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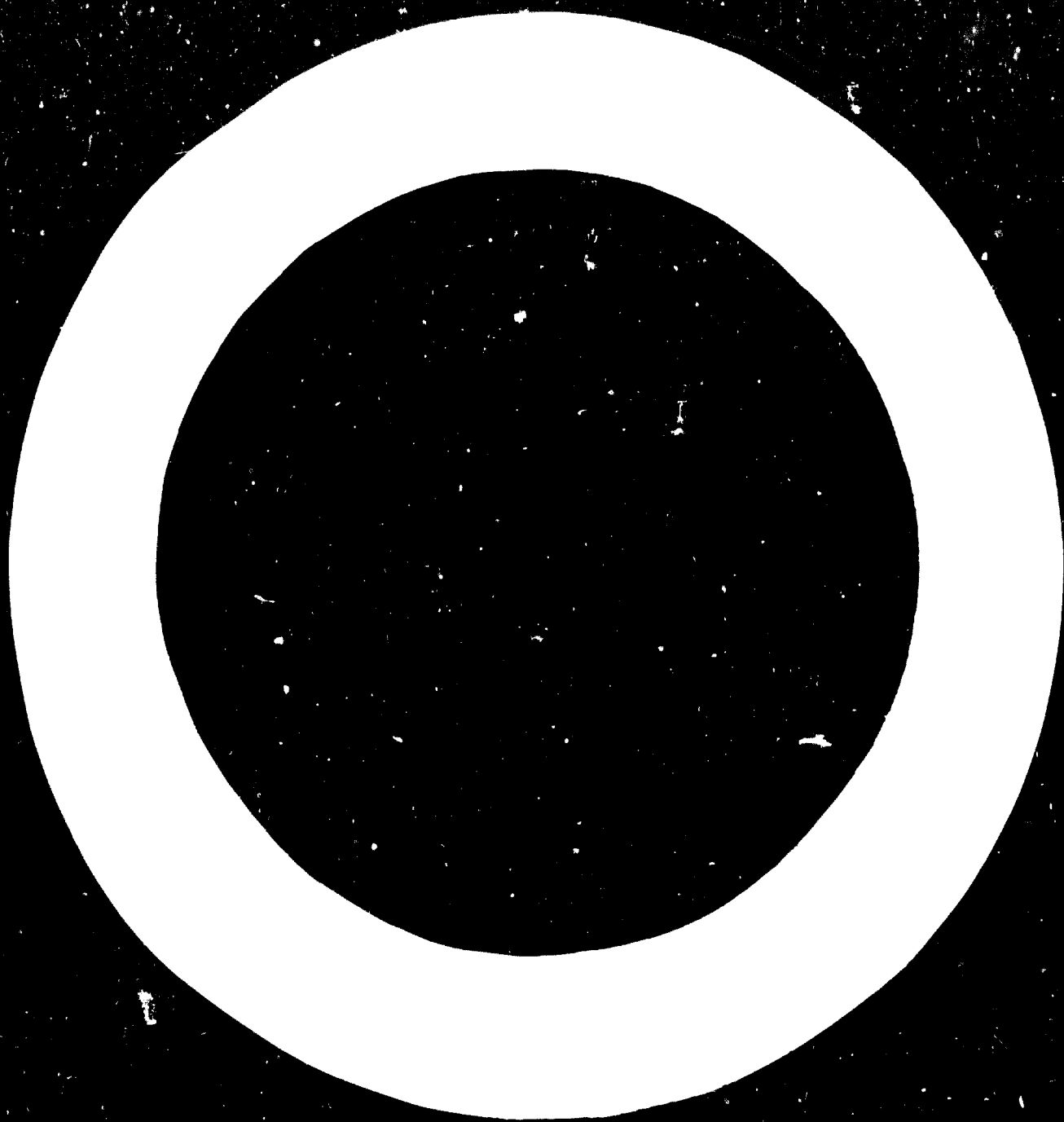
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**ASSISTANCE AT THE PRE-INVESTMENT STAGE AS
AN INCENTIVE MEASURE^{1/}**

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ASSISTANCE AT THE PRE-INVESTMENT STAGE AS AN INCENTIVE MEASURE

Issues for discussion

"It is generally acknowledged that one of the primary restraints on the expansion of private foreign investment in developing countries is the absence of fully formulated projects ready for implementation — or of organized facilities for their identification and preparation".

United Nations: Foreign Investment in
Developing Countries

I. INTRODUCTION - THE PROBLEM

1. A local entrepreneur wishing to establish a new industrial project in a developing country faces a number of obstacles or difficulties at the pre-investment stage. He is often unfamiliar with the technology of the industry and lacks facilities for selecting the most appropriate manufacturing process and source of supply for machinery and equipment. Experienced management and labour required are not readily available and he will have to rely on developing these skills and experience. The risks involved can therefore appear very great, particularly in the case of plants requiring substantial capital investment.
2. A good feasibility study can help reduce these risks. However, even such a study involves a risk that the expenses and time incurred by the potential investor will remain unrewarded if the project is not implemented. The incentive effect of assistance at the pre-investment stage depends (a) on attracting a domestic and/or foreign investor's interest in the project, and (b) on reducing the cost and risks involved in studying the feasibility of the project.
3. This paper will consider the issues involved in formulating assistance at the pre-investment stage as an incentive measure.

II. SURVEY OF ISSUES RAISED

4. A range of issues arises when considering this type of incentive measure. This section lists as many as possible under the following headings:

- A. What forms can this assistance take?
- B. What type of entrepreneurs benefit most from this assistance?
- C. Which projects should be covered?
- D. What type of machinery has been used to offer such assistance?
- E. How effective is this type of incentive compared with other incentive measures?

A. What forms can this assistance take?

5. Assistance at the pre-investment stage with the formulation of an industrial project can take a number of forms: (a) the identification of an investment opportunity in the form of a preliminary study; (b) a feasibility study; (c) detailed engineering studies for the project; and (d) adhoc advisory assistance to potential investors in studying the feasibility of a project. For the purpose of this paper, these forms will be defined in the following way.

6. A thorough preliminary study of the project would demonstrate that a local market exists for the product and examine both existing and projected future demand and existing and potential future sources of supply. It would justify the anticipated selling price for the product and examine its dependence on tariffs or other forms of protection. The proposed size of plant would be given and a rough guide to its capital costs. Availability and price of raw materials, power and other utilities would be verified. A rough estimate of the operating profit would be provided.

7. A feasibility study of the project would examine these aspects of the project more carefully, verify the technical and financial soundness of the project, and suggest appropriate management and financing plans.

8. For most projects, a further step is required before construction of the plant begins: detailed engineering studies. The purpose of

these studies is to select appropriate sources of machinery and equipment and prepare specifications for their purchase. This is often a costly exercise and is sometimes considered by accountants as part of the capital cost of the project.

9. Advisory assistance to potential investors in making feasibility studies is the most common form of assistance provided by the 20 developing countries whose experience has been studied in the Background Papers.

10. The general issue arises: which of these four forms is the most effective way of promoting new industrial projects?

Preliminary studies of projects are an efficient way of attracting the interest of domestic and foreign investors. Advisory assistance is a useful substitute if the interest is already established. Should the Government go as far as making or helping to finance feasibility studies and detailed engineering studies?

11. If the Government is willing to assist domestic entrepreneurs to have feasibility studies made by outside consultants, should this assistance take the form of (a) payment of the costs in full, (b) a contribution to these costs, or (c) a loan to finance the studies. In Brazil, a long-term loan at a favourable rate of interest is offered by FINEP (The Fund for Project Studies); in Argentina, the newly established National Fund for Pre-investment Studies can pay all or part of the costs or make a loan as it deems appropriate.

12. The American Government has adopted an interesting approach to encourage American investors to study investment opportunities in developing countries. As a general rule AID offers to pay 50% of the cost of making a feasibility study. The rules are that if the investor goes ahead with the project, he pays the full cost and does not use AID's offer to make a 50% contribution; if he does not go ahead, AID pays 50% of the cost and retains the study itself for the use of other potential investors.

B. What types of entrepreneurs benefit most from this assistance?

13. There are two ways of classifying entrepreneurs. First by ownership of the enterprise: domestic, foreign or joint ventures. Second, by the size of the enterprise: large, medium or small-scale industries. The issue arises: which type of potential investor benefits most from this assistance?

14. Foreign investors usually have an intimate knowledge of the technology of the industry they are interested in establishing and are usually in a position to use their own staff to make a feasibility study for their venture or joint-venture. The issue arises then: do foreign investors need more than a good preliminary study of a project to attract their interest? Do they require continuing advisory assistance?

15. Domestic investors are in a different position. They are usually less experienced in project formulation and they do not know where to turn for the appropriate technical know-how. Several Background Papers show that this is the case with the small or less well-established local firms. The issue arises: have developing countries done enough to assist domestic entrepreneurs at the pre-investment stage?

16. Some countries (particularly India) have recognized this difficulty for small-scale industries and provided a special advisory service. Do small-scale industries require a separate and specialized form of assistance at the pre-investment stage?

17. Has there been a tendency for existing programmes of incentive measures and investment promotion services to concentrate on foreign investors and large-size domestic firms? The Background Papers of Nigeria and Jamaica suggest that this has been the case, and that the development of national entrepreneurial skills has suffered as a result.

C. Which projects should be covered?

18. Industrial projects can be classified in a number of ways:

import-substituting or export-oriented; consumer goods, intermediate goods, capital goods; industries based on local raw materials; and other types of industry based on imported materials (particularly assembly-type industries). Can any of these classifications determine which industrial projects require assistance at the pre-investment stage? Or does the need depend on other factors such as the stage of industrialization in the country and the range and experience of its entrepreneurial class?

19. In countries at an early stage of industrialisation, there are very few local entrepreneurs with sufficient experience to establish major new projects. Where the Government has established a channel for providing assistance at the pre-investment stage (the Uganda Development Corporation is a good example), this problem can be overcome to some extent. Where such assistance is not provided, a good part of the initiative to establish major new projects must come from other sources such as foreign investors (Nigeria's experience) or the Government itself (Sudan's experience). The issue arises then: do countries at an early stage of industrialization need to pay special attention to the need to provide assistance at the pre-investment stage?

20. Where the industrialisation process has reached a more advanced stage, not every local entrepreneur will need such assistance; the issue then becomes: can assistance provided at the pre-investment stage result in the implementation of a project that would otherwise be delayed or not implemented at all?

21. It may be in the Government's interest to ensure that all major new industrial projects are implemented on the basis of a proper feasibility study. Governments wish to avoid wasting scarce capital and foreign exchange resources on projects which will not contribute successfully to the industrialization of the country. A thorough feasibility study can weed out unviable projects, particularly those which will create excess capacity or result in inefficient and high cost production of the product in question.

22. Are there particular types of project where the cost of making a feasibility study is a serious obstacle for potential investors? As a generalisation, one might conclude that capital-intensive projects such as steel, machinery manufacture, heavy chemicals, petrochemicals etc. all require extensive feasibility studies. Whilst these may not be beyond the resources of the firms interested in the project, some Government assistance may help to initiate or develop the interest of firms likely to implement the project.

23. In Brazil, the recently established Fund for Financing Project studies (FINPP) has concentrated on large or pioneering projects in the industrial, agriculture, infrastructure and other fields. Loans for up to 10 years at 13% (a concessional rate in Brazil) have been made for studies of the following industrial projects: a fertilizer plant; petrochemicals; fish, palm oil and milk processing; cement; and ceramics.

D. What type of administrative machinery has been used?

24. Assistance at the pre-investment stage is most frequently arranged on an adhoc basis as a service to assist entrepreneurs in making their own pre-investment or feasibility studies. Such services are offered by investment promotion agencies; industrial financing institutions may also assist potential borrowers in the course of their evaluation of an application for finance.

25. In some countries the preparation of lists of investment opportunities, preliminary studies of projects and even limited feasibility studies is included as one of the functions of the investment promotion centre; but where the main emphasis is on attracting foreign investors (e.g. Thailand, Jamaica), the preparation of such studies can often take second place. Other countries have started by emphasising the identification of investment opportunities in a specialised institution (e.g. CINDES in Ecuador and the UNIDO-supported Industrial Studies and Development Centre in Tanzania), leaving the investment promotion function to follow on the basis of well-prepared studies.

26. A number of issues arise then: does a developing country need to have a specialised institution to prepare preliminary studies of industrial projects? Or should this be one of the functions of the Government's administrative machinery responsible for planning, investment promotion, or another relevant institution?

27. If machinery exists for preparing preliminary studies of projects and feasibility studies, how far should these studies go before contact is made with a potential investor?

28. If the Government is willing to assist financially with the preparation of feasibility studies by outside consultants for major projects, does this require a separate administrative unit? In large countries (Argentina, Brazil), this may be necessary, but would countries at an earlier stage of industrial development be wise to follow this practice?

29. Finally, can the creation of a specific agency responsible for assistance at the pre-investment stage help to ensure that a Government devotes sufficient effort and financial resources to this type of incentive measure?

E. How effective is this type of incentive measure?

30. Assistance at the pre-investment stage aims (a) at attracting the interest of domestic and foreign investors in promoting specific new industrial projects, and (b) at removing any difficulties or obstacles that they may face in the early stages of the project's formulation.

31. It may be difficult to evaluate how effective this help is if it is used in conjunction with a number of other incentive measures. Nevertheless, the issue arises: have developing countries made the best possible use of the incentive effects of this type of measure?

32. Where assistance at the pre-investment stage has been provided, has it been provided on a sufficient scale supported by an adequate range of qualified staff?

III. SUGGESTED ISSUES FOR DISCUSSION

33. A wide range of issues have been raised in this paper. In order to make the session devoted to this subject of maximum value, it is suggested that discussion might concentrate on the following issues:

34. To bring out the experience of countries represented at the Seminar, participants might indicate:

- (a) To what extent assistance at the pre-investment stage has been provided in their country;
- (b) How important a role has this type of assistance played in promoting investment in new industrial projects?
- (c) If more resources and staff were devoted to this type of assistance, would they be effective?

More general issues which might be discussed include:

- (d) Does this type of assistance need to be made available on a non-selective basis or only to particular types of project?
- (e) What types of project can be promoted effectively with this type of assistance?
- (f) Should the Government contribute to the cost of feasibility studies made by outside consultants
 - (i) for domestic investors, (ii) for foreign investors?





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