed from banks against acceptable collateral, is supplied by the enterpreneural interests. Such funds represent a part of "equity capital" in the undertaking.

A short-fall in working funds arising from underestimation requirements may seriously impair the investor's initial equity position and may also jeopardise the progress of production and sales.

The practice of budgeting "working capital" for several months to support sales, accounts receivable, inventory purchases, etc., is standard procedure for the "going concern". But working capital needs for the inchoate company cannot be as readily calculated.

For example, prior to plant construction and completion there are many "out-of-pocket" cash requirements which the investor must provide. These would include feasibility and engineering studies, legal fees, possible foreign travel to negotiate for machinery and equipment, deposits for utilities installation, "gratuities", furniture, fixtures, office supplies, autos, trucks and contingency reserves to cope with costs arising from time delays in reaching optimum production.

The elapsed time from plant turn-key operations to production of quality controlled or "salable product" creates additional demands for "working capital". And more so if production is a complex process. Rarely does a new plant go on-stream without the exposure of countless production bugs. Meanwhile, wages and salaries must be paid, inventory is probably wasted, interest charges on debt continue and income from marginal sales volume is minimal.

Obviously these cash drains will continue until production can support the sales programme. Also, actual sales (shipments) may fall short of projections. For such reasons that working capital assumptions based on one, two or three months of initial sales and production may be seriously misleading.

Selling customs within the country of the proposed enterprise may also add to initial working capital requirements - depending on the product and whether sales may be for cash or on credit terms. If the latter should represent a sizable portion of sales and for 30 days or more, the manufacturer must be prepared to finance these "accounts receivable" from working capital.

Another squeeze on cash supply may arise from the fact that a new company, not yet having established a "credit line", may be compelled to pay cash on delivery for its purchases of production materials and supplies. Yet as noted, many of its large volume customers may purchase only on credit terms. This problem might be aggregated by sales to government agencies usually very slow payers.

The suggested steps to estimate working capital requirements which follow are undoubtedly tedious and time consuming. Unquestionably the problem of composition is severely handicapped by the fact that the financial backers may not have the opportunity to assess the proposal "on site". Such a vacuum in data collection livens the "credibility gap" - a serious deterrent to attracting or stimulating "prospective investors" to investigate the project proposals.

Suggested Steps to Estimate Equity/Working Capital[1]

For New Company Formation

Consider the procedure in two time stages:

1. The elapsed time period and activities requiring cash prior to construction up to "trun-key" operation.

2. The time period from turn-key to the months when cash income from sales continuously exceeds cash income. Non-cash items e.g., depreciation, depletion, amortization (patents), etc. are not considered.

Time Period 1

As previously noted, during this period of company formation, working/equity capital will be necessary to purchase a variety of services, (at the time of purchase) non-bankable facilities, equipment and possibly land necessary prepare this plant for turn-key operation.

The check list of items and activities for which cash is required is too lengthy to include here. As an alternative it is suggested that an amount ranging from 10 per cent to 20 per cent be assumed - the high and low percentage based on the total of capital investment involved. Lacking empirical data, this percentage may be upped or lowered depending on local or foreign banking policies and government attitude toward assisting such undertakings and the business reputation of the company's sponsors. Possibly, the

---

1/ The writer with US/Aid endorsement lectured on this subject at the Institute of Business Administration, Karachi University, Pakistan (1968). The University subsequently published these lectures in booklet form and distributed them to commercial and industrial banks and business firms. The Business Recorder, Karachi's leading business newspaper serialized the publication.

allocated funds also would include partial advance payments for imported raw materials, etc.

Time Period 2

The target of this projection is to estimate cash needs through the critical stages from turn-key and pre-production to a predetermined output of quality controlled product - ready for delivery to customers.

This cash requirement exercise mirrors the previously mentioned interplay of sales, engineering/production and finance.

The assumptions underlying the projection are these:

1. Engineering/production have agreed on optimum plant capacity.

2. Capacity (one or more shifts related to sales projections).

3. Production sets output goals based on sales requirements plus inventory accumulation.

4. Engineering/production estimate time required to debug production plus allowances for contingencies.

5. Production has hired and trained skilled, semi-skilled, and labour personnel. Salary and wages including fringe benefits are indicated.

6. All raw materials, supplies and accessory parts to complete the finished product are in-house or on order with anticipated costs and delivery dates shown.

7. Production/finance identify manufacturing fixed and variable expenses necessary for break-even calculations.

8. The ratio of cash to credit sales including credit terms is indicated.

9. Sales prices ex-factory are shown.

10. The poduction cycle time is considered in relation to shipping (sales) schedules or commitments.

11. A monthly sales/production manufacturing budget reflecting the items above is constructed for a minimum of eight months.

12. Annual administration expenses shown on a monthly basis.

The preceding steps - should provide a reasonable gauge of the cash deficiency from the time production starts to the time when cash income continuously exceeds cash expenses. And it is this deficiency less funds which may be borrowed against raw materials or other collateral acceptable to banks which the entrepreneur must supply from working capital.

It may be argued that the 10 per cent/20 per cent funds based on capital investment noted in Time Period 1 might be ample to absorb the deficit period of Time Period 2. It must be noted that the estimates for Time Period 1 should develop the funded or debt portion of the investment and, also show the amount of equity capital which must be infused into the project by the entrepeneurs. And working capital is an integral part of the equity for the start-up venture. The subject of debt/equity ratios deserves more treatment than can be provided in this discussion.

Profitability Restraints

Unfortunately, manifold problems - the gremlins - which can and do make shambles of the most sophisticated profitability forecasts are not neatly indentified in text books for analysis by students of finance or in fact, for corporate managers.

Fluid elements which can exert a powerful depressing (or euphoric) influence on the earnings margin would include: a country's economic health, political stability and policies, labour efficiency and turnover, corporate tax rates at all levels of government, technological advances, cost of capital, and managerial competency - indeed the most critical to long-term profitability.

Understandably, the negative external and internal corporate managerial problems and significantly their interaction are magnified in developing nations. As one analyst of the African business scene cogently observed: "the investment climate in Africa is determined basically by factors which affect the profit expectations of potential investors".

The reference above is an extract from Business International's Roundtable with African Governments (Addis Ababa November 1969) which canvassed foreign executives' views toward the Investment Climate in various African nations. The key word in the extract is "factors".

Although most likely well known to African officials it seems appropriate to restate the "grievances" - or factors - expressed by participants. The reasons: each complaint in one or more ways exercises a downward pressure on estimated earnings and capital investment.

Whether the following earnings depressants can be relaxed in the foreseeable future is a controversial question - answerable only by the will and desire of African officials.

Practical Problems Facing a Foreign Investor
Source: New Business Horizons in Africa
Business International Roundtable with African Governments, Addis Ababa, November 16 - 21 1969, pages 6-7-8-11.

"The capital costs can be a great deal higher per plant in Africa than Europe for a number of reasons, i.e., higher building costs, because of the need to hire high-salaried expatriate personnel for installation work

who also require expensive accommodations, to install air conditioning systems which will operate for longer periods, and to import machinery plus expensive inland freight rates and deliberate malpractices.

These elements in turn increase the running financial burden - depreciation and interest - per unit of output.

Raw materials vary in supply and in quality.

Industrial wages have been increasing rapidly in many African countries.

Skilled industrial workers are hard to find; where available, they command much higher rates than unskilled workers.

Technicians, engineers, managers, and in many countries trained secretaries and clerical help are scarce. At the same time, local governments are pressing for indigenization (sometimes called Africanization) of personnel. Where such a policy is absent or can be resisted, the only alternative - a barely more attractive one is to import and employ high cost expatriates.

Foreign expatriates sometimes cannot adjust to the inevitable pressures of living in a different society with its own scale of values and attitudes.

Often - especially around capital cities - foreign investors are pressured into employing members of local tribes.

In many African countries the markets are small in the first place and fragmented further by a range of imported supplies. As a result, in many cases of economies of scale cannot be achieved.

The unattractive size of many individual African markets is clearly revealed by the following statistics: There are at present 40 sovereign less-developed countries, with a total population of about 300 million (in comparison non-communist Asia has 33 sovereign less-developed countries with about 1 billion inhabitants). Of the 40 African countries, 27 have less than five million inhabitants.

An undercurrent of hostility is sometimes present, despite a country's protestations to the contrary because of its desire to invite foreign investment.

Political development is in its early stages, resulting in sudden changes in government, institutions, policies, and notions about a contract's validity.

A sticky bureaucracy (whose wheels grind inordinately slowly) often contradicts in practice what the State and its development plans preach.

Corruption is especially widespread in some countries.

There have been occasional cases where duties and taxes are higher on imported raw materials than on imported finished goods.

In some countries domestic prices have been rather unstable.

Local capital markets are generally non-esistent.

The external value (and in some cases, stability) of some African currencies has given rise for concern".

In light of the preceding extracts it may be of interest to readers to review some of the principal financial yardsticks used by corporate analysts to measure or rank one risk investment against an opportunity offered elsewhere. The following data were included in the writer's previously referred to paper "Suggested Capital Investment/Profit Guidelines".

Stripping polemics to bare-bone essentials, the prospective investor's go no-go decision will probably be based on the profit/capital investment/risk assessment values offered by the subject proposal compared with competitive opportunities offered elsewhere.

For these reasons, it is appropriate to explain briefly certain key financial tools for measuring risk undertakings in any country.

1. The Ratio of Net Income to Sales (Profit Margin)

Keeping in mind "competitive opportunities" - the lure to attract capital - this ratio provides an operating efficiency comparison between the subject company and others in the same industry, in the same country or elsewhere. The ratio is easily calculated: net sales are divided into earnings either before or after taxes. Note should be made of the amount of reserves which a company may create. Unless this step is made, comparisons of earnings may not be valid. The ratio allows the investor to detemine whether the undertaking meets his basic requirements of annual profitability.

2. Rate Return on Investment

It has been suggested that Discounted Cash Flow (DCF) or its variant Present Value (PV) methods for estimating rate of return on investment be included in project studies.

While undoubtedly a financial apostasy for this writer to by-pass the use of this managerial sciences technique in preliminary project appraisals, the reasons as described seem to justify the rejection.

These sophisticated risk ranking methods initially introduced by a handful of financial managers about 1955 are now generally employed by those companies with staff capabilities to amass and assess the statistical data required.

DCF and PV are based on the principle that money in hand today has greater value than estimated amounts of money to be received in fture time intervals. In effect, both acknowledge and measure the "time value of money".

A crucial underpinning for the required calculations is the reliability of the ESTIMATED annual flow of cash generated by future earnings. And for numerous types of projects scanned for possible consideration in developing nations, the highly questionable quality of extrapolated sales and operating cost data militate against the usefulness of these techniques for investment or ranking appraisals.

This viewpoint was cogently confirmed by John H. McArthur, Harvard University, in his paper: The Use of Discounted Cash Flow in Developing Nations. He said "As theory discounted cash flow is not at all the ultimate in refinement of logical elegance. Much more critical however is that one almost always encounters very significant practical difficulties in trying to apply the discounted cash flow method".

"If it is sometimes difficult and hazardous to usefully forecast conditions in these relatively ideal circumstances (US), one can easily imagine that these difficulties compound where the necessary professional skills and/or basic statistical data do not exist. Notions bases on perfect knowledge of markets, long run investment demand schedules, investment opportunity rates, investment analyses adjusted for risk differentials, and so on, would seem utopia when viewed in this less ideal context".

"... One would seem justified in observing that the practical limitations of discounted cash flow are likely to be even more constraining in the developing economies than they are in the economically developed nations' If this is true, what if any practical value is there in the discounted cash flow technique for the developing countries" (underscoring supplied).

This requirement for reliability of forecasted incoming cash streams (as well as other collateral data) is a caveat strongly expressed by practically all financial managers and eminent DCF and PV proponents.

With these facts in mind a rhetorical question is posed: What practical purpose would be served in including such dubious risk gauges in project studies aimed at financially skilled prospective investors?

3. Pay Back Period

Prior to the introduction of DCF and PV, the pay back period was used widely by firms to determine the time required for estimated annual cash flow to fully recoup the proposed capital investment.

Depending on internal corporate yardsticks the project would either be initiated or rejected. Its popularity was based in part on the simplicity of calculation which is dividing the estimated fixed capital investment by the average annual operating cash flow. This method obviously ignores "time value of money".

The writer submits that despite its limitations the method would be used for preliminary project studies. At the least, it would enable a prospective investor to calculate the estimated pay back time including his own probable revisions of data supplied.

It must be assumed that a number of those organizations with prior investment experience in developing nations or those contemplating such ventures demand higher profit margins than those obtainable in advanced nations. This prerequisite is justifiable compensation for total risks including loss of business opportunity for tied up capital should the venture fail to meet financial objectives. This comment may not be applicable to national or international financial groups whose purposes of investment may have overriding egalitarian motivations.

Of immediate relevancy however is the fact that the early years for start-up ventures are fraught with capital requirement uncertainties. These can flag success or failure. Therefore, one can postulate that pay back time is a viable assessement of risk (not return on investment).

Once original capital is recovered, subsequent operations may produce profits in line with expectations or even deficits. In the latter circumstance, the investor's philosophy might be succinctly summed up as business judgement sour but capital returned. Only loss was the profitable employment of those funds in business opportunities elsewhere.

4. Simple Rate of Return on Investment

This method is the reciprocal of the pay back period and is arrived at by dividing the average annual cash flow by net investment. It has the same limitations of pay back in that the time value of money is not utilized. The return on investment is at best an approximation although for plants with life expectancy of fifteen or more years, the percentage will approach that obtained by the more advanced techniques.

Break-Even Points as Sales/Profit Guidelines

It must be acknowledged that sales forecasts, profit projections and time-tables to reach targets, constructed without in-depth examination are collectively a quicksand trap of assessment.

The break-even point analysis would be a meaningful contribution to moderate this problem.

During the initial manufacturing period the rate of production will be scaled upward paced by the progress of the debugging programme. Several months or more may be required to obtain product quality necessary for sales acceptance. The elapsed time period will also be influenced in part by the simplicity or complexity or product composition.

Sophisticated investors particularly when analysing high risk project proposals of possible interest invariably sharpen pencils and recast submitted

overall estimates. Sales volume may be reduced, cost elements raised, and estimated time to reach the profit projection extended. Capital investment requirements undergo the same surgery.

Under such "real life" conditions, the investor referring to the components of the break-even analysis can make his own adjustments in near-term sales (units), production costs, timing, longer term sales/capacity relationships and other elements which he may consider are relevant to the level of earnings potential.

Financial Components for Break-Even Analysis

Break-even analyses range from relatively simple calculations to elaborate accounting gymnastics involving variations in sales volume, price adjustments and identification of the fluid family of variable and semi-variable expenses, etc. We cannot be concerned here with such exercises in advanced cost accounting and sales/profit margin analyses. Although undoubtedly redundant, it may be worthwhile as a refresher to touch briefly on the basic accounting data required for a simple break-even construction.

Fixed Expenses

Those fixed in amount regardless of sales volume. (Over a long time span fixed expenses will rise or fall reflecting economic or other germane circumstances).

Rent, rentals of equipment, interest, depreciation, indirect labour insurance, office supplies, office salaries, officer salaries, selling expenses. These do not necessarily constitute a complete listing of such expenses.

Variable Expenses

Those which vary directly with sales volume. Materials consumed, direct labour, various utilities (part of which might be considered "fixed"), repairs, maintenance, manufacturing supplies, fringe benefits on direct labour and sales commissions.

Calculation to Establish Break-even Sales Volume

Step 1			
	Sales	$100,000	100%
	Less variable exps.	63,000	63
	Contribution	37,000	37
	Less fixed expenses	25,000	
	Net income	$12,000	

Step 2 Divide Fixed Expenses by percentage of sales dollar remaining after paying variable expenses to meet total fixed charges (contribution %)

Fixed expenses	$25,000	equals Break-even Volume
Contribution %	37%	$68,000

Proof

Sales @ Break-even	$68,000
Variables @ 63%	43,000
Fixed expenses	25,000
Total expenses	68,000
Profit	none

As a concluding comment to this proposal, the writer believes that foreign investors could enhance their initial and subsequent relationships with African country officials by a tactful amplification of the financial issues just presented.

Proposal 4 : Nationalization

An examination of the motivation or act of an African Government in partially or fully nationalizing its foreign controlled business firms is not relevant to this tract. Complete nationalization probably forecloses an inflow of foreign risk capital (as differentiated from World Bank type of loans) and concurrently removes the controversial subject of Investment Climate of that country from further foreign investment assessment.

Undoubtedly, governments which decide to nationalize have formulated alternative domestic capital generating programmes to supply risk funds for industrial expansion and new establishments.

Partial nationalization - the assumption of fifty or fifty one per cent more of voting stock ownership of specific types of companies operating in the arena of "public interest, necessity, need or benefit" may still leave the door open for industries of special interest to governments. For example, Zambia which acquired fifty one per cent stock control of its copper mines (partial nationalization) was reported to have "signed a secret pact with Fiat, imposing prohibitive import controls on all other makes as an inducement to the Italian car-maker to set up an assembly plant at Livingston" (Newsweek 23/4/70).

Of prime relevancy however to this discussion is the sensitive problem - faced by the protagonists - of calculating a "just or fair" compensation to be paid to the owners of nationalized companies. The quoted words are those used in the Investment Laws of many African countries to "assure" foreign shareholders that indemnification on an equitable basis will be objectively considered.

Partial or full nationalization may be a "time" possibility for those African countries which so far have refrained from this course of action. But readers may concur that the prospect of industrial or services establishment take-over, however indefinite, hovers as a menacing cloud over the Investment Climate of individual nations.

The writer is not qualified to analyse or prognosticate the latent political, economic and social forces which may unexpectedly spur a government to demand the phasing-out of foreign risk capital and associated managerial skills. But even the remote possibility of such a drastic decision is of intense concern to prospective foreign investors however politically stable an incumbent government may be at the time of initial commitment.

Surely partial or full nationalization of specific industrial firms, banks, and insurance companies by the Governments of Somalia, Sudan, Libya, Ghana, Uganda, Algeria, and Kenya during the months of May, June, July, and August 1970 might be a genuine case for alarm that the philosophy or contagion of national ownership in preference to foreign control could spread to other African countries.

Legislative machinery of a sort to render "just" or "fair" nationalization compensation is integral to the Constitution, Investment Laws or official economic policies of many African nations. But when nationalization becomes a reality, the crucial and possibly abrasive problem faced by foreign owners is to obtain "equitable compensation" for accumulated capital investment or evaluation of their shareholdings - including perhaps authority to repatriate funds immediately on settlement agreement.

The resolution of acceptable indemnification with or without recourse to arbitration of other indigenous avenues may depend on at least two unpredictable factors; (1) the financial expertise of government officials administering the compensation machinery and, (2) the political government environment prevailing at the time of nationalization.

Comments

The vague language of "just or fair compensation" in the absence of clearly defined guidelines to calculate the present value of capital assets involved is unquestionably a fertile source of negotiation and final settlement friction, and more so in a possible hostile setting. This observation prompts an immediate and provocation query: It is conceivable to structure mutually acceptable pre-commitment indemnification agreements which will be honoured should nationalization be proclaimed.

Realistically, the answer must be a limited "perhaps". The reservation arises in part from an obvious inability to presage the particular circumstances which provoke nationalization decisions and, the temper of governments at that time toward foreign private investment. Intransigence by both parties toward reaching an agreement on the amount of involved capital assets might precipitate an unwelcomed and irrevocable indemnification decisions.

These remarks are not intended to suggest that an African government would deliberately abrogate a legal responsibility to provide just or fair compensation. Rather it acknowledges that final indemnification settlement depends in large measure on the accounting principles adopted by a company to record in-puts of capital investment and annual profit calculation. These (principles) as subsequently described in brief, can be and are controversial issues - everywhere in the industrial world.

Whether arbitration machinery as provided for by some of the African countries (but what about the others) have or will yield satisfactory compensation for foreign investors already trapped in nationalization proceedings is a moot question. The writer is not privy to the financial outcome in those 'fait accompli' instances. There is little room for argument however that the "fear" of partial or full recapture might reduce a potentially attractive industrial commitment to one of questionable interest to the prospective foreign investor.

Logically our concern therefore is for:

1. African governments aggressively soliciting private risk capital for industrial installation and expansion (profit reinvestment). Certainly no government can provide absolute guarantees that nationalization of specific companies will not occur at some future date.

2. Foreign private investors deliberating commitments in the shrinking number of non-nationalized countries. And as frequently mentioned, the spectre of recapture and possible adverse financial consequences constitutes a definite deterrent to an inflow of risk capital.

In the light of these incongruent positions as previously remarked, is it conceivable to structure and obtain bilateral adoption of corporate fiscal measures which would accomplish these objectives:

1. Alleviate investors' fears that nationalization would seriously diminish the amount of accumulated capital invested (and profits) for repatriation.

2. Pave the way for a nationalizing government to accept the financial representations of the private company for accumulated capital without recourse to time consuming and costly arbitration.

Perhaps so, assuming governments and prospective foreign investors - particularly the latter would be willing to accept and abide by the following pre-commitment conditions related to corporate fiscal disclosure and indemnification transfer:

1. The foreign private company submit to the government full or "reasonable" financial disclosure of its periodic balance sheet and profit/loss statements. Also open its accounting records for government audit if requested;

and in exchange

2. The government as its contribution readily acquiesce to payment and transfer of a company's accumulated capital investment as reported in its final balance sheet, within a prompt or reasonable time following the effective date of nationalization.

Many foreign investors may take a dim view or look with disfavour on the "disclosure" suggestion. Most reasons at this time are valid. Some border on the periphery of "sharp practice". It seems appropriate therefore to discuss briefly: (a) the meaning of full or "reasonable" disclosure and; (b) internal accounting and fiscal problems which may explain why a foreign controlled company would be reluctant to open its ledgers for government audit.

Full disclosure would require a company to submit profit and loss (and balance sheet) statements detailing the accounting treatment of total revenue transactions as they downstream from gross sales through all operating, selling, administrative expenses and "reserves" to profit subject to taxation. In effect, such a disclosure provides a vivid picture of a corporation's financial anatomy for the specific period under examination. But such a submission is impractical in that the entire complex of company accounting books and records would be required - obviously an unrealistic demand.

Partial (reasonable) disclosure would be a digest or abridgement of the principal items comprising the profit/loss statement - and balance sheet. Supplementary exhibits or footnotes might detail or explain specialized accounting principles adopted by the company to record cost of sales (labour, materials consumed and manufacturing overhead), selling and administrative expenses, creation and funding of various "reserves", non-recurring profit and loss transactions, finished goods inventory pricing practice, inter-company purchases and sales should the involved firm be multinational, modification of depreciation, depletion and amortization policies, write-downs for extraordinary losses on investments, fixed assets, etc., transfer of funds into and out of earned surplus, etc. Such a report would be similar to annual corporate statements issued by United States companies to shareholders.

The Problems of Disclosure

Comments

Simply stated, suppliers of risk capital whether in the form of collateralized loans, stock participation (equity) or a combination of both expect (and will insist) that annual earnings flow from an undertaking will be adequate to:

1. service debt (interest charges) and liquidate loans within scheduled maturity dates

and

2. provide a rate of return on equity investment commensurate with the degree of risks involved.

To ensure these objectives, capable management whether in Africa or elsewhere is duty bound to adopt all legal fiscal and accounting techniques which will shelter earnings from possible confiscatory, excessive, or unwarranted taxation. And it is precisely this obligation which underlies the complex problem of financial disclosure.

It is acknowledged in the United States financial and accounting professions that a company has various acceptable accounting options to report the amount of income earned for any given year. How can this anomaly be explained and what bearing does it have on the issue at hand - corporate financial disclosure for African Governments.

Adequate response to the first question would require an accounting dissertation far beyond the scope of this paper. However, a few key components of a typical United States manufacturing profit/loss statement are scanned briefly to illustrate how accounting treatment can on a given amount of sales produce a plus or minus impact on the amount of reported earnings.

At the outset it must be emphasized that American accounting rules (and most likely in other advanced industrialized countries) have been constructed, modified and upgraded with twofold objectives:

1. to permit a company to measure, monitor and continuously enhance profitability and corporate financial liquidity;
2. to record various operating, sales, administrative expenses as well as additions to or deductions from capital assets in a manner which legally conform to Government, State and muncipality tax laws but concurrently justifiably minimize taxable income.

Item 2 may appear to contain nuances of deliberate corporate subterfuge to mulct governments from rightful tax payments. No so. Most if not all tax laws promulgated by federal governments and subordinate taxing agencies generally are a maze of intricate language and definitions - thereby opening the door to controversial interpretive values. In the United States for example, most corporations of size either maintain in-house tax experts or resort to independent tax consultants for guidance in the preparation of fiscal returns.

Some examples and footnote explanations of "adjusted" earnings reported by leading U.S. companies are shown:

Anderson-Clayton			International Minerals & Chemicals		
Year	1970	1969	Year	1970	1969
Revenue (mlns)	639.08	503.82*	Revenue (mlns)	505.93	504.63
Profits "	12.37	6.43	Profits "	4.50	3.10*
Per share	3.83	1.97	Per share	0.22	0.09

* Based on results for 11 months ended June 30 due to change in accounting.

* Before extraordinary charge of $23.7 million which resulted in a net loss of $20.6 million.

Keystone Consolidated

Year	1970	1969
Revenue (mlns)	205.16	183.21
Profits "	3.97	4.67*
Per share	2.11	2.49

* Includes extraordinary gain of $921,000.

Zapata Norness Inc.

Their quarter	1970	1969
Revenue (mlns)	52.6	46.8
Profits "	2.30	3.50
Per share	0.41	0.73*

* Restated by Company.

Tax laws are not adequately precise to cope with the myriad changing economic and technical circumstances which affect profit generation and capital asset values. Thus in the United States the federal tax courts have heavy calendars of corporate claimants seeking relief from adverse decisions rendered by local federal tax examiners.

Now to a few oversimplified examples of profit/loss reporting which, depending on the accounting treatment, add to or subtract from earnings subject to taxation.

Pricing of Inventories (raw materials, components, etc.)

The calculation of "cost of sales" includes labour, overhead and materials consumed. Because of significant price changes for purchased materials consumed in the manufacture of finished product, companies can opt either for last in, first out method (LIFO) or first in, first out method (FIFO) for year and inventory pricing. Under LIFO items of inventory value are thus computed by assuming that goods on hand are those most remotely purchased and are valued at the successively most remote purchase prices. In contrast under FIFO rules, items of inventory used are priced out at the purchase price of the oldest batch in stock, then the purchase price of the next oldest batch and so on. Inventory value is thus computed by assuming that goods on hand are those most recently purchased and are valued at the successively latest purchase prices.

Thus, cost of sales - the first deduction from net revenues (sales) may be upward or downward depending on the inventory evaluation method used.

Depreciation

Bookkeeping charges for depreciation particularly in medium and heavy manufacturing, transportation, and technically oriented industries can and usually do exert a significant impact on reported earnings. In the industrialized countries governments acknowledge the necessity for providing realistic depreciation schedules. Company managements therefore can employ depreciation schedules compatible with assumed life expectancy of the fixed or movable assets. But it must be realized that capital assets have a life usage far greater in temperate zone areas than that in countries where extended periods of humidity and rainfall rapidly damage machinery and equipment of all types. Moreover, in this age of accelerated technological achievements, some manufacturing equipments and processes undergo rapid functional obsolescence.

Therefore, the United States companies have a choice of some twelve methods for depreciation of assets. The most popular are straight line, sum of the digits, and double declining balance. The last two methods allow a company to charge off almost fifty per cent of the investment within about the first half expected life of the assets where by using straight line, the assets are depreciated at a fixed rate over the complete expected life span.

Thus, it is evident that rate of reported earnings subject to taxation will be higher or lower depending on the depreciation schedule adopted.

Research and Development (R & D)

Of keen interest to African Government officials is the prospect, however minute at this point in time, of indigenous African company managements initiating industrial R & D efforts. R & D is a mandatory activity for a broad range of companies manufacturing durable, semi-durable and even consumers goods. R & D improves the quality of existing product, cuts production costs, and most important spawns a wide range of entirely new products.

Is this commentary pertinent to African related corporate disclosure, accounting procedures and taxable income? Indeed so.

American companies (and perhaps those in other countries as well) can elect two methods for treating (accounting-wise) R & D expenditures. By one, funds for R & D are expensed out fully in the year in which they occur; the other accounting procedure is to amortize or spread out R & D outlay for a specific number of years. The option usually depends on the nature, the technical involvement, and the amount of funds allocated to the programmes.

As is evident, the election of full expensing within a given fiscal year will lower income subject to taxation whereas by amortizing, annual earnings will be reported at a higher level.

This brief R & D reference may be and probably is academic to disclosure for African companies. But there is an outside possibility the foreign controlled company may correctly assess a portion of its headquarters R & D expenditures on either basis to costs of operating its African undertaking. African fiscal officials, unless aware of this practice, may deem such deductions as unacceptable debits against taxable earnings.

The preceding examples of profit adjustment are determined by corporate accounting policies - in a sense therefore controllable. But as astute managements are painfully aware, there are dozens of internal and external administration, production and sales activities which singly or collectively can and do destroy the most sophisticated profitability and corporate liquidity projections.

Operations in developing nations are particularly susceptible to a disconcerting array of expenses - difficult to predict and control. It would be almost impossible to catalogue the avaricious and pernicious expense sponges

which suck up anticipated profits. But a few, particularly prevalent would be: labour turnover and absenteeism, production inefficiency and associated raw materials wastage, inordinate interruptions in production line output, expenses of machine down time, unanticipated shortages of processing raw materials or components, paucity of semi-skilled and skilled personnel and effective "communications" between company and government agencies in instances where official permission is sought to undertake or complete some specific profit generation activity.

As is evident, a government "audit" of the corporate profit/loss report to comply with "reasonable disclosure" requires highly oriented industrial accountants or fiscal officers to assess impartially the submitted earnings statements.

And in the light of mutual benefits which might emanate from the "reasonable disclosure" proposal, African administration might look with favour on implementing their financial ministries with such skilled personnel. Their services would be extremely useful too in examining foreign as well as indigenous company earnings subject to government taxation. Perhaps their most vital contribution would be to participate in analysing a foreign corporation's claims for" "accumulated capital investment" for indemnification or establishing an equitable value for relinquished stock ownership should nationalization occur at some subsequent date.

Surrounding uncertainties (legal, political and financial interpretation) which may militate against obtaining a "fair deal" for a reasonably prompt return of invested capital or realistic appraisal and payment for forced sale of stock control haunt foreign investors in nationalization proceedings. Most certainly, this spectre of possible industry recapture tends to subdue the euphoric picture of Investment Climate painted by non-nationalized countries.

The hard core of nationalization dissension - confronted by the foreign company - are the controversial ingredients of the corporate balance sheet which reflect the accumulated record of "invested capital" or net worth subject to indemnification. We thus turn our attention to company accounting policies which influence several key items making up the aggregate of total or net assets (net worth).

As in the case of the corporate profit/loss statement, management accounting policy must take into consideration and act on fiscal events occurring during the year which may add to or subtract from realizable assets. Some example follow:

1. Realistic write-offs of possible accounts receivable bad debts.

2. Losses or gains or liquidation of fixed or moveable assets.

3. Significant changes in depreciation, depletion or amortization methods.

4. Write-up or write-down of fixed assets.

5. Creation, additions to or deductions from various types of reserve accounts.

6. Up or downward price adjustments for "current asset" inventory evaluation.

7. Inclusion, write-down or elimination of "good will", a balance sheet item usually arising from acquisition of other companies or a presumed asset mirroring established trade names, etc.

8. Amount of dividends paid to shareholders.

9. Amount of earnings expatriated prior to year and closing of fiscal books.

10. Amount of earnings retained within the business (shown as earned surplus).

It is pertinent to mention that items 8, 9 and 10 are governed first by generated earnings and second by a company's attitude toward present and foreseeable risks (Investment Climate) - particularly as applied to "expansion by reinvestment of profits". Tangential to this particular discussion but nevertheless vital to pre-investment decisions are the tax rates a government imposes on earnings following termination of "tax holidays" and other concessions. Thus as a company approaches expiration of its "holiday" it must take whatever defensive action is legally possible - through its interpretation of a country's taxation laws - to minimize the impact of imposts on earnings.

The latter issue complicates the problem of "reasonable disclosure" but one which might be resolved by viable communications and co-operation between government officials, skilled in corporate accounting and taxing laws and regulations, and corporate fiscal management. And in referring to "skilled corporate accountants" one must acknowledge that each industry e.g. mining, oil exploration, extraction, and refining, heavy, medium and light manufacturers of durable and semi-durable goods, consumers merchandise, service companies such as banking and insurance follow accounting procedures which are compatible to trade practices of the respective industries. Therefore, it is readily appreciated that government fiscal examiners must possess an industrial accounting versatility in order to render "just and fair" appraisals of profit/loss and balance sheet statements submitted under the "reasonable disclosure" proposal.

Should the fiscal staff lack the balanced "audit" expertise suggested here, a solution with far reaching benefits would be for a government to contact for such services with an international accounting firm for a specific period. During that time, the African staff would be taught the methodologies for analysing in-depth foreign company fiscal statements. In this manner the African fiscal staff would acquire an "audit" accounting experience useful in (1) appraising pre-commitment financial programmes submitted by the prospective investor and (2) a continuous evaluation of the tax returns of all foreign-controlled and joint venture establishments. Other foreseeable derivative benefits might be these:

1. The foreign firms (and joint ventures combines) would exercise greater 'caution' in 'expense' accounting

and

2. Because of such monitoring, a government's tax revenues from all enterprises, both domestic and foreign, might be significantly enhanced.

The underscoring of CAUTION IN EXPENSE ACCOUNTING opens the door to the relevant but extremely sensitive subject of accounting malpractices - a euphemism for world-wide business chicanery. As a Time magazine two page essay observed some time ago, pay-offs, kick backs, and bribes under various disguises are particularly prevalent in developing nations. Like outlawed prostitution, such insidious practices, however severe are the legal penalties with exposure and conviction, cannot be terminated for any protracted period.

The motivations and techniques are far too complex for even a cursory commentary. But because of their downward impact on reported earnings and balance sheet values, a few are worthwhile noting as below.

Obviously, it requires highly skilled accountants to detect these types of tax evasion subterfuges. Most assuredly these brief remarks must not be construed as a blanket indictment against all foreign controlled companies. Undeniably, there are numbers who regard "sharp practice" as a necessary and accepted modus operandi for conducting business in a high risk environment. Thus it becomes the obligation and responsibility of the African accounts to be well versed in this type of profit reporting.

A Few Questionable Accounting Practices

1. Over-- and under-invoicing for initial and subsequent capital equipment materials and supplies.

2. Excessive charges for parent company administrative expenses allocated to the foreign operation.

3. Establishing either high or low prices for inter-company purchases and sales.

4. Payment of dividends unwarranted in relation to the amount of annual earnings - in effect, milking the assets.

We cannot conclude this chapter of reasonable disclosure on such a miasmic note. Enlightened and progressive company managements contemplating long-term investments aware of the basic need to become "good citizens" of the host country undoubtedly new to acceptable accounting practices.

In summary then, the reasonable financial disclosure is nothing more than a "give and take" equitable commitment. Both protagonists should derive meaningful benefits by fulfilling commitments entered into at the time of initial and subsequent investment. And, mutual understanding and trust should encourage the foreign company to view African Governments eagerly sought reinvestment of earnings in expansion with the same fiscal security as exists in their own countries.

Finally, as earlier mentioned, the adoption and ultimate success of this proposal will depend in part on the accounting capability of African fiscal officers charged with the responsibility for monitoring the financial activities of the foreign company.

- - - - -