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REDEPLOYMENT OF PRIVATE CAPITAL IN DEVELOPING COUNTRIES

Submitted by the Government of the Netherlands

prepared by

J. H. van Oomen, Economist

Unilever N.V., Rotterdam, The Netherlands



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SUMMARY

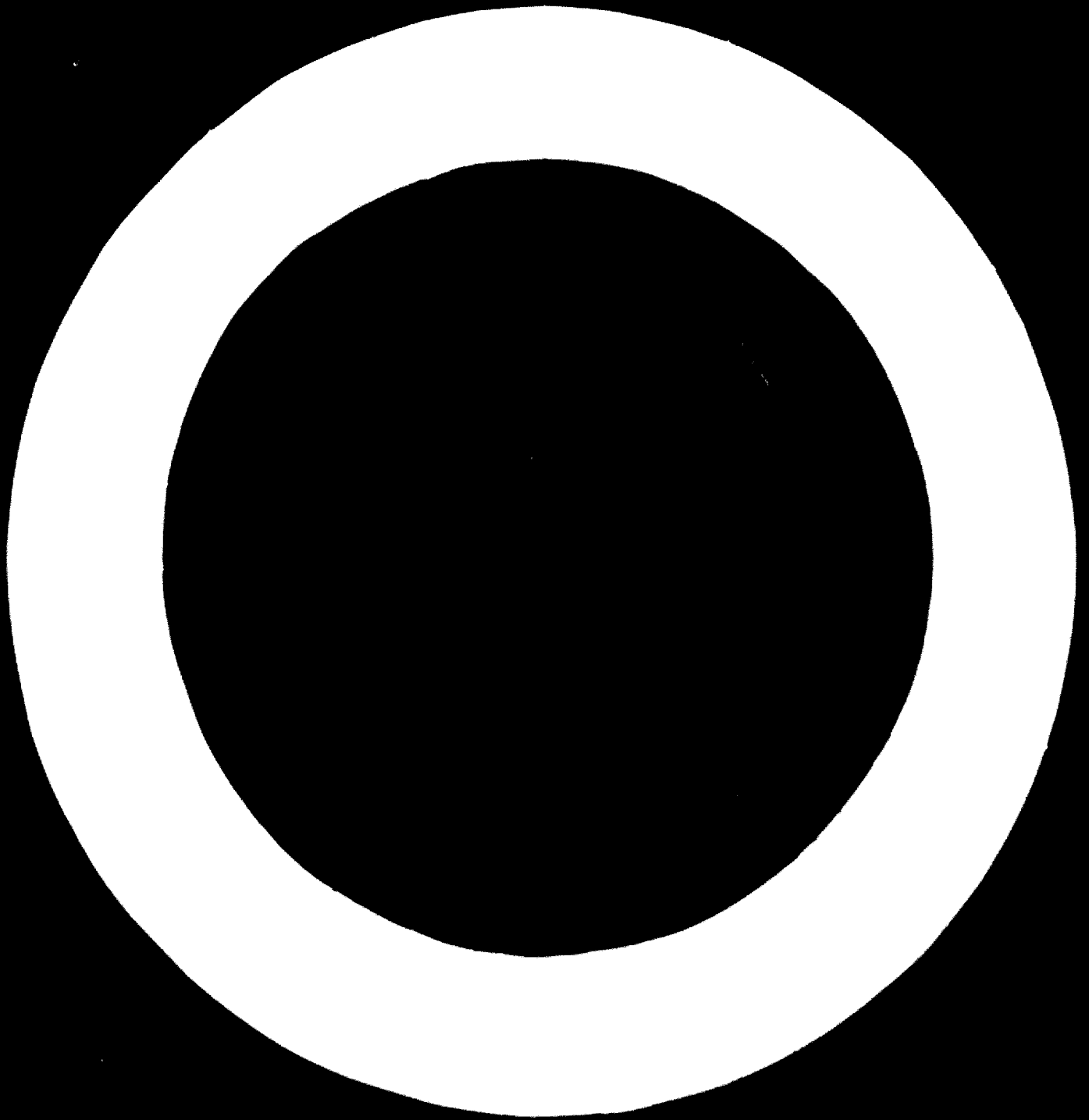
by

J. H. van Ommen, Economist

Unilever N.V., Rotterdam, The Netherlands

Submitted by the Government of the Netherlands

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Changing development structures

1. Redeployment of a firm's assets may become especially necessary when major changes occur in the economic, social and political structure of a country. This is, for instance, the case when a less advanced country acquires independence. It then often appears necessary for private companies, and particularly for expatriate companies, to adapt their activities and objectives to the changed conditions.

The function of redeployment

2. The main features of the process of redeployment are:

- (a) The withdrawal of capital and other assets, including labour, from activities which can no longer be continued, either because they are not profitable, or for political reasons; and
- (b) Re-investment of the assets for purposes which are more appropriate to the changed conditions, and which hold out some promise of profit.

Redeployment of capital

3. Redeployment of capital enables (foreign) private enterprise to go on operating in developing countries even when the original activities cannot for one or another reason be continued. The continuation of the activities of private enterprise in these countries is important for the encouragement of additional private foreign investments, since this is one of the scarce ways to avail of the combination of capital, management and technical know-how.

Private companies concerned with redeployment

4. The list of firms inclined to invest in the developing part of the world is limited. Up to the present it consists mainly of those firms which have acquired marketing know-how in developing countries.

Redeployment opportunities

5. The main opportunities for redeployment by private enterprise in the developing countries seem to be in:

- (a) The processing of raw materials;
- (b) Industrialisation for import-substitution;
- (c) The manufacture of simple capital goods; and
- (d) Investment in distribution organisation.

Diversification

6. In connexion with the process of redeployment, special attention may be given to diversification which means priority for exploiting national resources; in many cases this means the processing of locally produced raw materials.

Other development priorities

7. Apart from diversification, investment for import-substitution will generally have to be given high priority in developing countries because of savings in freight and foreign currency.

Execution of redeployment

8. Private businesses already established in developing countries can redeploy their resources by changing over to those industrial activities which fit best in the diversification plans of the country. Redeployment is, however, also possible in the case of foreign private firms engaged only in trade with developing countries.

Partnership

9. In many cases redeployment can best take the form of a joint venture. Joint ventures may be particularly important when marketing and commercial know-how possessed by the (local or foreign) partner already established in the developing country can be combined with technical know-how supplied by other foreign firms.

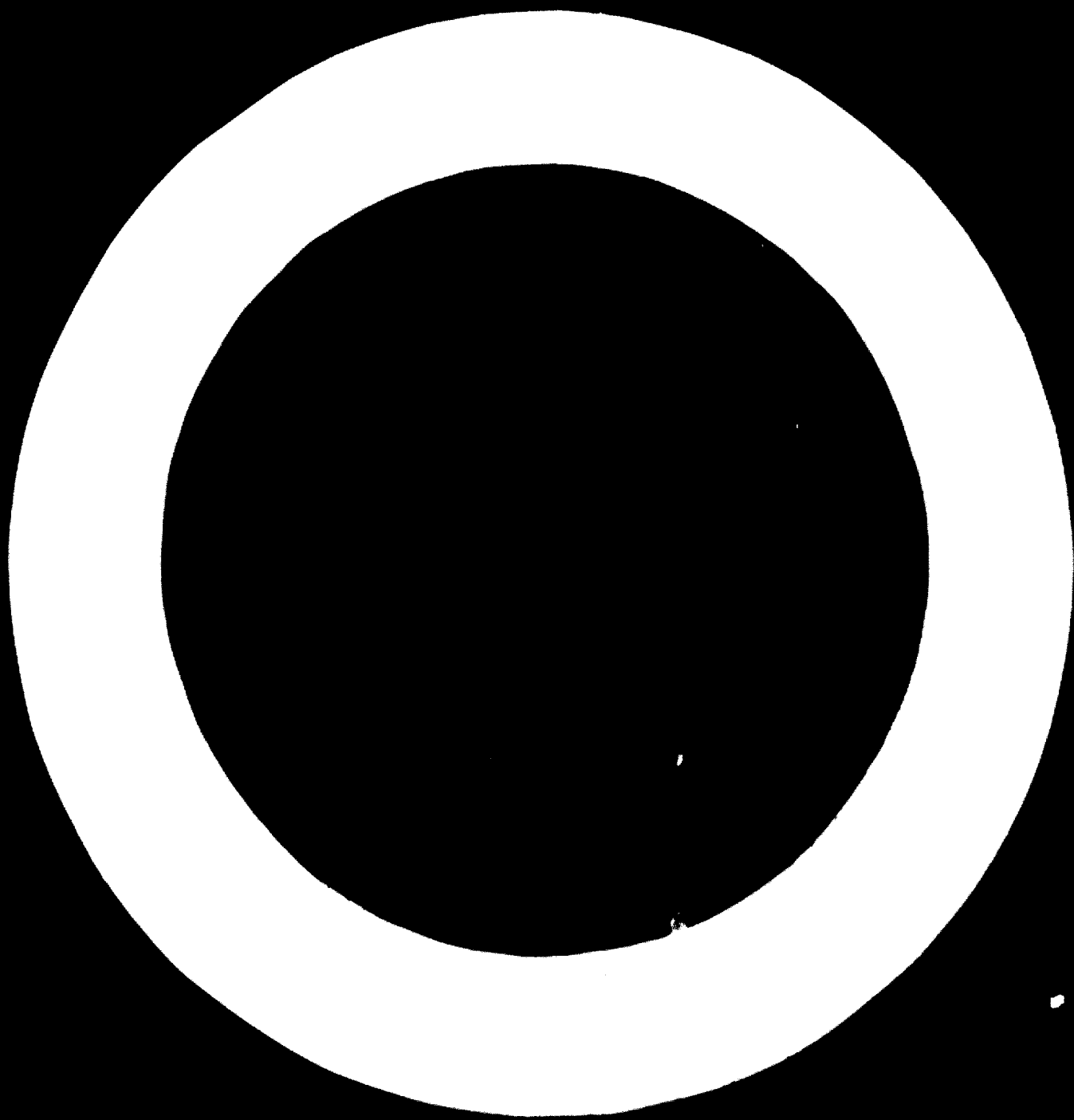
Financial aspects

10. In the case of enterprises originally engaged in produce buying or general merchandising, redeployment could take effect by means of:

- (a) Gradual reduction in stocks;
- (b) Changing over to financing of operations by means of credits or reduction of customers' credit;
- (c) Sale of superfluous assets (buildings);
- (d) Transfer of interests in certain enterprises;
- (e) Sale of shares to local investors.

Role of Governments

11. Redeployment may require a special attitude of Governments of the developing countries concerned. It seems to be important that Governments of developing countries be clear and consistent in carrying out their plans such as directing certain sectors especially suitable for redeployment activities.



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I. CHANGING DEVELOPMENT STRUCTURES

1. The role of the private firm in economic development is especially related to the process of innovation. In this connexion, not only the production and marketing of new goods, but particularly the exploitation of new processes and markets are important. For some time now, experience has shown that innovation in some cases is brought about by changes in the scope of the activities of private firms. In this connexion, one does not only think of diversification as a means of presenting new opportunities for profitable investment, but also of deliberate and radical changes in the way the firm's resources are being employed. This is what is meant by the notion of "redeployment" of the main resources of a firm, notably its capital, labour and management.

2. Redeployment of a firm's assets may become especially necessary when major changes occur in the economic, social and political structure of a country. This is the case when a less advanced country acquires independence and plans for rapid economic development. This has often happened since World War II. Similar structural changes may take place when some or more (developing) countries strive for a common and larger community and market. In both instances, it is often necessary for private companies and particularly for expatriate companies to adapt their activities and objectives to the changed economic, social and political conditions. This requires these firms to consider using their assets for purposes other than originally intended. Such adjustments seem particularly necessary for businesses engaged in activities which fit easily into the old structure, for example, activities which are related more or less exclusively to the role of the country in the colonial past. This has often been the case with expatriate firms originally established in "produce buying". Political reasons may require such activities to be reserved especially for firms with a strong national character.

3. The heavy emphasis in less advanced countries on economic development entails that nothing should be done to affect production and employment unfavourably. Therefore, it is of great importance that all private production capacity, - either indigenous or expatriate - be maintained and if possible extended for the benefit of employment and economic development in general. It is, therefore, obvious that redeployment - the adjustment of private firms to significantly changed circumstances - is of great importance to the planned development of less advanced countries.

II. THE FUNCTION OF REDEPLOYMENT

4. The main features of the process of redeployment are
- (a) The withdrawal of capital and other assets, including labour, from activities which can no longer be continued, either because they are not profitable, or for political reasons;
 - (b) Re-investment of the assets for purposes which are more appropriate to the changed conditions, and which hold out some promise of profit.

By this definition, redeployment requires that the private investors concerned will have to modify deliberately the structure of their activities. Redeployment means that the process of change should proceed in such a way that both the enterprise and the economy as a whole avoid substantial losses. Therefore, redeployment entails planning to prevent unemployment of personnel, and also of company assets. The possibilities of redeployment by foreign private enterprises in the developing countries depend mainly upon the existence of investment possibilities which (a) are commercially promising; (b) are focussed upon major development projects of the economy; and (c) fit in with the national political structure.

5. Redeployment, therefore, comprises not only alternative utilization of the capital invested in the original operations. It involves redeployment of available labour and the enterprise's research and business potential as well. Private foreign enterprises employing a large number

of foreign specialists, including management staff, can often achieve redeployment much easier than small local firms because they can handle this problem by means of internal transfers. Although redeployment of a company's labour and other assets is just as important as the reinvestment of capital, the following deals only with the latter.

III. REDEPLOYMENT OF CAPITAL

6. Redeployment of private capital and particularly foreign private capital, has a number of special aspects. In the first place it enables private enterprise to go on operating in developing countries even when the original activities cannot be continued for one reason or another. This is important not only to foreign or national private businesses, but also for continuation and encouragement of additional private foreign investments in developing countries, as well as for trade relations between the Western industrialized world and the developing territories.

7. In the second place, private investment entails a certain automatic growth in investment. With a view to continuity, private businesses will always plough back part of their profits - if there are any - in order to maintain their relative position and profitability.

8. In the third place, private enterprises traditionally operating in developing countries will be able to utilize the know-how associated with doing business in developing countries, especially in marketing and distribution. Moreover, these companies can attract other foreign know-how.

9. Finally, without locally known foreign enterprises, other foreign businesses will not be prepared to accept the special risks and uncertainties inherent to investment in developing countries - and the same applies to local investors and development banks. Therefore, private capital in developing countries often stimulates business activities in partnership with local or other foreign interests.

10. Private foreign capital is very scarce. Not only because private capital is in itself a scarce resource, but particularly because private capital combined with management and technical know-how are even scarcer. As the president of the World Bank once remarked, the combination of private capital and know-how is relatively little used and increases only slowly in the developing part of the world. Therefore, it is, in any case, of great importance not only to extend, but at least to try to retain, all the private resources which are being employed in developing countries.

IV. PRIVATE COMPANIES CONCERNED WITH REDEPLOYMENT

11. Why is redeployment of the capital of foreign businesses deemed so important? The number of firms inclined to invest in the developing part of the world is limited. It consists in the main of the following:

- (a) Foreign firms which have always been in developing countries, for instance, right from the colonial past; these firms have acquired the necessary marketing know-how for operating in countries with an advancing economy;
- (b) Large foreign businesses which have not been in the developing countries before, but consider this possibility from a diversification angle; as such firms are able to spread their risks, they can afford to have in certain cases lower short run expectations than other firms;
- (c) Medium-large foreign firms which, as far as investment in developing countries is concerned, are limited by availability of capital and staff; a stimulus for investment in developing countries, though, may be fear of losing existing profitable export outlets;
- (d) Foreign companies with existing profitable domestic activities which foresee a saturation of their markets and which do not find other readily available opportunities at home for investment of their retained profits;
- (e) Foreign firms which wish to safeguard their raw material supplies.

12. Redeployment does not imply that the private entrepreneur always has a wide freedom of choice in the process of adaptation to the changing environment. For example, the foreign company which is unable to withdraw its liquid assets from a certain developing country is almost forced to reinvest them in the same country "faute de mieux", sometimes against its better economic judgement. To some extent, this is also the case when a foreign private company regards the defensive investment aspect very highly - defensive in the sense of protecting an existing market share by local manufacture or local assembly.

V. REDEPLOYMENT OPPORTUNITIES

13. What are the main opportunities for redeployment of capital by private enterprise in the developing countries either from foreign or existing sources? The following possibilities would seem to be important:

- (a) The processing of raw materials adds more value to them. This depends upon the possibility of making good quality semi-manufactures and marketing them abroad as well as on whether profitable opportunities exist for selling by-products etc. Important examples are the sawing of timber, pressing oil from oil seeds, melting cocoa to produce cocoa butter etc.
- (b) Industrialization for import-substitution. This is mainly a question of production of primary necessities: consumer goods such as foods, textiles, simple tools, cement etc.
- (c) The manufacture of the capital goods of great importance to the country's development which can be made comparatively simple. This might include, for instance, the assembly of motor vehicles, agricultural implements etc.
- (d) Investment in distribution organization (setting up regional depots and transport for distributive purposes. Another possibility is the organization of the wholesale trade and the establishment of shops based on the local retail-trade structure).

The redeployment of capital in industrial projects in developing countries in the above conditions will usually produce some positive results. This

would mean that private enterprise has seized the opportunities that are most readily available in the economic structure.

VI. DIVERSIFICATION

14. The above is particularly the case with diversification, which, as far as the developing countries is concerned, means priority for development of agriculture and industry aimed at exploiting natural resources, that is, the converting of locally produced raw materials (usually an activity with comparative cost advantage).

15. For diversification to have good results, a comparatively rapid development of either some agricultural or industrial sectors should be possible. Development of the agricultural sector is normally only possible if the industrial sector provides employment for labour released as a result of productivity gains in agriculture. Industrialization in its turn is only possible if outlets for industrial activities are available. This requires not only production for import substitution, but also inter-regional trade in industrialized products, and further, the processing of semi-manufactures for export to industrialized countries. Apart from larger markets in the developing part of the world, this necessitates lowering or abolition of tariffs in the more advanced countries for at least semi-manufactures from developing countries.

16. As a rule, diversification could at the same time provide for the creation of interlocking external economies, which creates advantages brought about by the establishment in close vicinity of various kinds of businesses. These, together, produce a favourable industrial climate. Interlocking external economies are necessary in order to attain a well-balanced economic development and permit it to proceed more or less automatically.

VII. OTHER DEVELOPMENT PRIORITIES

17. From the above it follows that investment for the production of semi-manufactures and import substitution will generally also be given

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high priority. Two factors usually make investment for this purpose profitable in developing countries: (a) Savings on freight previously borne by the (imported) products concerned; and (b) artificial protection which the country usually tends to create for this industry by restricting imports. Both factors must offset (temporarily in the second case) the negative earning factors influencing private investment in many developing countries, that is,

- (a) The usually abnormally small markets and the impossibility of producing for markets in neighbouring countries;
- (b) Costs which are, on average, higher in developing countries owing, among other things, to the comparatively greater significance of the cost of supervisory staff;
- (c) The high risk attaching to direct investment in developing countries, which requires a relatively high profit.

VIII. EXECUTION OF REDEPLOYMENT

18. From the above it follows that redeployment can be executed in various ways. In the first place there are foreign private businesses dealing with general merchandising or produce buying in the developing countries. In redeploying their resources, these firms may change over to industrial activities of various kinds as set out before.

19. Further foreign private businesses which do not have positive expectations as far as redeployment is concerned in the country in which they are operating, can withdraw and reinvest their capital and other assets for more appropriate purposes in developing countries.

20. Redeployment is also possible in the case of foreign private firms only engaged in trade with developing countries, for instance, firms which export industrial products to or import raw materials from developing countries. Part of the capital of these firms can be utilized for direct investment in developing countries, for instance for the production of goods which can be substituted for imports. In many cases such redeployment takes the form of a joint venture. These investment activities

are chiefly of a "defence nature": the exporting company does not require more than a limited participation in the joint venture since this participation is only used to get a foothold in the developing country concerned and to show that the foreign firm is also actually interested in the economy of the developing country. As such, it creates goodwill for its other export-outlets.

IX. PARTNERSHIP

21. In some cases, redeployment can be carried out entirely by the foreign companies themselves, but in other cases, it is better for an arrangement to be made with foreign or local businesses or a local or interlocal development bank. (Although partnership with Governments is not always avoidable, it can generally be said that available public resources in these countries are more liable to be invested in less profitable ventures such as the necessary development of their infrastructure).

22. Joint ventures may be particularly important when marketing and commercial know-how possessed by the (local or foreign) partner already established in the developing country can be combined with technical know-how supplied by other foreign firms. As a rule, both parties will have to supply the requisite capital and management, although each of them may supply different proportions. If foreign participation is obtained for joint ventures in developing countries, this brings an additional flow of capital and specialized labour and these may help to open up new fields of production, which initiative, as a rule, none of the partners would have been able to take alone.

X. FINANCIAL ASPECTS

23. Redeployment requires a special financial structure for the company involved. There are various ways in which capital can be released from its existing uses. In the case of enterprises originally engaged in produce buying and general merchandizing, capital is for the most part

liquid. In these cases redeployment can take effect by means of:

- (a) Gradual reduction in stocks;
- (b) Changing over to financing of operations by means of credits or reduction of customers' credit;
- (c) Sale of superfluous assets (buildings);
- (d) Transfer of interests in certain enterprises; and
- (e) Sale of shares to local investors.

24. Whatever form is chosen for obtaining capital, it should be done in the way that is least detrimental to the profitability of the other assets of the business, and without adversely affecting employment. In the case of redeployment of capital invested in produce buying and general merchandising, the side effects, as stated earlier, will usually be comparatively slight.

XI. ROLE OF GOVERNMENTS

25. Redeployment may require a special role for the Governments of the developing countries concerned. It appears that economic planning in many developing countries often is reason for Governments to give detailed thought to the activities of private businesses. This results in many cases, in far-reaching interference with private enterprise, and it is not unimaginable to fear even more interference in the case of redeployment of the resources of private foreign companies. Still, such interference increases the risk and uncertainty for private enterprise and does not stimulate their commercial activities in general nor private foreign investment in particular. This might be detrimental to the development of the economy concerned.

26. There are many indications that redeployment can only be successful when private enterprise is convinced that it can operate as freely as possible in the new activities chosen. On the other hand, Governments of developing countries often wish to take the lead in development. In these cases, redeployment may well go off in collaboration with the

Governments concerned. There are many examples of cases where redeployment was executed in consultation between Government and private enterprise. It seems to be important that Governments of developing countries be clear and consistent in carrying out their plans such as directing certain sectors in what will especially be suitable for redeployment activities. It is also of great importance for private enterprise to be aware of the financial implications of redeployment in the sectors which have been singled out by the Government, and to know whether financial help can be expected from national development funds (banks). It should be clear from the outset that redeployment will only be successful if private enterprise is convinced that, in future, its role will not be hampered or made obsolete as a result of Government interference.

XII. FINAL REMARKS

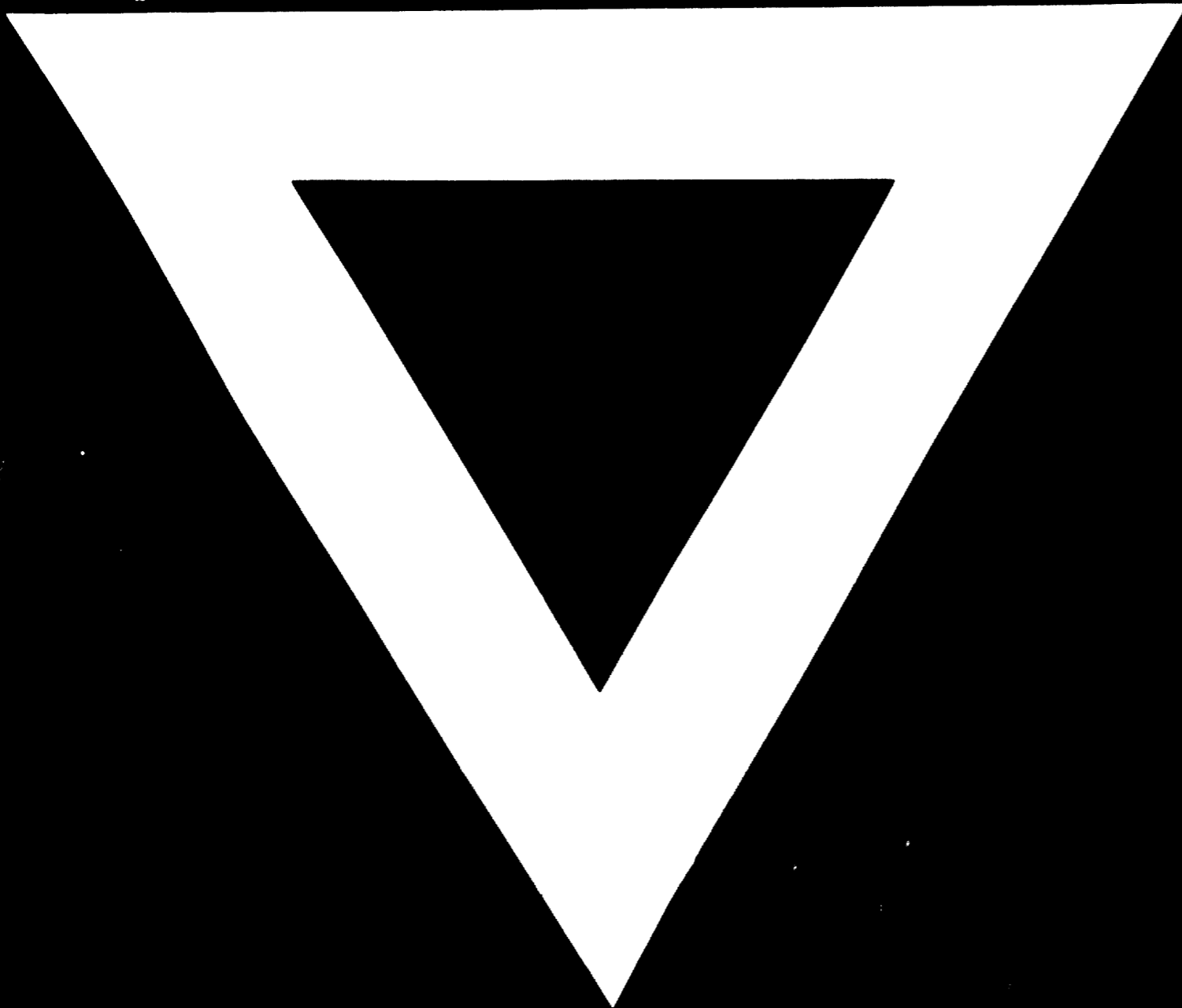
27. The redeployment process, as a reaction to technical and economic change, can be expected to continue as long as the changes themselves continue. Therefore, redeployment will be especially necessary when major changes take place in the economic structure of certain (developing) countries and territories, as such changes usually bring about shifts in the market and production structure.

28. Structural alterations certainly also occur when former colonial territories gain their independence, but also when larger economic communities are formed which make it possible to produce on a larger scale, and with greater specialization, because of the bigger market.

29. Many examples could be given of foreign private enterprises that have succeeded in completing the redeployment process. Such examples include both enterprises which have carried through redeployment in the countries where they operate, and enterprises which have re-invested their capital in other developing countries. An example is various companies in tropical Africa which have changed over to local industrial operations.

30. Many enterprises traditionally operating in Indonesia have switched their activities to other Asian, African and Latin American territories. This is also the case with shipping operations. When capital of these enterprises was redeployed, a choice undoubtedly had to be made between investment in developing and in industrialized countries. In many cases projects in developing countries were chosen because the know-how of these firms related mainly to production, marketing and distribution in such countries.





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