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A CASE STUDY IN A FOREIGN
INDUSTRIAL INVESTMENT VENTURE ^{1/}

Presented by

The Bank of America

to the

United Nations Industrial Development Organization Seminar

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I. PURPOSE:

The purpose of this paper is to illustrate the complex nature of project loan negotiations and to identify the functions performed by key parties to the negotiations. The paper is designed to induce the reader to ask questions in line with his particular desire and interest to develop information.

II. DESCRIPTION OF THE PROJECT:

A manufacturing venture to be located in a developing country. The proposed entity would be capable of producing 80% of the existing local demand for its products, all of which are presently imported into the developing country.

III. BACKGROUND INFORMATION:

a) The overseas office of a U.S. investment firm (Promoter), located in a developing country, learned of the developing country's interest in establishing a new manufacturing enterprise for the supply of products then being imported into the developing country.

b) The Promoter discussed the proposal in broad terms with officials of the Economic Development Board and obtained a letter of intent.

c) The Promoter immediately conducted an advance investigation and analysis which led to the development of a proposal to a U.S. turn-key contractor (Contractor).

d) Negotiations with the Contractor took place and resulted in an agreement to undertake a detailed feasibility study and to carry out an intensive investigation of all aspects pertinent to the proposed manufacturing establishment.

e) The Promoter assisted the Contractor's survey team in the accumulation, correlation and analysis of the research and technical data required for the comprehensive feasibility study report, which was ultimately submitted to various Government agencies, financial institutions and other interested parties.

- III. f) The U.S. Promoter also devoted a substantial part of its time and effort in the preparation and evaluation of the feasibility study.

When completed the study was submitted to the Development Board. The study concluded that the proposed project would be of substantial benefit to the Developing Country as well as an attractive investment for its stockholders. A promotion certificate was issued by the Development Board to the Promoter subject to satisfactory financial arrangements.

IV. PROJECT COST:

The overall cost of the project was estimated as \$28 million. The following financing plan was formulated:

1. <u>Equity (Common Shares)</u>	\$ 6,600,000
<u>Investors:</u>	
Developing Country Government	
Developing Country Agency	
U.S. Turn-Key Contractor (i)	
Developing Country Banks	
Developing Country - Public	
U.S. Investment Firm (ii)	
2. <u>Subordinated Loans</u>	\$ 1,900,000
(Developing Country Investors)	
3. <u>U.S. Dollar Debt</u>	\$19,500,000
c) Eximbank - 13 year loan including \$1 million of capitalized interest. \$15,000,000	
b) U.S. Dollar Debenture. (iii) \$ 4,500,000	
TOTAL	\$28,000,000

-
- (i) shares to be issued for machinery and equipment.
- (ii) shares to be issued for development expenses and cash advance.
- (iii) The Agency for International Development was approached by the Contractor Firm and agreed to guarantee the U.S. Dollar non-convertible debenture as follows:

- a) Cover 100% principal of amount of debenture with "Specific Risk" Guaranty, i.e., political risks; and,
- b) Cover 75% of principal amount of debenture with "Extended Risk" Guaranty, i.e., all purpose risks the same as bank guaranty.

The remaining 25% to be guaranteed by a local bank.

V. FINANCIAL NEGOTIATIONS:

1. The U.S. Contractor contacted Eximbank. Eximbank expressed interest in the project, but as a matter of policy could not finance the capitalized interest of \$1 million and properly insisted on a more favorable debt/equity ratio. It became apparent that the amount of U.S. dollar debentures would have to be increased to \$5.5 million to include the \$1 million capitalized interest and that the entire amount, \$5.5 million would have to be subordinated to the \$14 million loan by Eximbank.

2. The U.S. Contractor turned to one of its international banks for assistance. The U.S. Commercial Bank recognized that a 15 year subordinated loan would not fit its loan portfolio. Nevertheless, anxious to assist in bringing the proposal to fruition, the Commercial Bank suggested the following approach:

Induce AID to revamp its Extended Risk Guaranty so as to make it acceptable to private U.S. Institutional type investors, i.e., insurance companies, pension trusts, trust funds. In order to achieve this objective it would be necessary to:

- a) Permit the institutional investors to provide loans solely against the AID Extended Risk Guaranty portion leaving the 25% portion of the loan to the U.S. Commercial Bank.
- b) Permit the 25% loan portion to represent the earliest maturities of the loan (i.e., first 6 years) and permit the 75% portion to represent the latest maturities (i.e., following 7 years).

N.B. At the time AID required the holder of guaranteed notes to retain the corresponding 25% portion together with the 75% fully guaranteed portion.

3. The suggested approach in #2 involved extensive negotiations with AID on the revision of its Extended Risk Guaranty. Each step of the negotiations had to also be coordinated with prospective co-lenders (i.e., insurance companies, trust & pension funds) as well as with the

banking community through a sub-committee of the Bankers Association for Foreign Trade (BAFT). Because of the many parties involved in the process, negotiations were necessarily protracted. Yet, these negotiations represented only one aspect of the bank's functions. The overall role of the bank can be summarized as follows:

- a) Attempt to induce financial institutional investors to make loans to a new foreign enterprise.
- b) Negotiate with AID on the revision of its guaranties, coordinating with institutional investors and other co-lenders.
- c) Negotiate with Eximbank to insure that the terms and conditions of both loans are parallel.
- d) Negotiate with the commercial banks of the developing country who were to provide the guaranty of repayment on the 25% portion of the loan.
- e) Negotiate with developing country agencies to obtain approval of incentives including tax waiver on loan interest.
- f) With the assistance of special counsel negotiate terms and conditions of the loan to suit AID, Eximbank, co-lenders and the borrower; coordinating with each party in order to arrive at complete accord on all aspects of the underlying loan agreement and related documents. Attachment A shows a typical list of documents required for a project loan of this type.

VI. FUNCTIONS OF OTHER PARTIES:

1. The U.S. Investment Firm

The U.S. Investment Firm assumed full responsibility and paid all expenses leading to the establishment of the industrial venture. This responsibility included the selection and acceptance of individuals of the highest standing in the developing country to act as "promotion directors" under the regulations of the host Government. All required documents were prepared, general counsel employed, and all costs involving the organization and establishment of a corporation were paid in full.

The U.S. Investment Firm guaranteed and assumed the full obligation for the development of the necessary equity capital that resulted in a successful venture. This included:

- a) Discussions and invitations to local investors to subscribe to equity shares. (See Attachment B)

- b) Discussions and invitations to foreign investors to subscribe to equity shares.
- c) Preparation of the required prospectus and analysis necessary for the proper evaluation of potential investors.
- d) Subscription for debentures or preferred shares from local and foreign sources as required to finance the proposed venture.
- e) Securing subscriptions from foreign sources for all equity investment required in addition to those subscribed by local sources.
- f) Negotiation for participation in supplying private capital from banks or other financial institutions upon the most favorable terms.
- g) Negotiation with and securing loans and financial assistance from official U.S. Government or international financing institutions.
- h) Detailed and exhaustive negotiation with the Developing Country Government agencies to assure the granting of all investment privileges and concessions allowed under the Developing Country Investment Promotion Laws and regulations.
- i) Negotiation and liaison with developing country customs, internal revenue agencies and other departments to achieve prompt and satisfactory handling of the proposed venture's transactions.
- j) Responsibility for the selection and assistance in acquisition of a plant site acceptable to the directors of the company and upon the most economical basis.
- k) Assistance in the recruitment of capable developing country personnel, and the supervision of adequate training processes.
- l) Continuing advisory liaison services by and between local and foreign participants.

2. The U.S. Turn-Key Contractor

Besides the feasibility study that was carried out, the U.S. Contractor had to:

- a) Select, develop and improve the site of the plant.
- b) Construct the buildings and other civil works.

- c) Transport all machinery and equipment from plants of delivery to the plant site.
- d) Provide labor and materials for erection of machinery and equipment.
- e) Erect the machinery and equipment, and supervise the start-up of operations as well as providing other technical services.

Moreover, the U.S. Service Company undertook the market evaluation which was presented in their business proposal. The Service Company survey team carefully examined local consumption of the product in recent years, then projected future consumption on the basis of the experience of many other countries which have passed through similar periods of industrial growth.

These forecasts were further tested by examining the present and future product needs of a number of local largest users of the product.

The U.S. Contractor in this project was uniquely qualified to provide management as well as technical competence.

Acting as manager through a wholly-owned management company, the contractor undertook to supervise with the cooperation of the Government the development of the raw material sources, the laboratory and pilot plant investigations, as to the suitability of various factors involved in the operation process, as well as the continued operation of the plant after completion until such time as the training program produces qualified operating and management personnel.

3. Agency for International Development

- a) Assisted with the revision of its Extended Risk Guaranty, participating in negotiations involving the bank's co-lenders and the BAPF Sub-Committee.
- b) Cooperated with the Commercial Bank in obtaining necessary agreement of the U.S. Treasury to certain aspects of the proposal.
- c) Provided technical analysis skills necessary for properly evaluating the marketing and engineering aspects of the proposal.
- d) Cooperated in finalizing the loan agreement and related documentation.

4. Export-Import Bank of the United States

- a) Applied its technical ability to the evaluation of the technical and economic feasibility of the project.

b) Cooperated in reaching agreement on key terms and conditions incorporated into the loan agreements.

c) Cooperated in assuring that the loan agreements were drafted without conflicts in terms and conditions.

VII. BENEFITS TO THE HOST COUNTRY:

1. For the local consumer and business, the availability of the locally produced product bridges the gap between supply and demand and saves the expense and time consumed in importing the product.

2. The extra income benefits for the developing country; The paying rates and working conditions are as attractive as any to be found in the developing country. The plant created about 500 new jobs with an annual pay-roll of half a million dollars, besides the training of local workers in valuable technical skills.

3. Being a producer of an intermediate industrial product, the industrial venture worked as a supplier and customer to other businesses.

4. The following are the direct benefits to the Government:

- a) The foreign exchange savings of approximately \$13 million resulting from producing rather than importing the product.
- b) The establishing of a new and large industry for local consumption and world markets, in the future.
- c) The employment benefit which moves the production wheel of the developing country and solves a major problem that has always effected its economic development.
- d) The new and huge sources of tax revenue of approximately \$12 million in the first 13 years of operation and \$2 million yearly thereafter.

VIII. CONCLUSION:

After approximately two years of continuous negotiations the project arrangements were finalized and the loan agreements were executed.

A summary of the parties involved in the transaction should give the reader an idea of the complex negotiations which took place.

Equity Participants

Developing Country Government
 Developing Country Agency
 Seven private firms in the Developing Country
 1,200 individual stockholders
 Three Developing Country Commercial Banks

Debt

Export-Import Bank of the United States (Eximbank)
Three U.S. Commercial Banks
One U.S. Insurance Company
One U.S. Trust Fund
One U.S. Pension Fund
Agency for International Development (AID) (provided
guaranties)
Two Developing Country Commercial Banks (Provided guaranties)
U.S. Turn-Key Contractor (Provided undertakings)

Others

Sub-Contractors
Consulting Engineer
Developing Country Agencies
U.S. Treasury
U.S. Commercial Banks through Sub-Committee of BAFT
(Senior Officers plus legal counsels)

ATTACHMENT ADOCUMENT INDEX

(Names, dates and amounts have been omitted)

I. Basic Documents

1. The Loan Agreement
- 1A. Amendment No. 1 to Loan Agreement
2. Promissory notes of the Borrower.
3. A.I.D. Specific Risk Guaranty.
4. A.I.D. Extended Risk Guaranty.
5. Guaranty of the Early Maturities of the Loan by local banks*
6. Withdrawal Schedule
7. Schedule of Maturities

II. Lenders' Documents

8. Certificate of authority of officer executing the Loan Agreement on behalf of each Lender.
9. Eligibility letter from each Lender.
10. Investment letter from each Lender.

III. The Industrial Venture Documents(a) Corporate

11. Memorandum and Articles of Association of the Borrower, duly certified by the Secretary of the Borrower.
12. Certificates of Good Standing.
13. Resolutions adopted by the Stockholders, certified by the Secretary of the Borrower, consenting to and ratifying the Resolutions of the Board of Directors.
15. Certificate of Incumbency.
16. Power of Attorney.
17. Certificate as to capital stock.
18. Certified Specimen of Stock Subscription Agreement.

*In the developing country

ATTACHMENT (Cont'd)DOCUMENT INDEX (Cont'd)

19. Undertaking covering balance of unpaid subscriptions to capital stock.
20. Underwriting Agreement covering the face value debentures of Borrower.
- (b) General
21. Certified copy of Feasibility Study covering the Project.
22. (a) Certificate attesting that the Borrower is entitled to the benefit of Investment Incentives, issued by the Board of Investment of the developing country.

(b) Certified copy of Exchange Control approval by the Central Bank.
23. Certified copy of Contract between Borrower and U.S. Contractor firm and U.S. management corporation covering the construction, management and equipment of the Project.
24. Overrun Agreement of U.S. contractor and the other major shareholders of Borrower covering the availability of additional funds to the Borrower in the event construction costs exceed estimates.
25. Guaranty of U.S. contractor Incorporated covering the performance of its subsidiaries and affiliates.
26. Performance and Equipment Bond covering the performance of the U.S. contractor under the construction contract.
27. Undertaking to engage a Consulting Engineer.
28. Undertaking by the local bank (a) and the local bank (b) to provide Borrower with a line of credit.
29. Certified copy of Loan Agreement between Borrower and Eximbank.
30. Undertaking to obtain satisfactory insurance coverage.
31. Certificate of Officials of Borrower as of the date of closing the loan updating any certificate furnished or dated prior to closing.

ATTACHMENT (Cont'd)DOCUMENT INDEX (Cont'd)**IV. U.S. Contractor, Subsidiaries and Affiliates, Documents**

32. Undertaking of U.S. contractor that it will not dispose of its equity in the Borrower.
 33. Undertaking of U.S. contractor that it will retain ownership of its subsidiaries until all of their obligations to the Borrower have been fulfilled.
 34. Certificate of Incorporation of U.S. contractor certified by the appropriate authorities.
 35. Resolutions adopted by the Board of Directors of contractor certified by the Assistant Secretary of contractor.
 36. Resolutions of the Stockholders of contractor certified by the Assistant Secretary of contractor.
 37. Certificate of Stock Ownership and Incumbency of contractor.
 38. Certificate of Good Standing of Contractor issued by the Secretary of the State where it is located .
- P.S. Subsections 35, 36, 37 and 38 applies similarly to the contractors, subsidiaries and affiliates.

V. A.I.D. Documents

39. Certified copy of Agent's* application to A.I.D. for the Specific Risk Guaranty.
40. Opinion of general counsel of A.I.D., covering the issuance and execution of the Specific and Extended Risk Guaranties.

VI. Miscellaneous Documents

41. Opinion of United States counsel for Borrower.
42. Opinion of local counsel for Borrower.
43. Opinion of counsel for U.S. contractor, its affiliates and subsidiaries.

*Agent represents the U.S. Commercial bank

ATTACHEMENT (Cont'd)

DOCUMENT INDEX (Cont'd)

44. Opinion of counsel for the local bank (a)
45. Opinion of counsel for the local bank (b)
46. Opinion of special United States counsel for the Lenders.
47. Confirming opinion of special local counsel for the Lenders.

ATTACHMENT BInvitation to the Public for Subscription
of Shares in the Industrial Venture

A well planned advertising campaign had been made for the project to ensure that the public were kept well informed of the project with the aim to invite them to join in so as to spread the ownership of the proposed company as widely as possible. As a result total public subscription was at \$1,600,000 with over 1,000 shareholders holding less than 50 shares in the Industrial Venture. Total number of shareholders is 1,200.

Following are the summary of advertising schedule made for the paper company:

- Press Receptions;

This was followed by short articles written by newsmen in both local and English newspapers.

- Interview on Television (channel 4);

- 4 page supplement of Prospectus in the English newspaper;

- 4 page supplement of Prospectus in all local newspapers;

These were followed by small advertisement in all local newspapers every day until the closing date for subscription.



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