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08091

Distr.
LIMITED

UNIDO/IOD.173
21 April 1978

ENGLISH

UNITED NATIONS INDUSTRIAL
DEVELOPMENT ORGANIZATION

MOTIVATIONS AND PRE-CONDITIONS FOR THE ESTABLISHMENT OF INDUSTRIAL JOINT VENTURES*

by

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***This material was compiled to serve as a basis for discussions at the Tech-Transfair '78, Utrecht, Holland, May 1978.**

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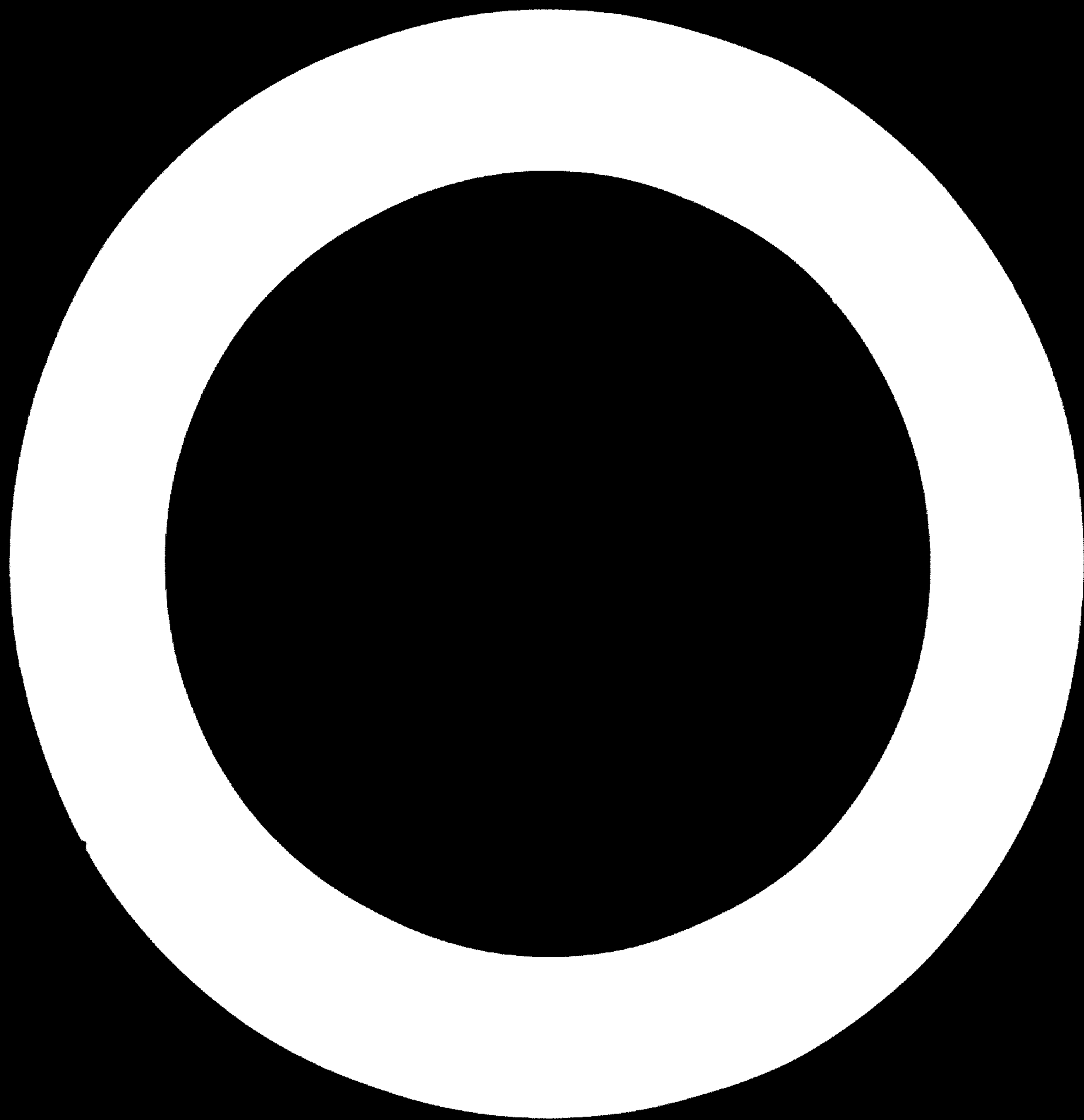
id.78-2133



1. Motivations for the establishment of joint ventures

From the outset it should be well understood that private foreign investors will not normally go to a developing country for humanitarian reasons alone or as a measure of development aid. From the point of view of an investor, his investment in a joint venture must give him a return one way or another, at least in the long run, and consequently he will always be motivated by commercial considerations. Nevertheless, in most cases his investment will have a positive effect on the industrial development of the country in question, particularly when the motivation and preconditions for the establishment of the joint venture have been well understood by both partners.

1.1 Motives for foreign partners

A few years ago a German working group made a study of the motives of German industrialists for their investments in developing countries. Ranking the motives by their importance, the following sequence of items:

1. Safeguarding of markets to which goods had been exported;
2. Extension of activities abroad to provide new markets;
3. Safeguarding of markets by investing prior to competitors;
4. Safeguarding of the raw material supply;
5. Possibility to install second-hand machinery;
6. Expectation of a high return on investment; and
7. Other motives, e.g. equity participation in order to secure large orders for machinery supplies, etc.

The working group observed that 90% of the investments had been made in the form of joint ventures, of which one half consisted of majority or parity joint ventures and the other half of minority participations. The remainder (10%) had been made in the form of wholly-owned foreign subsidiaries.

On closer examination of the above-listed motives for these investments, the following conclusions can be drawn:

1.1.1 Safeguarding of existing markets:

Many industries in industrialised countries depend to a great extent (up to 60-70%) on export business, often to developing countries. In case such an industry finds that, for certain reasons, its exports have become more difficult or even impossible, and if the importing country represents an important and sizeable market, the exporter will begin to think about direct investments in that country. The reasons for export obstacles may be the following:

1.1.1.1 The most common reason is the imposition of import restrictions by a developing country which will make future sales in the respective market impossible unless a local production line is built up. The rather precarious foreign exchange situation of a developing country can be the reason for such import restrictions, but also the desire to force further industrialisation to take place or to protect already existing indigenous industries. Imposing or raising import duties to a prohibitive level will have a similar effect.

1.1.1.2 A second reason on that exports become more difficult may be a favourable cost situation in which local industries are able to compete with the imports from industrialised countries.

1.1.1.3 Another reason could be the fact that buyers in a developing country may prefer or be obliged to purchase locally-made goods; this refers particularly to government authorities which often have to give preference to indigenous products even if they are sold at a considerable price differential.

Under the above circumstances, an export industry in an industrialised country may seriously contemplate the establishment of a production unit in the respective developing country, especially when the exporter anticipates that other foreign competitors may invest in the country in question. The existence of a free trade zone or an economic community will facilitate the decision to invest in a developing country since, in any case, the existence of a sufficiently large market is a prerequisite for local production.

1.1.2 **Opening of new markets**

Similar reasoning applies in principle to cases in which foreign entrepreneurs intend to open new markets for their products in countries where they have not been active in the past. The extension of sales activities is a legitimate goal of every businessman. As the developing countries are considered the "markets of tomorrow", foreign investors may find it advisable to secure for themselves in time a sufficient market share by producing within this market before import restrictions and customs barriers [illegible] form.

1.1.3 **Safeguarding of the raw material supply**

If an industry in an industrialised country depends on one or more key raw materials which are found in or produced by a developing country, it may be advisable to safeguard the steady supply of such materials by direct

investment in the country of origin. Two main reasons will motivate such an investment: the scarcity of raw material and/or its high price on the world market. In both cases, the user industry would wish to secure its own source or at least to have it under its influence with a view to ensuring a constant access to the raw material source and/or to reduce the cost thereof by eliminating intermediate trade.

This motivation refers in particular to the extracting industry, such as oil extraction or the mining of various kinds of ores or minerals. It may also apply to certain agricultural products which the user industries or other buyers need in [illegible] quantities and qualities if the supply is not sufficiently organised to meet these requirements. In the latter case, the industry or trade in a developed country may be interested in organizing the growing, harvesting and partial processing on-the-spot of such agricultural products.

Foreign-owned extracting industries have, however, come under heavy criticism in the developing countries. In particular, it has been said that foreign companies exploit the national resources of the developing countries without leaving to these countries an appropriate share of the benefits derived from such exploitation. This criticism is mostly directed against large multinational or international companies active in the oil and/or mining business. This criticism has led to nationalization of natural resources in several countries so that joint ventures are no longer possible in these areas.

As much as these complaints may be justified in quite a number of instances, one could perhaps argue that in the well-understood national interests of the respective developing countries it would also be advisable to welcome joint ventures in the extracting industries also in the future. The huge capital investments and the sometimes complicated technical know-how necessary to bring the national wealth to light and process it, as well as marketing considerations, would be a justifiable motivation for the local partner, who will often be the government, to work in partnership with foreign companies. The foreign partner, on the other hand, should accept fair and reasonable regulations covering the rights and responsibilities of both sides in the joint venture in a spirit of "good corporate citizenship".

1.1.4 Shortage of labour in industrialised countries

In some of the industrialised countries a [illegible] new motive for investments in developing countries has emerged during recent years: the shortage of labour in general or in certain geographical areas or for certain jobs.

To a great extent the problem has been resolved by inviting guest workers from developing areas in Europe or from developing countries, for instance, in such countries as Germany and Austria. This system solves the problem of labour shortages in the industrialized countries and contributes to the solution of unemployment in the developing countries (apart from the remittances of guest workers to their families, which have a favourable impact on the foreign exchange situation of their home countries). But the transfer of a huge number of people from developing countries to Europe creates other problems which lie both in the humanitarian and the economic spheres.

In the recent past some labour-intensive industries in developed countries have found it more feasible to transfer the production to the place of the workers instead of transferring the workers to the place of production. This refers both to the transfer of existing plants to developing countries as well as to the creation of additional capacities in these countries. As most of these factories do not produce mainly for the local market but for export purposes, they not only provide employment possibilities for the local labour force but also contribute favourably to the foreign exchange situation of the host country, resulting in a means of synchronization of interests between foreign investor and developing country.

1.1.5 Cost and price [illegible], economic return aspects

The return on investment will be influenced mainly by two factors, i.e. from the cost side on one hand, and from prices on the other. The motivation to invest in a developing country can therefore stem from either of the two factors or from a combination of both.

1.1.5.1 Cost advantages

Advantages from the point of view of costs will mostly concern four main subjects: the cost of labour, the cost of raw materials, transportation costs and taxes.

The example of labour-intensive industries investing in developing countries due to a shortage of workers in industrialized countries has already been mentioned. However, the motive for such investment lies also in the advantage of "cheap labour" expected in developing countries. Although this does not always hold true there are, in fact, quite a number of developing countries that show a considerable differential in the level of wages as compared to the industrialized countries. Whether this

differential will be sufficient to favour investment in a developing country will, of course, depend also on other factors, one of them being the skill and efficiency of the local worker which will be examined later.

The cost of raw materials is a decisive factor if it constitutes a rather high percentage of the value of the finished product and provided it can be obtained or is much cheaper in a developing country. Traditional intermediary trade costs, export levies on non-processed raw materials or the high cost of transportation of bulky material and import duty in the industrialised country, may add to the cost of the raw material and make it comparatively expensive in an industrialised country while these additional costs could be avoided if the raw material is processed on the spot. Such material-intensive projects are not only found in the agro-industrial field but also in the processing of oil and/or minerals.

Transportation cost advantages in connection with production in industrialised countries can also arise with reference to finished products if they are voluminous (e.g. steel structures) and are to be sold on the local market of the developing country or nearby areas.

Last but not least, it can be stated that the incentives of various kinds granted by developing countries to attract foreign investment play an important role in the motivation of an investor although one should perhaps not overestimate their importance in the decision-making process if other conditions, such as the general investment climate, in a developing country are not favourable.

1.1.3.2 Price advantages

The price advantages which motivate a foreign investor may be seen either in low or high prices.

If goods can be produced at lower cost in a developing country due to the cost advantages just described, and subsequently be sold at lower prices on the world market, these lower prices will give the foreign investor a better sales position as compared to his competitors and will therefore induce him to invest. If, on the other hand, goods can only be produced at higher costs than in an industrialised country, a foreign investor may still be interested in investing provided he can sell the goods at higher prices on the local market due to market protective measures of the developing country. Such protective measures like customs barriers, import bans or restrictions for

competing foreign products or the restriction of local competition by way of restricted issue of production licences, will normally also secure a good profit margin for the foreign investor which could be the motivation for his investment.

In this context it should be added that in most cases an insight to high return on investment is not the decisive factor for industrial investments. Foreign investors normally know how difficult it is and how much time it takes to make a new product successful and to derive profit therefrom. Consequently, they will often think in longer terms with respect to profitability and will see their investments more from the point of view of market strategy. The local partner, on the other hand, especially if he comes from trading circles and has not yet gained industrial experience, is often more inclined to think in terms of a quick turnover and fast returns to which he is used from the trading business. Long-term and short-term thinking may therefore give rise to certain difficulties in determining the financial policies of a joint venture.

1.1.5 Possibilities of transferring existing production units to developing countries

One motive which has been mentioned before is the wish of foreign investors to transfer existing plants and machinery to a developing country. This question will mainly arise if it is found that under the conditions prevailing in an industrialised country it will no longer be possible to produce economically with certain machines or with the whole technical set-up of a factory. Instead of scrapping the machines or the factory, industrialists may first think of transferring the equipment to a developing country under the assumption that even with machines which are not up to the latest technical standards, production could still be profitable. In the early phases of development policy it was also thought that it might be even more advisable to start industrialization with less sophisticated second-hand machinery at lower cost. The importance attached to the transfer of such machinery has also further to the desire of industrialists and second-hand machinery dealers to effect transfers of this nature. The advantages and disadvantages of second-hand machinery need, of course, to be carefully examined.

1.1.7 Spread of risks

One motive which may refer more to investments in other industrialized countries but can also be applied to investments in developing countries is the desire of an investor to spread the risk of his business activities over a number of countries or geographical areas. The idea behind such spread is that political and/or economic risks in one or two countries may be offset by investments in other countries which remain unaffected and one could assume therefore that a major proportion of the investments would always work under favourable conditions producing a positive overall result. Such a system could only be implemented, of course, if the size of the total operation of the foreign company lends itself to a split-up into a number of separate production units in different countries, thereby avoiding accumulation of risks.

1.2 Motives of local partners

After a broad assessment of the above-listed motives of foreign partners, the following deals with the motivation of local partners in order to determine whether their motives to establish joint ventures are similar or at least if their interests can be harmonized or synchronized with those of the foreign partners and to examine whether there are additional motives typical of local partners.

1.2.1 Safeguarding of existing markets or establishing new (local or export) markets

In the case of import obstacles (in the various forms previously outlined) a local firm which so far has been the import agent will have a strong interest in not losing the market for the goods so far imported, and may therefore be prepared to follow a proposal of the foreign exporter to establish a joint venture. It goes without saying that it could also be the local partner who suggests the joint venture to his foreign business friend - it certainly must not always be the foreign partner who takes the initiative.

Should the importer not wish, or should he not have sufficient means to participate in an industrial joint venture, other local entrepreneurs may grasp the opportunity if it appears promising. The importer may therefore find himself out of business or, at best, his organization may be utilized for the distribution of the then locally-manufactured goods.

Even without any import restrictions imposed or expected to be imposed, a local entrepreneur in the developing country may find it more advantageous to have goods manufactured locally instead of imported due to favourable

cost condition, new tax incentives or other measures of the local government. In this case, the motive would not be the safeguarding of a market which stands to be lost, but the substitution of imported goods by locally-manufactured ones. The motive, however, could as well be a completely new product, or a range of products, for which a local entrepreneur discovers good selling prospects if manufactured locally. This could refer both to sales within the developing country as well as to exports. The motive for establishing a joint venture will then be the extension of business activities into new (local or foreign) markets.

One could, of course, argue that these activities need not necessarily take the form of a joint venture. This leads to perhaps the most important motive for the establishment of joint ventures.

1.2.2 Securing of technical know-how

The reason for a local entrepreneur to enter into a partnership with a foreign collaborator lies in most cases in the insufficiency or lack of specialised technical know-how on the part of a local partner (this includes those cases where the initiative came from the foreign partner and the provision for technical know-how plays an equally important role in the conclusion of the joint venture agreement). Again, one could argue that this insufficiency or lack of technical know-how must not necessarily lead to a joint venture but that there are other forms of co-operation available which are limited to the technical field only. Such forms of limited co-operation are, for instance, licensing agreements between a foreign company and a local firm in a developing country under which the local company (licensee) is authorised by the foreign licensor to manufacture and sell licensed products within a certain territory and the licensor agrees to supply to the licensee technical data, information, know-how and assistance related to the licensed products. While such an agreement will work between companies in industrialised countries or if the licensee in the developing country is already a manufacturer in the same or similar line of products and has therefore sufficient basic technical know-how which only needs to be supplemented, a pure licensing agreement will not serve the purpose in many instances in the developing countries. Under the usual provisions, it does not give the local licensee the full range of services for the planning, construction and running of a completely new factory including

management and training of personnel. Although it enables him to have access to specialised technical knowledge, a licensing agreement does not appear to serve the interests of the licensor. Under the circumstances prevailing in many of the developing countries he will find it difficult to have the quality standard of licensed products maintained by the local licensee if he cannot exercise direct control over or influence on the quality during all stages starting with the purchase of raw material, components, etc. through the various production processes up to the sales and after-sales service. Such influence could perhaps be secured by means of a management agreement in addition to the licensing agreement but that would not normally give the licensor representation on the Board of Directors of the licensee and for the local company a "hired" management would have the drawback that one could not expect the same identification with the interests of the local company as in a joint venture with the management responsibility of a fully-integrated foreign partner.

For these reasons the joint venture will have to be given preference over other forms of co-operation in all those cases where complex production processes are involved. The joint venture appears to be the form in which the interests of the local and foreign partners, although based on different grounds, can be best synchronized.

1.2.3 Securing of management

As indicated above, the question of management is closely related to the question of technical know-how. A local entrepreneur in a developing country who has not yet acquired industrial experience will find it difficult to manage a new industrial venture by himself. This refers both to the pre-production phase and to the proper running of the factory afterwards. The planning and construction period, particularly if the project is not handled as a turnkey job, requires considerable organizational and technical talents and knowledge. Although in a different way, but to an even greater extent, specialized technical knowledge will be required for the running-in period and operation of the factory.

While machinery suppliers are often willing to delegate personnel to a developing country for the construction and running-in phase, they will not normally be in a position to provide management for the operation of a factory for a longer period of time. The local entrepreneur will therefore either be confronted with the difficulty

of taking over management by himself or establishing a partnership with a foreign partner who is not the machinery supplier but a manufacturer experienced in the line of production to be set up. Management provided in this way could mean the top management but will certainly mean the technical management on the upper and middle levels, while the local partner may wish to concentrate on the commercial aspects of management. It is clear that the foreign partner can only be interested in such a proposal if it suits one or more of the possible motives discussed above.

1.2.4. Securing of foreign exchange financing

Another motive for inviting a foreign partner to enter into a joint venture in a developing country is to be found in the lack of foreign exchange for the financing of machinery and equipment which must be imported from abroad. This motive will be of special importance in developing countries with unfavourable balance of payments situation and for projects with a rather large foreign exchange component. In such cases it would not be necessary to have an industrial partner from abroad. As proper financing is the problem to be solved, financial institutions, either from the country where the bulk of the machinery is to be supplied or international institutions like IFC, could be asked to join as partners. These institutions will not be prepared, however, to finance part of the requirements of a joint venture unless the necessary technical know-how and management have been secured. Thus the need for an industrial partner arises which makes such a joint venture a model case for a quadripartite partnership which unites ideally the resources of its different partners in the endeavour to reach a common goal.

2. Preconditions

The deliberations concerning the preconditions and incentives for the establishment of a joint venture are the first and often decisive stage in which both partners will carefully consider the pros and cons before entering into the planning phase of a given joint venture.

2.1 The investment climate — a determining factor for the establishment of joint ventures

From the foreign partner's point of view these deliberations will concern what may be called very simply "the investment climate", i.e. the complete aggregate sum of the general political, economic, legal and administrative conditions prevailing in a specific developing country including its incentive measures to attract foreign investors and to foster the establishment of joint ventures. While the local partner usually will have only the choice to invest or not to invest in his home country, the foreign partner has also the choice of the country in which to invest. The private investor will naturally go to the country which offers the most favourable conditions.

For the local partner, it will be necessary to acquaint himself with the considerations of the foreign partner as well as to study the local investment conditions in order to arrive at the right decision.

As mentioned above, the thinking of an industrial investor is guided by long-range considerations and consequently he will not be disappointed by temporary difficulties or losses if the long-term prospects are good. If they are generally dull, however, and there is little hope for safety or confidence in the political and economic stability, the best incentives will not attract foreign investors nor induce local entrepreneurs to invest their money in a new industry.

2.2 Political conditions

The first and most obvious conditions to consider relate to the general political situation of the country in question. They include:

(a) the question of stability of the government and the political system;
(b) the probability of civil war or unrest, including racial rivalries between or among various groups of the population;
(c) the danger of permanent political unrest in an area;
(d) the danger of war between neighbouring countries;
(e) the danger of infiltration from the neighbouring countries; and
(f) the political relations between the host country and the home country of the foreign investor.

The local partner will normally be in a better position to judge the above problems and he may therefore be able to give valuable advice in this respect to his prospective foreign partner.

2.3 Economic conditions and incentives

2.3.1 Stability of the economy and government policies

Next to the political stability, the general economic conditions and government's policies with reference to the economy will have the greatest influence on a potential investor's decision. A foreign investor having the choice of various developing countries will turn to the country which appears to offer the best prospects for steady development. The investor will carefully inform himself on the economic growth rates, he will study whether there is a steady increase in the Gross National Product (GNP) as sufficient indication that such increase will continue and thereby ensure a continuous growth of the overall market possibilities. Other economic indicators will also be watched closely, such as the average increase in the cost of living, the rate of increase in salaries and wages (which may adversely affect advantages on the cost side), and the development of prices of local raw materials and other products. In other words, a low rate of price increase in a developing country will be of special attraction to investors, although in some countries, e.g. Brazil, investors have learned to live with inflation and have developed methods to cope with the problems of steadily-increasing prices, and most important, the government has shown its determination to bring inflation under control. In this connection there is another important factor to be considered, i.e. there must be confidence in the government's economic policy, in its intention and ability to foster steady economic development and in its intention to follow sound economic and financial principles to avoid costly experiments which serve prestige purposes only.

2.3.2 Foreign exchange situation and controls (including currency fluctuations and protective measures), repatriation of capital and profits, import licenses

The general economic situation and respective government policies will become apparent to the foreign investor when he examines the foreign exchange situation and controls of the country under consideration. In particular, the foreign exchange situation has far-reaching consequences for the foreign investor, the local investor and for the success or failure of their joint venture. The foreign investor is mainly

concerned with the question of what guarantees are provided to enable him to repatriate his invested capital if he so desires and to transfer dividends (or interest on shareholders' loans) to his home country. The best guarantee, of course, would be a positive balance of payments in the developing country. Unfortunately, there are not many developing countries having a favourable foreign exchange situation which would allow them to practise free foreign exchange transactions. Most of the developing countries are exercising more or less strict foreign exchange control which relates to both capital transactions and current payments for imports, etc. The foreign investor will normally expect that the government will give him an assurance that the repatriation of capital and profits (including capital gains) will be permitted (by way of an "Approved Status" or "Certificate of Approved Enterprise" or other forms of registration certificate). Qualification for such assurances ("subject to availability of foreign exchange" or "subject to the then-prevailing foreign exchange regulations") will make the investor hesitant, although one has probably to accept that no country would give an unconditional assurance forever. For profits, some countries have adopted a system of "ceilings" for the remittance of dividends or of progressive taxes which may be necessary in the interest of the country but will discourage the foreign investor.

Both the foreign and local investors have to attach special importance to the question of whether or not the foreign exchange situation will allow the necessary imports in connection with the projected joint venture. While the capital structure of the joint venture can in most cases be designed in such a way as to secure the foreign exchange needed for the purchase of machinery and equipment, this **cannot normally be done for** current imports, raw materials, components, spare parts, etc. All of these items are vital for the smooth operation of the factory, since without a continuous supply of material, the capacity of an enterprise cannot be utilized economically and missing spare parts may cause a long standstill of an essential machine resulting in heavy losses to the joint venture. Before issuing a production licence the government should therefore carefully examine whether or not the proposed investment will cause a drain on the foreign exchange resources (without appropriate compensation by import substitution or additional exports) and it should rather decline to give the licence if it is felt that the drain would be excessive for the time being. Once the investors have been granted the

production licence, they should be reasonably assured that the necessary foreign exchange will be made available to them for their current requirements.

The better the foreign exchange situation and the general economic situation of the developing country, the less is the risk of substantial fluctuations in the exchange rate and the need for protective measures against such fluctuations. There are rather few direct protective measures available. The joint venture may protect itself against such a risk, however, by not utilizing foreign exchange loans or credits for expenditures in the local currency or by incurring foreign exchange liabilities only to such an extent and for such terms as it has export returns on the other hand, which is not easy to manage. A certain protection which governments can give to the investor is an annual revaluation of the (fixed) assets of the joint venture corresponding to the rate of internal inflation. Provided this rate of up-valuation corresponds nearly to the devaluation of the foreign exchange rate, the value of the investment in foreign exchange will remain more or less unaffected. This system has been successfully developed in Brasil.

2.3.3 **Size of market and purchasing power**

One of the most important economic pre-conditions for a successful investment is a market of sufficient size. This is determined by the geographical size of the market, the size of population and the purchasing power of the people, which is often limited by the rather low per capita income in many of the developing countries.

Generalizations in this respect are rather difficult to make but it must be well understood that the size of the local market must be large enough to support the production of the joint venture, i.e. that apart from exceptional cases where the factory is specially built for export purposes, the joint venture should be able to sell its full production - at least up to the break-even point - on the local market. The term "local market" could also mean, however, a market in neighbouring countries united in an economic community. For small developing countries this will probably be the only possibility to attract industrial investments, that is, to combine their limited national markets with a view to forming a sizeable regional market and to plan jointly the establishment of industries in the different parts of this regional

market. This, of course, depends on the willingness of the respective governments to co-ordinate their industrialisation efforts.

2.3.4 **Local labour situation**

Unemployment is one of the most serious problems of the developing countries. The creation of new permanent employment possibilities through establishment of joint ventures is therefore a welcome contribution to national development. Abundance of local labour in itself, however, is not a guarantee for a foreign investor to find the right people for the right job. Before he decides on his investment, he will carefully study the skills and qualifications of the local workmen. He will hardly expect to find adequate numbers of sufficiently skilled workers to meet his requirements, but it is most important that the local people show willingness and ability to learn and that they possess some natural manual talents. If these basic conditions are fulfilled, the investor will also be willing to invest money in training facilities and programmes for various types of work, both on the job in the developing country and in the factories of the foreign investor in his home country.

Another question is whether public training facilities are available for certain types of jobs in the form of vocational schools. If not, the investor will have to take care of the respective training, unless similar industries already exist from which at least a skeleton staff can be drawn.

A further pre-condition for a foreign investor is that he can be reasonably assured not to experience large-scale labour unrest, strikes or similar events which disturb the smooth operation of the factory. The influence of trade unions or similar organisations on the workers, discipline and general behaviour of the workers, their policies with respect to wages and general working conditions, the attitude of the workers towards foreign supervisory personnel, in short, the "labour climate" will have a considerable impact on the foreign investor's decision as to the place he will select for the intended production.

2.3.5 **Employment possibilities for expatriates**

Security of constant employment is one of the foremost motives of the local partners to enter into a joint venture. The possibility of employing foreign experts in top and middle level positions in the new

venture is of special importance as a pre-condition for both the foreign and the local partners.

Depending on the type of industry and the difficulties of the technical processes involved, employment permits may also be necessary for a number of other personnel. In this connection it should be noted that employment permits are not being sought in order to create lucrative employment opportunities for foreign nationals and to deny such positions to local staff members. On the contrary, the investors will keep the number of foreign experts as small as possible in view of the high costs involved in the employment of expatriates. It should also be well understood that it is not an easy task for the foreign investor to find a sufficient number of experts who are qualified, fit for climatic conditions, have a good command of the foreign language and who are also willing to go to a developing country.

Unfortunately, the **attitude** of governments in developing countries is not always favourable towards the employment of foreign nationals and in a number of cases difficulties have been encountered in obtaining working permits, either for the required number of expatriates or period of employment. It is appreciated, of course, that these governments may have valid reasons for being reluctant to issue working permits and may find themselves in a certain conflict of interests. This may result from the feeling that the difference between the salary and fringe benefits granted to expatriates on the one side **and** and to the local staff on the other may lead to difficulties, that foreign exchange situations may be strained by remittances abroad and that the local staff is not accorded sufficient chances for promotion to higher grades. Accordingly, some countries have laid down formulae or regulations which stipulate that local counterparts must be appointed for all expatriates (or expatriates in certain positions) and that these expatriates must be substituted by their counterparts within a given period of time. While by principle such regulations should not be looked upon by foreign investors as being unjustified, they may constitute an obstacle for investment if their wording does not leave sufficient room for flexible solutions and also if they are applied too rigidly in individual cases without due regard to the well understood interests of the joint venture and the country.

2.3.6 Infrastructure of host country and project requirements

Considerations regarding the infrastructure of the developing country in general, and of a potential site for the joint venture in particular,

rank highly among the pre-conditions and incentives. The infrastructure includes public utilities, transportation and communication facilities.

Public utilities provide the supply of power, energy and water as well as the [illegible] system. Transportation must be assured for raw material and finished products as well as for the labour force of the joint venture. Port and airport facilities (if imports of raw materials or exports of finished products are involved) must be sufficient and efficient enough to handle the contemplated volume of traffic; roads, railways, inland waterways, etc., must be available to facilitate the transport of men, materials and products during the entire year.

Communication facilities will be needed especially in the form of telephone and telex connections for prompt and quick communication with suppliers, customers, and authorities, between the factory and town offices or between various production units of the enterprise. The non-availability of these facilities will seriously impede the day-to-day operation of the factory and the activities of the sales, purchasing, and administration departments of the joint venture. While the joint venture itself will take care of a number of related investments, the investors will expect that a great proportion of the infrastructure will either be existent or will be provided by the government or municipal authorities until completion of the factory. If that is not the case, the investment would either become impossible or would be burdened with such high (unproductive) costs that the enterprise could not be operated profitably.

In a number of developing countries, these problems, or at least part of them, have been solved in the form of industrial estates. The estates do not only offer public utilities, transport and communication facilities, but the investor will often find land and factory buildings at low cost. Such estates and the conditions offered by them are a considerable incentive for foreign investors as they can complete their project quickly and with less complications. The industrial estates can also serve as duty free zones which will allow the joint venture to conclude job processing agreements for the account of foreign-based companies or to produce for re-export purposes without having to pay import and/or export duties.

2.3.7 Other measures for market protection

In view of the limited markets in many developing countries which allow only small production units and due to other adverse cost factors, the

manufacturing of certain products is only possible at higher costs than those of imported goods. If the government of the developing country is willing to accept this situation in return for other advantages which an import substitution will have (e.g. positive effect on the balance of payments, employment, etc.), the partners would have to ask the government for appropriate market protection measures as a pre-condition for their investment.

There is, of course, the possibility of tariff protection by way of raising the import duty on competing finished goods to a prohibitive level. Such an increase of the import duty may not be an appropriate measure, however, e.g. if imports are still needed to a certain extent. In this case the government would have to grant protection to the new industry in a different way, that is, by imposing restrictions (quota system) which would not make the remaining imports more costly. A combination of both measures may perhaps put local production and imports on an equal footing.

Another way of protecting local industries would be an instruction to all government authorities to give preference to locally-manufactured goods over imported goods even if prices of the local goods are higher. This type of protection is important when the government is the only one, or one of the main customers, of the goods in question.

But even the protection measures just described may not be a sufficient guarantee for the investor in the case of a limited market. They may ask the government therefore to provide assurances that no further production licenses for the same kind of goods will be issued to other investors unless, and until it has been established that, there is room for a further factory without jeopardizing the business of the existing one.

2.3.3 Other incentives

In addition to, or instead of, the incentives so far mentioned, governments of developing countries have granted other incentives to attract foreign investments. These incentives range from the lease of land at nominal fees and concessional rates for the supply of water and electricity to the grant of investment premiums or subsidies. For the encouragement of exports, preferential exchange rates, export premiums or bonuses are incentives without which many industries in developing countries may not be able to compete with the traditional exporting companies on the world market. Some of these incentives may not be

granted to foreign-owned companies but only to indigenous industries or joint ventures in order to foster their establishment.

2.3.2 **Local facilities for financing and insurance**

Since the financial requirements of a joint venture cannot normally be met from the resources of the partners, it is a pre-condition for the establishment and running of a joint venture that adequate sources of suitable finance are available to meet the long-term and short-term demands of the new company in local currency. In many developing countries a well-functioning system of commercial banks exists which can cater to the needs of short-term credit requirements of joint ventures although sometimes at very high rates of interest. But there are other countries where even in this respect difficulties arise which make foreign investors hesitant if they have to supply the financing for the day-to-day requirements of the joint venture.

Even greater difficulties will arise with reference to long-term financing. Unlike in industrialized countries where many long-term financing facilities are available, the developing countries have often only one long-term lending institution in the form of a mostly government-owned development bank. Such institutions will have to carry the greatest part of the burden and function once more as a substitute for a local capital market. They will not only have to provide the financial means but also will have to make them available at such conditions that the interest rates, maturity and grace periods of the loans make investments still feasible. Preferential interest rates will certainly be a special incentive to investors and can be one of the instruments of competition between developing countries or regions in their endeavour to attract foreign investors.

Among the facilities needed by joint ventures are also insurance companies. Here again, the normal insurance coverage required is usually available, i.e. fire, theft and burglary insurance. What is missing in most cases is the typical industrial insurance for machinery breakdown and consequent loss of profit. In view of the difficult conditions under which machinery has to work in developing countries, such insurance can be of special importance as the financial consequences of a breakdown can be very severe. Joint ventures should therefore be given the opportunity to take out such insurance coverage abroad if the local insurance cannot issue the respective policies or issue them only at exorbitantly high rates.

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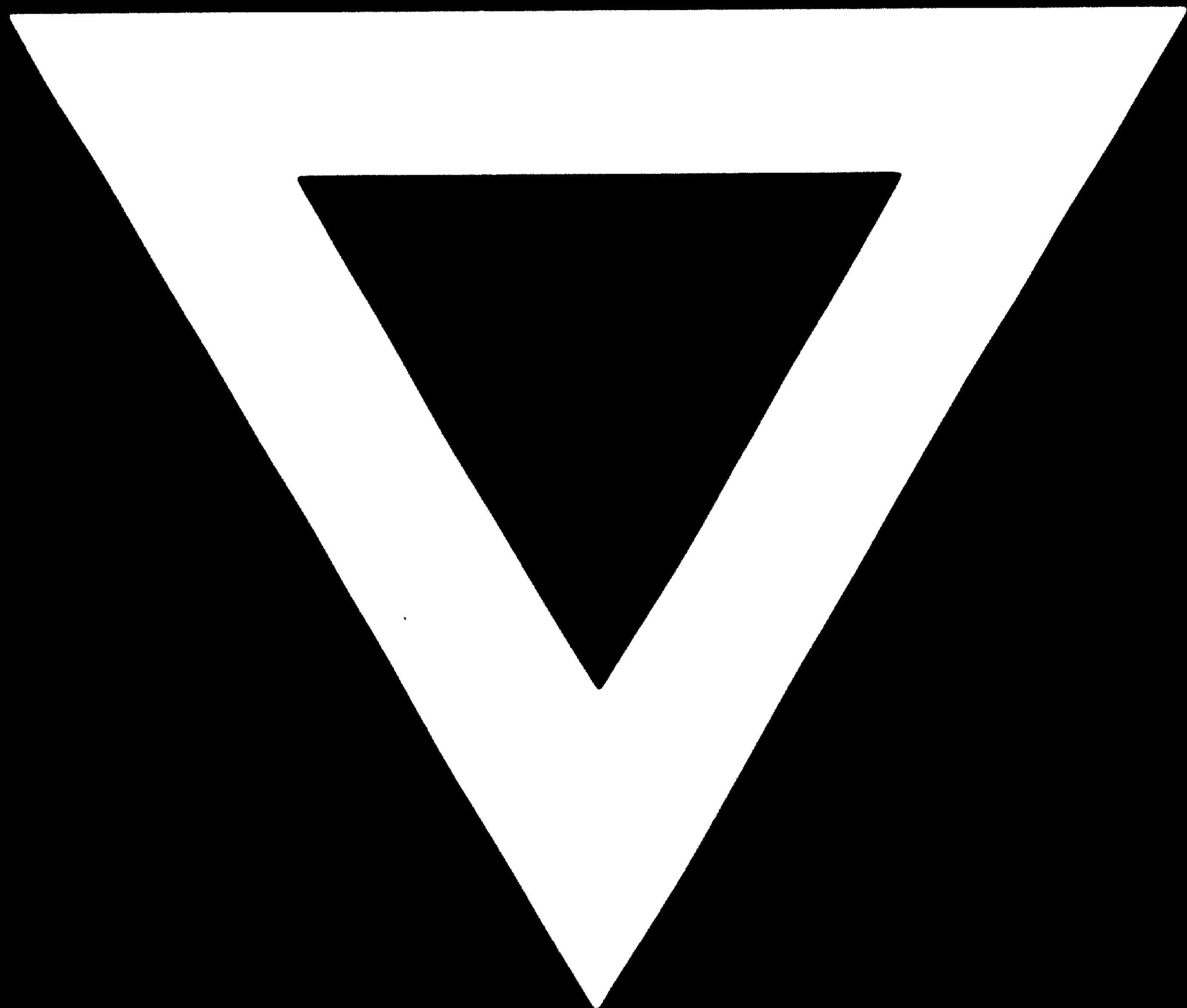

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