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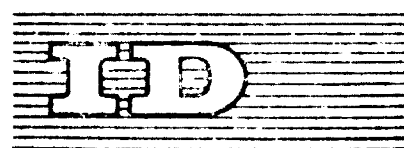

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INDUSTRIAL FINANCING OF PUBLIC MANUFACTURING ENTERPRISES IN TANZANIA [1]

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INDUSTRIAL FINANCING OF PUBLIC MANUFACTURING ENTERPRISES IN TANZANIA

PART A

FINANCING OF PUBLIC MANUFACTURING ENTERPRISES

1. INTRODUCTION: Government Investment Policy for Manufacturing Enterprises in the Public Sector.

Tanzanian public sector investment policy is laid down in the Arusha Declaration. The 1967 document stresses that "to achieve economic justice, the state must have effective control over the principal means of production". Consequently the state participates actively in the economic life of the nation "so as to ensure the well-being of all citizens and so as to prevent the exploitation of one person by another or one group by another and so as to prevent the accumulation of wealth to an extent which is inconsistent with the existence of a classless society".

More specifically this means that national control is required in a number of the processing industries of the major raw materials and foodstuffs. Public sector partnership is required in other manufacturing areas while some areas are kept open for private and/or public participation (See Annex A).

The vehicle assigned the task of controlling these industries is the parastatal organization. Parastatals also enter into separate or joint ventures in the areas where private enterprise operates.

The Tanzanian Government created the parastatal organizations to assume responsibilities and act according to overall financial profitability criteria that would be difficult for the state to exercise since the state mainly uses other performance criteria for its activities.

The largest parastatal is the National Development Corporation. The Arusha Declaration resulted in NDC assuming responsibilities for enterprises in a wide range of sectors from agriculture to tourism.

For greater administrative ease and in order to place each parastatal under the care of one ministry, the government instituted a rationalization scheme in March 1969. NDC comes under the Ministry of Commerce and Industries and is entrusted with the manufacturing and mining sectors. Two other parastatals operate within the manufacturing area - the National Milling Corporation and the Tanzania Sisal Corporation; the Tanzania Petroleum Development Corporation is in the mining sector. These, however, are specialized corporations without the conglomerate character of the NDC.

Starting with the above institutional framework for public manufacturing enterprises we can add the financing policy which in a basic sense is quite simple: "The capital we shall obtain largely from our own efforts - from re-investment income which we earn from our existing industries - and this means from the products of our agriculture". 1/

1/ Arusha Declaration, p. 23

Investment capital is therefore expected to flow from the agricultural to the manufacturing sector via surpluses generated by the export of agricultural products and raw materials. From 1969/70 to 1973/74 NDC is expected to invest about Shs.300,000,000 (most of it in manufacturing). ".....we must increase the proportion of earnings - material well being from industry, and since we want to do it in as short a time as possible, we must expand our growth at the ambitious but feasible rate of 20%;" 2/ this annual rate represents the five year planned investment shown above. Ministerial annual growth ceilings range from 3-10% over the same period.

This paper will examine the financing of public manufacturing in a number of ways. First, the sources of finance are described showing the various domestic and external channels. With the sources in mind, the cost of capital, how that cost is arrived at, and the advantages and disadvantages of using the given sources are discussed together with the future financial requirements of the current five year plan. Some suggestions are given for policy changes to lower the costs of finance and harmonise the use of the numerous sources.

The second part of the paper concentrates on illustrating the financial planning and operations of a public manufacturing enterprise using NDC as the case study. NDC's organisational structure and its relationship with the government are given to place the financial discussion in a proper context. The NDC method of determining the financial requirements of new projects is demonstrated followed by some points on the analysis of commercial and national profitability and cost, pricing, and profit policies. The planning and operations part is concluded by a short discussion on operational efficiency and incentives.

2/ from a speech by the Hon. A.M. Babu, Minister of Commerce and Industries at the NDC General Manager's Conference August 22, 1969.

2. SOURCES OF FINANCE

2.1 Domestic Sources

Since 1964 the decreases in foreign exchange receipts resulting from decreases in the unit prices of agricultural exports, on the world market have more than offset the total amount of foreign aid received by Tanzania. Domestic sources providing foreign exchange are consequently much smaller than they could otherwise have developed.

2.1.1 Government Channels

2.1.1.1 National Budget

Each year the national budget appropriates a certain amount for development expenditure. For 1969/70 this amounts to Shs.676,396,200/- or about 30% of the total budget. Development expenditures are those requiring capital outlays or involving the training of manpower. Maintenance of existing facilities comes under the 70% of the budget which consists of recurrent expenditures.

Since parastatal development has been very rapid and will continue at an even more accelerated pace NDC will have much of its funds tied up in equity of gestating projects. Government will therefore continue to finance about 30% of NDC's annual expenditures over this period.

Over the last five years investment in the national economy rose from about 15% of the GDP to 23% in 1967. The second plan target is 25%.

To achieve this aim the Government has embarked on an administrative austerity program as well as a sales tax on many intermediate goods with a range of [illegible] of value. The funds so generated will allow the current budget and the current plan to finance about 30% of NDC's investment budget although it will more than double over the current five year plan period.

2.1.1.2 Government Lending Institutions

In addition to budgetary allocations, the National Bank of Commerce (a state owned lending institution), makes funds available to the public manufacturing sector. The National Bank of Commerce is the only commercial bank in the country which at present is giving medium term loans. Other commercial banks are the People's Bank of Zanzibar, and the National Cooperative and Development Bank. At present the NBC has no lack of investment funds, the major bottlenecks being properly prepared feasibility studies and inadequate staff to process the applications. The service consists mainly of loans and over-draft facilities. Bank loans and over-drafts are readily available for established NDC companies. New companies without a profit record, or the occasional company in difficulties may require an NDC guarantee for funds received from NBC.

Recently NBC has announced a long-term loan scheme with an initial guideline ceiling of Shs.150m. Purely long-term loan finance will be available for the first time from a commercial bank on a major scale for a maximum period of 10 years plus a three year moratorium. Interest rates are between 7 and 9 percent.

NBC prefers to lend to the public sector and is interested in aiding industrial decentralization as laid down in the Second Plan.

2.1.1.3 Public Funds for Small Industries

Cottage industries are not state owned, but are aided by public funds through the National Small Industries Corporation, (NSIC) a subsidiary of NDC. NSIC owns a number of small workshops and provides working capital for the workers running them but does not decide on the pricing and production policies.

2.1.1.4 Coordination of Policies

Recently steps have been taken to work towards an integrated public sector financial policy. To this end Treasury representative the major public financial organizations and NDC meet from time to time to coordinate their financial policies and activities.

2.1.2 Private Sector Channels

The Arusha Declaration states "NO TANU" or Government leader should hold shares in any company (and) no TANU or Government leader should receive two or more salaries.

The definition of a leader includes a salary level from slightly over Shs 1,000 a month. Consequently there are very few people able to invest directly in public manufacturing enterprises. Indeed it is intended that the majority of private savings be indirectly channelled through:

a) the Commercial Bank and the Government Trustee's list of approved investments, which consists mainly of government securities;

b) the Permanent Housing Finance Co. of Tanzania Ltd.

c) the Post Office Savings Bank; and

d) Credit Unions;

From this list of institutions mobilizing private savings only NBC will invest in public manufacturing.

This still leaves some room for mobilizing private savings for public manufacturing without directly competing with government issues. The instrument created for this purpose by NDC is the Tanzania Finance Company (TAFCO). TAFCO is a subsidiary of NDC with Industrial Promotion Services the National Insurance Corporation the National Provident Fund and the National Bank of Commerce as the other major share holders.

TAFCO is intended as a source of funds from the private sector to purchase equity from the public manufacturing sector, thus freeing development finance for more new projects. Over the last two years TAFCO has been expanded, stabilized, and a divided record established. It is now ready for public participation once governmental approval is obtained.

Since the propensity to save in less developed countries is quite low, direct investment from the private sector will continue to be limited. A major reliance for saving in the economy is therefore placed on the tax system. Parastatals which do not have to pay dividends but can plough back their earnings into development are another way of reducing consumption expenditures. Even if the propensity to save were high, there would be no guarantee that investment would go into priority projects and sectors. Taxes and parastatals rather than a reliance on the private sector remain as instruments for the mobilization of development funds.

It is expected that the public manufacturing sector will provide 30 percent of its own development finance over the current five year period starting 1/7/69. In effect there are a large number of new enterprises where new funds are needed and a small number of relatively large enterprises (notably diamonds, beer, salt, tobacco and meat processing) that can expand from retained earnings and still pay dividends for group development.

2.1.3 Internal Channels

Over the last five years the manufacturing sector has doubled in size to where it now accounts for 7 percent of the gross domestic product. Starting from a small base requiring a high growth rate and diversification, has prevented retained earnings to be the major source of public manufacturing finance.

2.2 External Sources

2.2.1 Loans and other forms of Financing facilities

Tanzania has begun to see dividends reinvested by foreign partners in other NDC projects. It is hoped that the stability and growth potential offered by associating with the NDC group will make dividend reinvestment a regular feature in the NDC community.

An important source of loans comes from bilateral arrangements. Denmark and Sweden are prominent in this respect. Similar terms have been obtained from foreign banks notably in France and Japan. Most of these loans finance a portion of local costs and some are not wholly tied to purchases in the donor country. Terms range from "soft" in the case of bilateral loans to the lower commercial range for foreign banks.

Additional finance comes in the form of medium and long-term supplier and buyers credits. The nominal interest cost is usually low being about 6%. Real costs have not been assessed in detail but it is estimated that they exceed those of multilateral commercial loans. Since most manufacturing projects have a gestation period of some years, and the shorter term credits carry a heavy burden of debt servicing in the early years of a project, NDC wishes to rely less in the future on this type of financing facility.

2.2.2. International Financial Institutions

NDC receives little finance from international financial institutions. Only the East African Development Bank has loaned NDC some substantial funds at an interest rate of 8 percent to finance two projects. The ventures consist of a tyre factory, and a bicycle factory, for which the total EADB loans amount to Shs.11.75 m. A loan for a coconut processing plant is under consideration. Because NDC is a government organization it is not able to obtain funds from the International Finance Corporation

which limits its assistance to the private sector. NDC revenue producing projects however lie within the terms of reference of the International Development Agency; IDA loans are interest free, have long maturities and grace periods.

Besides the above mentioned World Bank affiliates multilateral loans are available on better than commercial terms from the International Bank for Reconstruction and Development itself. Another multilateral source could be the African Development Bank.

2.2.3 Joint Ventures

By far the greatest source of external finance in the public manufacturing sector comes through joint ventures with private firms. Of the development funds which are externally financed, the majority represents joint ventures.

Foreign firms wanting to expand into Tanzania usually find a certain amount of additional security and stability in associating with the NDC group of companies. Foreign investment is initially protected by the Foreign Investment (Protection) Act.

Joint ventures are further encouraged by the Tanganyika Development Finance Company (TDFL) an associate of NDC which gives loans and equity financing to private ventures establishing in Tanzania. TDFL has an issued share capital of Shs[illegible] million which is held in equal proportions by the NDC, the Commonwealth Development Corporation, the Deutsche Gesellschaft fuer wirtschaftliche Zusammenarbeit and the Netherlands Overzeese Financierings-Maatschappij.

3. [illegible]

3.1 Opportunity Cost of Government Grants and Subsidies

Little work has been done to calculate the opportunity cost of government grants and subsidies although the policies adopted by the current plan such as the regional equalisation policy, [illegible] some implicit value for opportunity cost as well. The opportunity cost criteria is only a financial measure, [illegible] however also places [illegible] value on the [illegible] and social aspects of development. Hence a financial measure of relative returns although significant, is not always of major importance in the allocation of resources.

With regard to the public manufacturing sector government policy has been to avoid grants and especially subsidies wherever possible. Investment in the equity of viable enterprises is preferred to grants. More recently government investment in [illegible] has concentrated on loan capital. [illegible] equity and loan capital are therefore more relevant to analysis than the opportunity costs of grants and subsidies.

Government is taking steps at the present time to co-ordinate the criteria for cost determination. The second plan calls for "a high level committee [illegible] evaluation of projects". The Committee would establish criteria for appraisal and desired rates of return on investment to be used in project evaluation.

Provisional standards for interest are given in the plan with the view that these would be studied more thoroughly and revised from time to time by the "[illegible] Committee". The interest rates are then given as follows:

	Target for	
	National Economy	**Parastatal and Private Enterprises**
i) Minimum return on risk capital:		
local currency	8½	12 */
foreign currency	6½	6½
ii) Long term loans:		
local currency	5½	6½
foreign currency	6½	8 **/
iii) Short term loans:		
local currency	[illegible]	[illegible]

3.2 Cost of Equity and Loan Capital

The cost of equity capital is usually agreed to be the compensation that has to be paid to the shareholders for them to retain their funds in the company. This will, of course, include a component for foregoing consumer expenditure during the period of the investment. If the size of the compensation is less than the shareholders expect, they will, over time, transfer their money to other investment, so reducing the market value of the company. This is described as the implicit cost of capital, reflecting the shareholder's opportunities to invest outside the firm.

Usual methods for computing the cost of equity capital use some measure based on dividend yield or earnings yield.

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*/ before tax

**/ based on normal rate of 8%

Basically the theory has some relevance in the Tanzanian case but the methods do not. NDC headquarters is wholly owned by the government - there can be no market for its shares. The cost of capital from government sources to NDC is determined by:

a) rates of return as set out above in the provisional criteria and changed from time to time by the "Policy Committee"

b) explicit valuations by the government of the opportunity costs of investing in the sectors open to them.

c) social priority considerations

d) negotiations with NDC

Similarly for the cost [illegible] loans from the Treasury of the [illegible] the interest rate arrived at was [illegible] 3/4%. Long-term and intermediate term loans range from [illegible] 3/4 - [illegible]% for NDC. These include bilateral arrangements and foreign bank loans, Suppliers' credits [illegible].

Capital costs for NDC group companies are somewhat different since many are joint ventures with external financing. In the absence of a stock market and established dividend records NDC equity investments are normally valued using the rate [illegible] of return [illegible]. The usually required rate is [illegible]% after tax [illegible] as a rate of return achievable [illegible] gives the prevalent equity to loan [illegible] satisfying debt requirements. NDC loans to group companies [illegible]% for long-term loans and [illegible]% for short-term deposits [illegible] loans from [illegible] group companies generally fall in the range of [illegible].

Partners' equity capital costs to group companies vary over a wide range. In the older established companies with marginal expansions, the various measures of dividend yield and earnings yield do apply. Empirical studies of the cost of capital supplied by partners have not yet been made; the costs would be expected to range from [illegible]-25%.

When new proposals are submitted [illegible] examines the cost of partners' equity. Generally a rate of return on investment significantly above [illegible]'s [illegible]% will be judged excessive for import substitution enterprises. The projected dividend yield is also to be kept at or below the [illegible]% figure especially in the initial years of production.

Recently, however, [illegible] has examined a small number of projects which are desirable from the social welfare point of view and which, in spite of [illegible] (as opposed to social welfare) accounting, profitability may be low, [illegible] number of these projects are [illegible] for their foreign exchange effects, balance of payments effects, employment effects, or because they provide [illegible] of the industrial base and decentralization of industry to foster regional development. These projects require [illegible] substantial equity for which [illegible] investors cannot expect the commercial rate of return.

An assessment of the social welfare and intangible aspects is made to consider at what capital cost the project is feasible; then negotiations with the sources of finance are made for funds within the allowable cost range.

3.3 Cost of Retained Earnings

Normally the cost is calculated at 15% since this is the minimum rate that could be obtained in many areas of the NDC group.

Companies considered to be in difficulties are nevertheless given assistance if their long term prospects are good or if they fall into the small category where social accounting principles are of primary importance.

4. COMPARATIVE ADVANTAGES AND DISADVANTAGES OF THE VARIOUS SOURCES OF FINANCING PUBLIC MANUFACTURING ENTERPRISES

4.1 Government Policy on Sources of Finance.

As stated earlier, the main policy on sources of finance is a lowering of the sights for external finance to a realizable level. There are a number of reasons for this move.

The first plan had envisaged a high proportion of external finance for development which did not materialize. Domestic efforts were however considerably more effective than expected. As a result the current plan calls for only 35-40 per cent external finance on the parastatal development program.

The government also feels that the aims and policies of some external sources of finance may be incompatible with the aims of Tanzania and its projects. To accept finance under such circumstances may often be undesirable for a country that does not wish to compromise its development policies.

In addition Tanzania wishes to have firm control over the key industries as outlined in the Arusha Declaration. External participation in these areas is therefore limited to a maximum of 50%. In the other manufacturing areas joint ventures are encouraged.

Domestic savings, or rather investment mobilization, is of the greatest importance and it is felt that a dependence on foreign finance can reduce the domestic savings effort. This is meant in no way to bar external finance on favourable terms for Tanzania's public manufacturing sector.

Indeed external capital inflows are considered a useful source of foreign exchange for the machinery imports and technical assistance required in manufacturing. At the same time a close watch is kept on the terms offered so as not to impair the sector's debt servicing ability. Tanzania is, for example, presently concerned about the recent and rapid increases in bank rates in Europe and elsewhere. Interest rates for new commercial loans have climbed in many instances to 9½%. If the cost of foreign exchange goes above the 9½% Tanzania may find external commercial loans prohibitive due to their expense.

4.2 Advantages and Disadvantages of Supplier Credits

National policy as reflected in the second five year plan deemphasizes supplier credits, for these are seen as essentially of a short-term nature. NDC's supplier loan credits are, however, more of an intermediate term length of about 5 to 13 years. It is reasonable in this case to continue using these credits as long as competitive interest rates and the intermediate term nature are available; although at the same time taking every advantage available to replace these with multilateral soft loans.

NDC realizes that in many instances inflated supplier prices and other terms such as required shipping in the vessels of the credit giving country may outweigh the otherwise favourable credit terms. In such cases government to government industrial credits would be an improvement. A multilateral loan would be better still since all purchases of goods and services would be done at world prices.

NDC's experience with multilateral finance has not been altogether happy. When the corporation operated in a multisectoral capacity, loan applications for projects in non-manufacturing sectors were made. The World Bank group has taken up to three years to arrive at the stage where funds are actually paid over to the project in question. NDC estimates the processing time for multilateral finance applications to range from one to three years, i.e. considerably longer than it takes to arrange long term supplier credits. A development plan that seeks to more than double industrial capacity in five years leaves little room for unreasonable delays in project implementation while searching for the most appropriate source of finance. This has meant that NDC projects are made less viable than they would otherwise be. The costs to the economy of delaying many of the projects are simply assessed to be higher than the decrease in potential profitability owing to the loss, or short notice, of multilateral finance.

4.3 Advantages and Disadvantages of Joint Ventures

A substantial number of manufacturing projects are initiated by external companies seeking joint ventures or expansions in Tanzania. Joint ventures with NDC participation are especially desirable as foreign exchange is not spent while retaining local control over the enterprise. Although the majority of these ventures are well-meaning and seek only a reasonable rate of return, NDC has found those that do not comply with its policies.

For example, some proposals seek to jump the external tariff barrier by simply locating in Tanzania. While some equity and loan capital is offered, the raw materials and equipment are almost totally imported, the value added low, and the employment effect negligible. There may be sizable concessions required, such as remission of import duty on the raw materials, a monopoly or barring of competing imports, and a large payment for royalties. Technical management agreements may be another feature. Still other proposals with token external [illegible] and loan features in reality are only a means by which machinery sellers with inflated costs avoid the normal supplier credit terms, which turn out on balance to be much more liberal.

The price to the consumer often remains the equivalent of the former total of the previous import price plus duty. High profits are reaped and sent abroad, the effect on the national budget is strictly negative.

While the number of proposals with features as shown above remains small, careful screening and analysis is required from the project evaluation staff to ensure that costly and often irreparable mistakes are not made when the submission is one of "project cum finance".

Some of the same problems appear in external financing of technical assistance where a project, experts and finance all come from one source. Although in many cases the machinery source and experts cannot be separated owing to the special nature of the equipment, Tanzania has found that where possible, a better control of technical assistance can be exercised by drawing on several countries and mixing one-country expatriates with Tanzanians and expatriates on private contract with Tanzania.

4.4 Advantages and Disadvantages of Domestic Sources

The second major category of advantages and disadvantages in the sources lies in the field of domestic financing. The basic problem appears to be the degree and level of control that the parastatal should have in the financing of public manufacturing.

The question inevitably involves profit and tax policies for parastatals as well as the type and terms of financing by government channels. The problem is dealt with presently on an ad hoc basis from time to time as exigencies arise.

Profit policy is also discussed further below but at this stage we can note that if profits are high given a proportional tax structure, the parastatal will be able to finance more out of retained earnings. On the other hand profits can be set lower by lowering the price to the domestic consumer and the tax system (such as the recently imposed sales tax) could be used to bring the price to what it was before. The financing would then have to come primarily from government channels. At this stage the 15 per cent return on capital necessitates high profits but suggestions for a lower rate of return have been made. The optimum policy mix, which would see a trade off between retained earnings and government sources (to attain a desired investment level) to enable a better coordination with other plan instrument variables, has not been devised.

[illegible] management believes that in light of the fact that econometric studies of this nature have not been made, a reasonable policy is to keep the rate of return at 15% or slightly less. This would continue to ensure that internal sources remain at about [illegible] of total required finance over the next few years.

NDC is consequently in a position where less than one third of headquarters' investments should be in equity form. This contrasts with the government policy charging NDC to invest mainly in equity. The situation is compounded by the fact that government sources supply NDC only with loan finance. In the end some of the loans have been used for equity but this is an extremely undesirable state of affairs.

Since 1966 NDC's equity to loan ratio has dramatically fallen from 18:1 to where it is currently 2.2:1. Management is of the opinion that unless NDC can obtain more equity funds, its opportunities to raise finance on the open market are seriously circumscribed, leaving it to rely mainly on more government loans. On the other hand, government has stated that it wishes to see a point where NDC would depend much less on government sources - this however is difficult to forsee at the present time for the above mentioned reasons.

As NDC Headquarters' loan account has increased while its capital account has not increased at the same rate as its loan capital, so also its debt servicing ratio has fallen to a point where income is now roughly only about twice debt servicing charges. Internal sources which can provide equity cannot be increased, already being at a very high rate of return and so more equity must be found from government or external sources.

Although the private sector (TAFCO) could partly fill this gap once the public participates, it is not expected that it could become large enough to fill more than a portion of the requirements.

PART B.

FINANCIAL PLANNING AND OPERATIONS OF PUBLIC MANUFACTURING ENTERPRISES

1. INTRODUCTION:

Organisational Structure of Public Manufacturing Enterprises and their operational relationship with controlling authorities (Government).

For reasons discussed previously, public manufacturing is entrusted almost entirely to the parastatal organizations. The National Development Corporation and the National Milling Corporation were both set up by an act of parliament. NDC is used for the case study for two reasons. First, the lack of a typical representative enterprise, plus the small size of many firms would make the study of one enterprise uninteresting. Second, since NDC comprises most of the public manufacturing sector and therefore a channel for the sources of funds, an analysis of the NDC group is at once both specific, for it deals only with NDC and general for it speaks virtually for the whole of the public manufacturing sector.

The aims of NDC as given in the legislation which established it are to facilitate and promote economic development and the participation of other persons and bodies in the economic development of the country. Moreover, the corporation "shall use its best endeavours to secure that its business as a whole is carried on at a net profit, taking one year with another".

When a decision was reached to rationalize parastatals by sector, the means used was the Presidential Order. The Act and the Order constitute NDC's terms of reference, rights and responsibilities.

NDC consists of subsidiary and associate companies. Policies are formed and controlled through NDC representation on the board of directors of each company. Direct intervention in the day running of the enterprises is kept to a minimum and then usually only at the request for assistance from the group company. There is however a system of monthly and quarterly management information reports instituted for the group and processed by NDC's operations department. The reports deal with the physical situation as well as the financial, and measures performance relative to each company's plan.

NDC Headquarters is divided into the General Manager's Office plus six departments: Planning and Finance, Operations, Development, Executive Development, Accounting, Administration. The Operations Department deals with the running and reporting on the recurrent operations of the existing group companies.

Before rationalization the NDC board consisted of government ministers and leaders, and members from private enterprise and the senior academic community chaired by the Minister for Economic Affairs and Development Planning. Government Ministers were in the majority.

This arrangement ensured that government policies were translated into practice, as all projects and investments have to be approved by the NDC Board.

The rationalization exercise served to bring NDC under the Ministry of Commerce and Industries, the board to be chaired by the Minister responsible. Development plans are usually based on a sectoral framework and the change also facilitated a much more detailed account of what NDC would be expected to do over the current plan period.

Successes and shortfalls can now be measured more easily against the expected performance of the manufacturing sector and the ministry responsible for that sector.

Government budgetary allocations for finance to NDC are then based on NDC's plan, consisting of the list of projects to be undertaken over the next two years, the budget, and cash flow forecast.

2. PLANNING (FORECASTING) FINANCIAL REQUIREMENTS FOR NEW INDUSTRIAL ENTERPRISES

2.1 Constructing the Financial Section of the Feasibility Study

New Enterprises start as projects and financial requirements are part of the overall feasibility study conducted by the Development Department. The basic financial data are collected and estimates are made of:

Revenue
Operating Costs
Capital Costs
Working capital requirements

and all assumptions and trends are clearly stated on detailed standard worksheets. Costs and revenues are broken down into their component parts according to established procedures. Foreign exchange data is segregated from local currency data. Next profitability is calculated using both the Discounted Cash Flow and Pay Back Methods.

2.1.1. Profitability

The calculated return on the project investment is then compared with the minimum acceptable rate of return for the relevant type of projects. This comparison provides the primary basis for judging whether the project should be promoted by NDC. The minimum acceptable rate is determined by the weighted average cost of capital funds available to NDC and an allowance (plus or minus) to reflect priorities attached to projects in particular sub-sectors. The Pay Back period is entered as a secondary measure in the evaluation.

Financial requirements and profitability are then assessed for uncertainty by first calculating what would be the effect on the estimated return on investment of a change in the value of the individual elements making up the net cash flows. This is done in three steps:

First the key factors that will influence future costs and revenues (e.g. unit sales, costs, investment) are identified.

Secondly, the probable range of variation in the estimates for these key factors is noted from experience and trends in the particular industry.

Thirdly, the effect of the more favourable and unfavourable outcomes in each respect (i.e. higher costs, lower sales volume), is calculated on the total return of investment.

The extent of possible variations on return of investment and the resultant financial requirements is calculated explicity and presented to top management as that they can judge how likely the worst outcome is and how willing they are to accept the risk of it.

2.1.2 The financial Forecasts

A major part of planning financial requirements involves establishing a financial structure and identifying and managing sources of finance through to the completion of the project. The Development Officer will list the project's cost and investment items in the Financial Forecasts covering the implementation and initial operating phases. These forecasts show the amount (identifying local and foreign currency) and timing of every project cost on a quarterly basis. The project cost , which were estimated in the profitability calculations, are ressessed on the basis of the detailed technical feasibility work. The forecasts include also financial costs.

These financial plans are a key element in finalising the financial structure of the project during implementation and early operations of a new enterprise. They also provide basic data used in the raising and managing of funds during implementation.

2.1.3 Establishing the financial structure

The plan for the project's financial structure reflects the changing requirements of the project through (i) the implementation phase, when the timing of cash flows is liable to rapid changes; (ii) the initial operating phase, when preliminary costs and start-up losses are [illegible]; and then (iii) the going concern phase, when the project is being run at the expected level of operation and is financed by usual sources of commercial finance.

When the total project costs and revenues have been revised, the form (loan or equity) in which capital should be provided is determined. This is done separately for the two sets of financial requirements (implementation and start-up). Then, in preparation for negotiations, the total financial needs and potential sources of funds are set out in a Summary Financial Plan. The financial structure of each project will depend on a number of factors - including the recommended form of VDC's participation, partners, type of business, asset structure, managing and marketing contracts - and therefore must be arrived at by specific calculations of these factors. The following paragraphs represent general VDC guidelines for establishing a suitable financial structure.

a) **General**

In most investment opportunities [illegible] requires control and yet at the same time wishes to spread its available investment [illegible] as many profitable development projects as possible. [illegible], [illegible] share of long-term or short-term loans should be no more than its share of equity.

Ratio of debt to equity – the relationship between funds that are loaned to the project for one year or more at an interest rate and shareholders' capital – should be at least [illegible]. In [illegible] special case would long-term debt [illegible] shareholders' funds.

b) **Specific**

Equity funds should generally finance basic assets – land, buildings, basic plant and the initial establishment costs including start-up losses. Long-term loans finance operating assets – machinery, [illegible], and basic raw materials. Short-term funds, to provide working capital for sundry debtor financing, stocks, and other cash and near cash assets, are obtained from the National Bank of Commerce and, on a temporary basis, from the projects' shareholders.

The long-term debt/equity financing is reviewed when the project has become a going concern. It is important to confirm, once the level of stocks and the repayment performance of debtors have been established in practice, that the enterprise has been adequately capitalized. Naturally, care must be taken to ensure management is properly controlling these activities.

2.2 The Raising of Funds

The fund raising stage is next. The cash flow forecast clearly demonstrates when and how much money the project needs. This detailed document is used, not only to control the financial performance of the implementation but also to raise and co-ordinate funds from the sources of finance.

Prime responsibility for planning and conducting negotiations to obtain finance rests with the Director of Planning and Finance. He contacts financial institutions and solicits their support for the project. He presents the financial plan and supporting agreements for approval by the NDC Board.

3. ANALYSIS OF COMMERCIAL AND NATIONAL ECONOMIC PROFITABILITY

Little work has been done on analysing national economic profitability. In general the government applied a rule of thumb minimum 10 per cent commercial return on most of its projects once they are in the going concern phase. The time allowed to reach this stage was approximately five years.

More recently the Second Plan was given provisional criteria as outlined above in Part A 3.1. The proposed Rules Committee would through research establish improved criteria and levels. Overall the annual growth rate of Tanzania's GDP 1964-9 was about 5%; the expected rate 1969-74 is 6½% in real terms.

NDC calculates commercial profitability for its projects and then applies the general and specific National plan guidelines dealing with sub-sectoral priorities, regional development, and social development.

The major analysis of commercial profitability is made by using the Discounted Cash Flow method to determine the expected return on investment. The DCF analysis takes into account:

a) the total cash flow generated by a project over its life;

b) the <u>timing</u> of the cash flow. Thus it reflects the fact that funds immediately available for reinvestment are worth more than funds available in the distant future. A different approach is of course used on mutually exclusive projects.

The completion of this analysis consists of three steps, extracting the cash flows from the market data, operating costs and capital requirements; calculating the income tax effects; and computing the profitability rate. Thus in the final step the rate of interest is calculated which will recover the net capital outlay (which excludes finance costs) and yield a specific return on investment. This rate of return is determined by applying compound interest tables to the cash flows in a Profitability Calculation Schedule.

As outlined further above, the rate of return is then compared with the minimum acceptable rate and the project profitability is further assessed for uncertainties.

4. COST, PRICING AND PROFIT POLICIES FOR PUBLIC MANUFACTURING ENTERPRISES

4.1 Government Guidelines and Policies

The Government's guidelines for public manufacturing are fairly simple and are used in the absence of specific policies on these issues. Public manufacturing is expected to make enough profit to be independent from government subsidies. In the case of import substitution the locally made good should not generally be priced higher than the import which is being substituted plus the existing revenue duty on that good.

Labour costs are somewhat controlled by a wages policy which limits annual increases to a maximum of 5 per cent. Parastatal staff salary ranges are held constant by a government directive bringing them in line with civil service salaries.

Cost and pricing may at times come under the economics of monopsonies and monopolies since both are encouraged in an economy with scarcity of capital but with a desire for the economies of scale. Government intervention can, however, come at any time with ample precedents existing. Some agricultural foodstuffs have a fixed maximum price to the consumer. Agricultural produce to the processing plant may also be priced by the government at a level calculated to give the manufacturer a reasonable rate of return.

4.2 NDC Guidelines

NDC advocates a fairly high - about 15 per cent - rate of return to enable profits to be ploughed back directly into new ventures and thus keep up a growth rate which is significantly higher than the [illegible] percent population increase per annum. The Second Plan calls for a yearly increase in investments in public manufacturing of the order of [illegible] per cent.

4.3 The NDC Management Plan

Policies and individual company objectives are by 1970 to be implemented via the NDC Management Plan. Companies state their objectives and strategies to reach them. NDC provides a frame for reference by supplying view-of-world assumptions on which companies base their plans. In the first year of the annual plans draft plans submitted by companies will be assessed for validity, consistency with NDC policies, and coordinated by the head office. Once finalized, the plans will begin operating on the first of January, 19[illegible]. More and more details and sophistication will be introduced in the plans as planning experience accumulates.

5. [illegible]

5.1 Group Company Efficiency

Group company efficiency and performance is gauged by the company monthly and quarterly reports. The Financial Operating Summary gives production, sales, cost of sales, gross profit and trading expenses. Actual figures are compared to plan for the current period and year-to-date. A statistical analysis section gives unit breakdowns: units sold, produced, raw material usage, inventory position, and production efficiency. Another section gives changes in working capital and any significant capital expenditure.

Basic to all these sections of the monthly report is the required explanation of any variances from the previously approved plan. In addition the Operations Officer responsible for a given company writes a detailed comment on sales and production performance, expense control, and liquidity and sundry debtors management.

The documents remain brief, designed for a system of management by exception.

On the whole plants are often less efficient than their competitors in developed countries. The price to the consumer may even be higher than the price of the import less the duty on it. In such a case there may be a loss in import duties that is not compensated by taxes paid with a resultant adverse effect on national revenues. In these instances the other effects have been estimated to outweigh the budget effect; i.e., linkage effects, employment effect, training of nationals, and various longer run effects on the enterprise and the economy.

To ensure management and technical efficiency, the President has stated that the Africanisation policy is not designed to replace or place unqualified Africans into positions that can otherwise be filled by expatriates.

5.2 STC Headquarters Efficiency

STC Headquarters efficiency and performance are checked by departmental monthly and quarterly reports. Expenditures are shown against budget with explanations for any variances. Progress on various action programmes is outlined and compared with the previous month. Monthly reports are discussed at executive meetings whereas quarterly reports go to the STC Board.

5.3 Incentives

Official government policy has so far been to exclude incentives from the socialist economy. Recently the policy on incentives has changed, and the Standing Committee on Parastatals has asked for the investigation and development of incentive schemes. Research is now underway to construct a viable and dynamic incentive program compatible with the country's socialist objectives.

ANNEX A.

Government Participation in the Manufacturing Sector

Types of Government Participation

1. CONTROLLED - Basic industries in which government usually requires 50-60% of the participating shares.

2. PARTNERSHIP - Industries upon which a large section of the population depends upon for their living, or which provide essential components for other industries. Government or its agent will play an active role although not necessarily holding a controlling interest

3. OPEN - All other industries. These industries are open to all investors including government, local and foreign private investors.

Manufacture of Food, Beverages and Tobacco

Food manufacturing	
Slaughtering, preparing and preserving meat	PARTNERSHIP
Manufacture of dairy products	PARTNERSHIP
Canning and preserving of fruits and vegetables	PARTNERSHIP
Canning, preserving and processing of fish, crustacea and similar foods	PARTNERSHIP
Manufacture of vegetable and animal oils and fats	PARTNERSHIP
Grain mill products	CONTROLLED
Manufacture of bakery products	OPEN
Sugar factories and refineries	CONTROLLED
Manufacture of cocoa, chocolate and sugar confectionery	OPEN
Manufacture of food products not elsewhere classified	OPEN
Manufacture of prepared animal feeds	PARTNERSHIP
Distilling, rectifying and blending spirits	CONTROLLED
Wine Industries	CONTROLLED
Malt Liquors and malt	CONTROLLED
Soft Drinks and carbonated waters industries	OPEN
Tobacco Manufacture	CONTROLLED

Textile, Wearing Apparel and Leather Industries

Manufacture of textiles spinning, weaving and fishing textiles	PARTNERSHIP
Manufacture of made-up textile goods except wearing apparel	OPEN
Knitting mills	OPEN
Manufacture of carpets and rugs	OPEN
Cordage, rope and twine industries	OPEN
Manufacture of textiles not elsewhere classified	OPEN
Manufacture of wearing apparel, except footwear	OPEN
Manufacture of leather and products, of leather, leather substitutes and fur, except footwear and wearing apparel	
Tanneries and leather finishing	CONTROLLED
Fur dressing and dyeing industries	OPEN
Manufacture of products of leather and leather substitutes except footwear and wearing apparel	OPEN
Manufacture of footwear, except vulcanized or moulded rubber or plastic footwear	PARTNERSHIP

Manufacture of Wood and Wood Products, including Furniture

Manufacture of wood and wood and cork products, except furniture	
Sawmills, planing and other wood mills	PARTNERSHIP
Manufacture of wooden and cane containers and small cane ware	OPEN
Manufacture of wood and cork products not elsewhere classified	OPEN
Manufacture of furniture and fixtures, except primarily of metal	PARTNERSHIP

Manufacture of Paper and Paper Products; Printing and Publishing

Manufacture of paper and paper products	CONTROLLED
Manufacture of pulp, paper and paperboard	PARTNERSHIP
Manufacture of pulp; paper and paperboard articles not elsewhere classified	OPEN
Printing, publishing and allied industries	PARTNERSHIP

<u>Manufacture of Chemicals and of Chemicals, Petroleum, Coal Rubber and Plastic Products</u>

Manufacture of industrial chemicals	
Manufacture of basic industrial chemicals except fertilizers	PARTNERSHIP
Manufacture of fertilizer and pesticides	PARTNERSHIP
Manufacture of synthetic resins plastic materials and man-made fibres except glass	PARTNERSHIP
Manufacture of other chemical products	
Manufacture of paints, varnishes and lacquers	OPEN
Manufacture of drugs and medicines	CONTROLLED
Manufacture of soap and cleaning preparations, perfumes, cosmetics and other toilet preparations	OPEN
Manufacture of chemical products not elsewhere classified	OPEN
Petroleum refineries	CONTROLLED
Manufacture of miscellaneous products of petroleum and coal	PARTNERSHIP

Manufacture of machinery except electrical

Manufacture of engines and carbines — PARTNERSHIP

Manufacture of agriculture machinery equipment — PARTNERSHIP

Manufacture of metal and wood working machinery — PARTNERSHIP

Manufacture of special industrial machinery and equipment except metal and wood working machinery — PARTNERSHIP

Manufacture of Office, computing and accounting machinery — PARTNERSHIP

Machinery and equipment except electrical not elsewhere classified — PARTNERSHIP

Manufacture of electrical machinery, apparatus, appliances and supplies

Manufacture of electrical industrial machinery and apparatus — PARTNERSHIP

Manufacture of radio, television and communication equipment and apparatus — OPEN

Manufacture of electrical appliances and housewares — OPEN

Manufacture of electrical apparatus and supplies not elsewhere classified including lighting equipment	PARTNERSHIP
Manufacture of transport equipment	
Ship building and repairing	PARTNERSHIP
Manufacture of railroad equipment	CONTROLLED
Manufacture of motor vehicles	CONTROLLED
Manufacture of motorcycles and bicycles	CONTROLLED
Manufacture of aircraft	CONTROLLED
Manufacture of rubber products Tyre and tube industries	CONTROLLED
Manufacture of rubber products not elsewhere classified (mainly very small scale)	OPEN
Manufacture of plastic products not elsewhere classified	PARTNERSHIP
<u>Manufacture of Non-Metallic Mineral Products, except Products of Petroleum and Coal</u>	
Manufacture of pottery, china and earthenware	OPEN
Manufacture of glass and glass products	PARTNERSHIP

Manufacture of other non-metallic-mineral products	
Manufacture of structural clay products	**OPEN**
Manufacture of cement, lime and plaster	**CONTROLLED**
Manufacture of non-metallic mineral products not elsewhere classified	**OPEN**
Basic Metal Industries	
Iron and steel basic industries	**CONTROLLED**
Non-ferrous basic industries	**CONTROLLED**
Manufacture of Fabricated Metal Products, Machinery and Equipment	
Manufacture of fabricated metal products, except machinery and equipment	
Manufacture of cutlery, hand tools and general hardware, (arms CONTROLLED 100%)	**PARTNERSHIP**
Manufacture of furniture and fixtures primarily of metal	**PARTNERSHIP**
Manufacture of structural metal products	**PARTNERSHIP**
Manufacture of fabricated metal products machinery and equipment not elsewhere classified	**PARTNERSHIP**

Manufacture of transport equipment not elsewhere classified | OPEN

Manufacture of professional and scientific, and measuring and controlling equipment not elsewhere classified, and of photographic and optical goods

Manufacture of professional and scientific, and measuring and controlling equipment, not elsewhere classified | OPEN

Manufacture of photographic and optical goods | OPEN

Manufacture of watches and clocks | OPEN

Other Manufacturing Industries

Manufacture of jewellery and related articles | OPEN

Manufacture of musical instruments | OPEN

Manufacture of sporting and athletic (arms: 100% controlled) | OPEN

Manufacturing industries not elsewhere classified | OPEN

[illegible]

Period covered [illegible]

Report Number [illegible]

DATA ITEM (Sh. [illegible])	[illegible] 2 3 4 5 6 [illegible]	[illegible]	[illegible]	[illegible]
[illegible] revenue (Exhibit [illegible], Item [illegible])				
[illegible] operating costs (Exhibit [illegible], Item [illegible])				
[illegible] before tax [illegible] less Item [illegible]				
[illegible] payments				
[illegible] savings allowances				
[illegible] payable				
[illegible] (Exhibit [illegible], Item [illegible])				
[illegible]				

Date________

Page____ of_____

[illegible]	PROJECT [illegible] STATISTICS	EXHIBIT X

[illegible]

	1	2	3	4	5	6	7	8	9	10	SUM OF PRESENT VALUES (Shs.000)
[illegible]*											
Trial Discount Rate [illegible]											
Resultant Present Value (Shs.000)											
Trial Discount Rate [illegible]											
Resultant Present Value (Shs.000)											
Trial Discount Rate [illegible]											
Resultant Present Value (Shs.000)											
Trial Discount Rate [illegible]											
Resultant Present Value (Shs.000)											
[illegible]**											
Trial Discount Rate [illegible]											
Resultant Present Value (Shs.000)											
Trial Discount Rate [illegible]											
Resultant Present Value (Shs.000)											
Trial Discount Rate [illegible]											
Resultant Present Value (Shs.000)											
Trial Discount Rate [illegible]											
Resultant Present Value (Shs.000)											

*Exhibit [illegible], Item [illegible]

**Exhibit [illegible], Item [illegible]

Date ____ Page ___ of ___

ITEM	TOTAL COST	FOREIGN CURRENCY COMPONENT (CONVERTED TO Shs.000)	LOCAL CURRENCY	QUARTER 19.. FOREIGN	LOCAL
[illegible]					
[illegible] survey fees					
[illegible] consultants' fees					
[illegible]ment					
[illegible]					
[illegible]					
[illegible]					
[illegible] houses					
[illegible]ilities					
[illegible]					
[illegible]					
[illegible] vehicles					
[illegible] and equipment					
[illegible] fees					
[illegible]					
[illegible] and overheads*					
[illegible] site manager)					
[illegible] and subsistence					
[illegible]					
[illegible]ity and water					
[illegible] on funds					
[illegible] costs					
[illegible] fees					
[illegible]					
[illegible]					
[illegible]					
[illegible]					
[illegible] contributions					
[illegible] of Commerce					
[illegible]					
[illegible] assistance					
[illegible]					
[illegible] credits					
......					
[illegible]					

Period Covered ______________________________

Report Number ______________________________

QUARTER 19..		QUARTER 19..		QUARTER 19..		QUARTER 19..		QUARTER 19..	
FOREIGN	LOCAL	FOREIGN	LOCAL	FOREIGN	LOCAL	FOREIGN	LOCAL	FOREIGN	LOCAL

N D C

FINANCIAL FORECAST: START UP AND INITIAL OPERATIONS

Shs.000

To ______________________________

From ______________________________

ITEM	TOTAL	QUARTER 1	QUARTER 2	QUARTER 3	QUARTER 4
[illegible]S					
[illegible] CAPITAL					
[illegible]					
[illegible] formation costs					
[illegible] fees					
[illegible] fees					
[illegible] sales					
[illegible] agreements					
[illegible] rials (standard stock)					
[illegible] materials (basic stock)					
[illegible] in progress/transit					
[illegible] (standard level)					
[illegible] deposits					
[illegible]					
[illegible]	Shs.000				
[illegible]					
[illegible]					
[illegible]					
[illegible] and water					
[illegible]					
[illegible] loans					
[illegible]					
[illegible]					
[illegible] salaries					
[illegible] subsistance					
[illegible]	Shs.000				
[illegible]					
[illegible] materials					
[illegible]					
[illegible] maintenance					
[illegible]					
[illegible] costs					
[illegible]	Shs.000				
[illegible] costs	Shs.[illegible]				

Period Covered ______________________________

Report Number ______________________________

QUARTER 1	QUARTER 2	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

[illegible] INITIAL OPERATIONS

Shs.000

ITEM	TOTAL	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]					
TOTAL Shs.000					
[illegible]					
[illegible]					
[illegible]					
[illegible] short-term loans					
[illegible] Bank of Commerce					
[illegible] creditors					
TOTAL Shs.000					

19..				19..			
QUARTER 1	QUARTER 2	QUARTER 3	QUARTER 4	QUARTER 1	QUARTER 2	QUARTER 3	QUARTER 4

Page_______ of ______

[illegible]

SUMMARY FINANCIAL PLAN

[illegible]

To ______________________________

From ______________________________

USES OF FUNDS	TOTAL	QUARTER 1	QUARTER [illegible]	QUARTER [illegible]	QUARTER 4
[illegible]entation Phase					
[illegible] Capital					
[illegible] Requirements					
[illegible]					
[illegible] FUNDS					
[illegible]lders					
[illegible]ity					
[illegible]-term loans					
[illegible]t-term loans					
[illegible] Bank of Commerce					
[illegible] Bank, etc.					
[illegible] assistance					
[illegible] banks					
[illegible]ry credits					
....					
....					
[illegible]					

[illegible] ____________

Period Covered ______________________________

Report Number ______________________________

QUARTER [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible]

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