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D02872

Distr.
LIMITED

ID/WG.10[illegible]/P.2
[illegible] October 1971

ORIGINAL: ENGLISH

United Nations Industrial Development Organization

Expert Group Meeting on Industrialization
in Countries at Early Stages of Development
with Special Reference to Small-scale Industry

Vienna, 6 - 10 December 1971

PARTNERSHIPS 1/

A Note on Co-operation Between Developed and Developing Countries in the Field of Small-scale and Medium-sized Industry in African Countries

prepared by

the Secretariat of UNIDO

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Contents

I. BACKGROUND

1. In some parts of the developing world, especially in Africa, the industrial structure consists essentially on the one hand, of a certain number of large-scale or medium-sized industries belonging to foreigners or expatriates, to the Government or to the Government and foreign investors (mixed economy companies) and, on the other hand, of relatively large numbers of artisans, handicrafts and cottage industries operated by indigenous craftsmen. In these countries, there is hardly any middle class of modern but small manufacturing undertakings owned and managed by indigenous entrepreneurs.

2. The creation, in African countries, of the first modern indigenous industries is an exceedingly difficult task. Because of the lack of industrial tradition, the lack of knowledge of technique and management, the shortage of financial resources and the inadequate credit-worthiness of the indigenous population, the number of prospective African entrepreneurs is extremely limited.

3. It is the task of industrial extension agencies, that is, of national centres for assistance in technique, management and marketing, to promote entrepreneurship and to help in the establishment and early operation of small-scale industries. UNIDO is carrying out, at the present time, operations in a large number of African countries, aimed at establishing or strengthening industrial extension centres. Many of these operations are also concerned with the establishment of industrial estates, that is, of tracts of land with the basic infrastructure, standard factories erected in advance of demand and, in many cases, common service facilities such as a mechanical workshop with tool room and heat treatment, a testing laboratory etc. The industrial estate is, indeed, an effective instrument for promoting entrepreneurship in small-scale industries.

4. In view of the difficulties of orienting Africans towards industrial activities, of the fact that extension centres have been established only recently, that their usually small staff has not yet gained the necessary proficiency, that financing is not readily available and that there is a scarcity of sound, "bankable" projects, the number of modern indigenous

industries remains very small in most African countries.

5. It may be expected that, once a certain number of such industries have been set up and a demonstration has been made of what can be accomplished through the combined efforts of the Government and of international and other technical co-operation programmes, a breakthrough will be achieved and the promotion of small industries will progress further until a spontaneous trend towards their establishment becomes apparent. Much effort, however, will have to be exerted until these stages are reached.

6. UNIDO feels that, as part of this effort, and in addition to the current and planned technical co-operation projects relating to industrial extension centres and industrial estates, there is scope for certain activities involving partnerships or other forms of co-operation between, on the one hand, industries and certain organizations in the developed countries and, on the other hand, entrepreneurs and supporting institutions in the developing countries, especially in Africa. The purpose of the present note is to outline the various forms which such partnerships can take and the role which UNIDO intends to play in promoting them.

II. FORMS OF PARTNERSHIP

7. There is evidence that a number of European private industrial corporations, private or public export organizations and other institutions are interested in sale of machinery and equipment to developing countries or in licensing, investment or joint ventures in small or medium-sized industries in such countries.

8. In many cases such projects falter or collapse before materializing because of difficulties and high costs of carrying out preliminary surveys, identifying local entrepreneurs, securing local financing, complying with administrative and legal requirements and other reasons.

9. There are, however, some cases where various types of partnerships, including joint ventures, have been successfully negotiated between European and local entrepreneurs. Almost invariably, success was achieved, after lengthy negotiations, owing to persevering prospection in the developing

country by the European investor, and to co-operation by local banks, government departments and promotion agencies.

10. It is the feeling of UNIDO that special efforts to promote and facilitate partnerships of different types are necessary. These partnerships should be mainly developed in Africa, because it is in the countries of that region that the creation of indigenous industrial enterprises is confronted by the greatest difficulties.

11. The partnerships or other co-operative arrangements might take the following forms:

(i) Sale of machinery and equipment at liberal conditions, such as instalment credit granted by the foreign manufacturer or exporter or the local importing agent. After-sales services might also be provided;

(ii) Sale of machinery and equipment with provision of services of technicians for the time necessary to instal and test the machines, and train local personnel in operating, maintaining and repairing it;

(iii) Secondment of managerial and/or technical personnel to solve difficulties in an existing enterprise in the African country, and train its staff; as a rule, such co-operation would be extended to an African enterprise in which the foreign company has some interest;

(iv) Training of personnel from the African enterprise in the factory or office of the foreign co-operating company; this too would normally be provided to an associated enterprise;

(v) Subcontracting arrangements for the production of parts and components by the African enterprise on order of the foreign co-operating company; these parts and components are to be incorporated in the products manufactured by the foreign company;

(vi) Assistance in marketing products manufactured by the African enterprise in the country of the foreign company or in other countries, including, if need be, direct purchasing of a given percentage of these products by the foreign company for its own use or for resale: these items are not to be incorporated in the products of the foreign company;

(vii) Licensing and franchising agreements, which might involve financial participation and technical assistance on the part of the foreign company;

(viii) Joint venture in the African enterprise with equity participation and co-management on the part of the foreign industry.

12. The above arrangements would not be concluded by the foreign company as a philantropic gesture. They would be commercial operations motivated either by profit, desire to open markets for machines, components and other products, using local raw materials and other considerations. They would necessarily be expected to pay back, after a time, the initial investment and other operational costs of the foreign partner and eventually to provide for re-investment in the African enterprise. However, it is evident that, under the conditions surrounding such operations, some costs incurred by the foreign partner would, in the initial period, limit if not cancel out any profit or pay-back. Travel costs and subsistence during prospection or preliminary negotiations, the salaries commanded by foreign technicians and managers, the added administrative costs of instalment credit, the costs of training and other special commitments would be high. Unless outside assistance or subsidies are available, these costs would have the result of lengthening the maturation period of investment and of deferring the time when normal returns may accrue. As will be seen below, the project described in the present note might contribute to reducing such costs for the co-operating enterprises.

13. It is quite clear that enterprises interested in partnerships in Africa must be prepared to carry out prospection and assistance activities and bear costs in excess of those they would have to assume in similar operations in their own or other developed countries. Their expectation must be that developments in the future would justify heavier initial efforts. Thus, sale of machinery on the instalment plan and provision of services of technicians to set up and operate the first few enterprises might lead, through demonstration and publicity, to further orders by other enterprises at more normal

conditions. In some cases, technical assistance might need to be provided not only to the associated African enterprise, but also to other enterprises having a relationship to its production process. To give an example, assistance to a shoe factory might require additional assistance to tanneries with a view to improving curing and skinning methods so as to reduce or eliminate cuts and defects in hides and leathers. Help by a contractor to its subcontractors is an accepted practice in the industrial countries, but more technical assistance would have to be provided to subcontractors in a developing country. Secondment of managers and technicians to an associated company would not only benefit the foreign associate by accelerating the achievement of successful operation, it should also be considered by the foreign company as a form of investment in human resources, since its managerial and technical personnel seconded to the African company would acquire, through exposure to unusual and difficult conditions, a practical experience which they could not gain at home. This experience would be of great value to their company when they return to it.

14. The joint venture is the closest form of partnership envisaged here. It involves co-ownership and, as a rule, co-management of the industrial enterprise. The participation of the foreign partner in total equity capital should normally be of 50 per cent or less, but not more. 1/ The foreign partner would bring in the machinery, equipment and spare parts and the services of a co-manager, engineers and/or technicians and other cadres. In case of need, he might share in the working capital, e.g. for the procurement of raw materials. The national partner would bring in land, building, a co-manager and other cadres, supervisory and operating personnel and office employees, working capital etc. The authority and responsibility of each partner should be clearly defined. Co-management should allow for the development of indigenous management by the foreign partner.

15. It is likely, however, that the value of the machinery and equipment brought in by the foreign partner might often exceed that of the land and building contributed by the national partner. In that case - and in others as well - part of the foreign contribution to fixed capital might be in

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1/ Such ventures might also allow for minority equity participation from the Government or the development bank of the African country. This might help in giving confidence to the foreign investor and facilitating the opening of credit for current needs as well as for the future expansion of the enterprise.

equity and part in credit. Repayment of the debt by the national partner might begin after a grace period and the terms of credit should be favourable. This system would have the advantage of reducing the risk of the foreign partner and of increasing the stake of the national partner.

16. A joint venture deal might provide for a licensing agreement, a commitment, on the part of the foreign partner, to buy a given percentage of the finished products or to help in marketing them, to train manpower, and other special obligations. The partnership would normally be concluded for an indefinite period. Ideally, the national entrepreneur should have an option to buy out the foreign partner's share and be entirely on his own, after the enterprise and its national personnel have become self-supporting. This would evidently be consonant with the promotional objective of the venture, which is, to a large extent, to help an African enterprise in the difficult infant and adolescent stages. 2/ However, there are mutual advantages in a permanent partnership, especially if an export market is being planned or developed. This would ensure the availability of marketing expertise and entrée to markets. It would also enable the firm to keep abreast of new trends and developments in technology. A permanent partnership would better meet the purposes of the foreign partner, which, as stated earlier, cannot be entirely disinterested. It would be desirable, however, if, when this becomes possible, full managerial responsibilities were taken over by the African partner, the foreign partner keeping his equity and share of profits.

17. In a joint venture, the salaries commanded by foreign managers, engineers and other executives would, if paid out of earnings, exert a considerable drain on these. The excess of their salaries over those paid to the national counterpart personnel might need to be absorbed by subsidies. The subsidies might be granted for a specified period of time and might decrease from year to year as corporate earnings increase. The subsidies might be paid by the "parent" foreign company or, conceivably, by the Government of the foreign company's country, under its bilateral technical co-operation programme. The possibility for UNIDO of assisting in this area is currently

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2/ On the other hand, giving the foreign partner the option of pulling out or of buying the share of the national partner could be detrimental to the business or be inconsistent with the purpose of the deal, which is to encourage indigenous enterprise.

under study. Under the scheme under consideration, executives would be placed by UNIDO in industrial enterprises in conditions similar to those under which operational and administrative personnel is placed in government departments in the developing countries (Operational Assistance - OPAS). Under this system, the United Nations recruit executive personnel and pay the difference between their actual salary and the local remuneration.

18. It is unlikely that joint ventures might be negotiated in very small industries in which the initial costs would be relatively high and the prospective returns too small to be of interest to any foreign investor. The size range of suitable industries would seem, in general, to be of $ 50,000 to $ 250,000 in machinery and equipment. 3/ This range would appear to correspond to the threshold at which the interest of the foreign partner might be aroused and to the ceiling of the financial resources which the national partner would be able to muster. There might be lower limits for certain industries requiring relatively small investment, e.g. garments, woodworking, ceramics, leather, etc.

19. Joint ventures can be concluded only in countries which have no restrictions limiting drastically the percentage of foreign ownership or the degree of foreign control in management and which are prepared to give assurances as regards the future in this respect.

III. THE PROJECT

20. UNIDO proposes to assist in bringing together prospective partners from developed and developing countries - as is being done under UNIDO's Industrial Promotion Service, of which the present project is a variant - and to facilitate the implementation of the various types of partnerships described in the present note. A two-way system of collection and dissemination of information will need to be built up in the developing and in the industrial countries. As stated earlier, the project will, at any rate in the beginning, be limited to African countries south of the Sahara.

3/ A frequently employed definition of small-scale industry is a manufacturing enterprise with a capital in fixed assets (machinery and equipment but excluding land and building) not exceeding the equivalent of $ 100,000. The industries considered here would be small-scale (upper range) to medium-sized.

Action in African countries

21. A fundamental condition for the success of any partnership operation in an African country is to enlist the co-operation of local promotion and financing organizations: small industry department of a Ministry of Industry, industrial extension centre, development corporation or development bank and commercial credit institutions. The local Chambers of commerce and industry and other industrial associations have a particularly important role to play. The search for a prospective national entrepreneur with the required leadership and other basic qualifications can be carried out successfully only with the help of one or several of these organizations.

22. The co-operation of experts in the field is no less essential. For this reason, the project provides for a joint effort by experts of UNIDO, of the specialized agencies and of bilateral and multilateral technical assistance agencies, for the identification of suitable projects and entrepreneurs for possible partnerships. Some complementary assistance and follow-up action might be undertaken under UNIDO's technical co-operation programme.

23. UNIDO intends to send copies of the present note (in English or in French) to the Resident Representatives of the United Nations Development Programme (UNDP) in African countries for distribution to the following persons or organizations:

- UNIDO small industry experts, other UNIDO experts in industrial development and UNIDO field advisers;
- ILO and FAO experts and regional advisers (after agreement with their organizations);
- Experts serving in Africa under bilateral, multilateral and other programmes, including those of organizations such as Ford Foundation, Société d'aide technique et de coopération (SATEC), representatives of the European Development Fund (FED) etc., (after agreement with their organizations);
- Ministries of Industry, centres for the promotion of indigenous enterprises, industrial extension centres, development corporations and banks in African countries, Chambers of commerce and industry and National Committees for UNIDO in African countries, where these exist.

24. These persons or organizations will be requested to forward to

UNIDO, through the Resident Representatives, information on the various types of partnerships which appear to be desirable and feasible. This should be done after a suitable industry of high priority has been recognized to be feasible and a detailed pre-investment study of the enterprise has been carried out, and, if possible, after a prospective entrepreneur has been identified. The proposals for partnerships should be drawn up in co-operation with the promotion and financing authorities of the African country concerned.

25. UNIDO would also take some further action. In case of need, it would provide complementary assistance through short-term expert missions under the technical co-operation programmes. These should be requested by the Government of the African country concerned, through the usual channels. Such missions would be undertaken principally to make a detailed pre-investment study and financing plan of the proposed industry, if the UNIDO experts or local authorities in the country do not have the necessary expertise in the field under consideration.

26. UNIDO might also provide, at the request of Governments, the services of experts to give advice in technique, management or marketing to established enterprises involved in partnerships. Some fellowships for training African cadres overseas, e.g. in the associated foreign company, might also be made available by UNIDO. As indicated earlier, the possibility of using the OPAS system for providing executive personnel in industries being considered.

27. While UNIDO cannot, for obvious reasons, participate in the investment in joint projects, it might, upon request, facilitate the negotiations between partners, through experts, consultants or field advisers.

28. The two-way channelling of information would be carried out by UNIDO on a continuing basis. Action will also be taken on the occasion of the industrial fairs and other schemes in African countries, where the Industrial Promotion Service of UNIDO is in operation.

Action in industrial countries

29. UNIDO will forward the information received from the African countries to potential partners in the industrial countries. It will also invite potential partners in the industrial countries to send it offers of partner-

ships for transmission to the field.

30. It would be very useful if, in each of these countries, a single agency served as a focal point for this two-way collection and channelling of information on partnerships. The Chambers of Commerce and Industry in the industrial countries seem to be the most appropriate liaison agencies for this purpose. The National Committees for UNIDO, where they exist, would be invited to co-operate in the implementation of the project.

31. UNIDO intends therefore to send copies of this note to the Chambers of Commerce and Industry in certain industrial countries for distribution among interested industries. Copies will also be sent to the National Committees for UNIDO and to certain institutions and government departments in these countries.

32. In addition to ensuring the two-way liaison between UNIDO and the business community of their country, the Chambers of Commerce and the National Committees for UNIDO in the industrial countries might induce their own Governments to participate to some extent in the proposed scheme. For instance, prospective partners from the industrial country or experts might, under the bilateral technical co-operation programme, undertake prospection work, carry out feasibility and pre-investment studies and assist in the search and identification of entrepreneurs. The services of experts might also be provided for advisory services to established enterprises. Subsidies might be given for offsetting the high cost of managers and other cadres seconded by the foreign company. Fellowships might be granted for training of African industrial personnel in the industrial country.

33. In some industrial countries, a few private or semi-public organizations interested in the promotion of such partnerships have been set up. These organizations are usually non-profit making foundations or other corporate bodies. They normally charge fees for their services, on a no-profit no-loss basis. In some cases, they receive subsidies from their Government. Their income is derived from fees for services extended to the prospective industrial and other partners in their country. The subsidy, when available, covers overhead costs. Their activity is carried out in two main directions: (i) feasibility studies and other surveys and prospection work in the developing

countries; and (ii) contacting enterprises in their own country, and assisting in the establishment of partnerships. The setting up of such organisations deserves to be encouraged by the Government of their country. Their action might be of considerable help to the proposed scheme.

34. All the promotion and assistance described above will never obviate the need for the prospective foreign partner to conduct negotiations in the African country itself. In the last analysis, the partnership deal will put in presence the two interested parties, and them alone. Moreover, full reliance for prospection cannot be placed on outside persons or organizations. Much should evidently be done in the field by the interested foreign company itself. Among the important means of action which such companies should adopt would be - apart from the catalogues or lists of machinery which they could supply - the preparation of special pamphlets describing in detail complete small-scale or medium-sized plants which they could help installing in African countries under partnership agreements. Such pamphlets, to be issued in English and in French, should describe the products, employment, list and price of all the machinery and equipment, layout, flow-chart, annual production plan, working capital requirements, technology, materials and energy consumption, materials handling and storage, floor space requirements and anticipated profitability. Some information should also be made available on the special services (instalment credit, training, seconding of cadres, purchasing and marketing of products) which the foreign company might be prepared to extend.

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