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NATIONAL POLICIES AND SUPPORT ACTION FOR INDUSTRIAL RESTRUCTURING FOR THE LONG-TERM PROFITABILITY OF THE FOOD-PROCESSING INDUSTRY IN AFRICA

International co-operation and financing for industrial restructuring in Africa*

Prepared by
the UNIDO Secretariat

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CONTENTS

I. INTRODUCTION

1. The importance attached to industrialization led many post-independence African governments to formulate and implement import substitution policies in their respective countries as a first step in achieving a sustainable economic growth and independence.

2. Despite these policy measures, it has been observed that since the mid-1970s, the industrial sector in general and the food-processing subsector in particular in most African countries have been stagnating and even declining in terms of output, capacity utilization, manufactured value added (MVA), employment, etc. These problems have been caused mainly by the following factors: hasty investment decision-making in technically and financially unsound projects; construction cost overruns, high operational costs due to weak management; obsolete equipment and outdated technology; lack of spare parts; shortage of foreign exchange, inadequate supplies of raw materials and power, changing market conditions; deterioration in the external economic environment; unfavourable government industrial policies that do not foster linkages between industry and agriculture and other sectors of the economy; as well as lack of supportive infrastructure.

3. In order to promote the long-term viability of the food-processing subsector it is necessary to launch suitable programmes of rehabilitation and restructuring. While rehabilitation addresses plant-specific problems such as management, machinery and equipment, spare parts, raw material input, infrastructure etc., restructuring relates to the macro-economic aspects of policy options. Industrial restructuring could be seen as a process of structural changes in response to external pressures, arising out of changes in technology, markets, financing and industrial organization and management. Industrial restructuring presupposes that economic resources such as labour, capital and technology be transferred from one part of the economy to another with the aim of achieving optimal utilization.

4. Elements of industrial restructuring include inter alia, policy measures such as liberalization of foreign exchange regimes, reduction of protection for import substitution, rationalization of the import regime conducive to linkages among industries, phasing out of direct control with public sector, liberalization of interest rates, import and quantitative controls. These measures are geared towards reversing the industrial decline trend and redirecting industrial processing plants towards efficiency, competitiveness, high productivity and profitability. In turn, they contribute towards the overall growth and orderly development of the economy on a self-sustained basis.

II. INDUSTRIAL STAGNATION IN AFRICA: FACTORS BEHIND THE DECLINE AND MAIN REASONS FOR RESTRUCTURING

5. In the food-processing subsector, capacity utilization below 40 per cent has been recorded in many countries since the mid 1970s while in terms of MVA, there has been a negative growth since the 1960s. The average growth rate in the sub-Saharan African MVA of 6.5 per cent per annum in the 1960s declined to 4.5 per cent in the 1970s and decreased further to 2.5 per cent per annum for the 1985-1987 period. 1/ The fall in the real per capita incomes of most African countries emanates from a decline in the GDP growth accompanied by

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1/ UNIDO: Industrial and Development, Global report 1989-90, Vienna, p. 59

even higher population growth rate. Many African economies are vulnerable because they depend mostly on primary production and trade. Agriculture often accounts for more than 60 per cent of their labour force 2/ and between 30 to 60 per cent of their GDP. 3/ African countries have witnessed in the past decade, a decline in the demand of their primary export products due mainly to loss of competitiveness, change in tastes or substitution of materials or products and restrictions in importing countries. The share of African exports in all world trade is estimated to have fallen from 2.4 per cent in 1970 to 1.7 per cent in 1985.

6. The negative growth rate of industrial production since the mid-1970s reflected structural weaknesses within the continent's industrial sector. At the early stage of industrialization, most African countries developed and implemented an import substitution strategy with the objective of processing locally-produced raw materials using imported machinery and equipment as well as spare parts. Export revenues from the primary commodities, particularly agricultural raw material, mineral products as well as foreign borrowing and aid, financed these new industries. Linkages between the agricultural sector and the food-processing sub-sector have not developed sufficiently. The decline in export earnings due to adverse terms of trade for commodity exports could not support the importation of essential goods such as food, machinery, spare parts, intermediate inputs, etc.

7. Direct public investment in the manufacturing industry sector reflected a major element in this industrialization strategy. Governments of many African countries believed that direct public participation in industrial development was the most effective method of increasing industrial capacity and fostering economic development while at the same time reducing reliance on foreign companies. Against the background of underdeveloped domestic private entrepreneurship and negligible domestic capital in most of these countries, direct public investment was seen as the only viable alternative. As part of the strategy to foster overall economic development, private industries which were regarded vital or strategic to the economic development of the country were nationalized in some countries.

8. To achieve the objective of making the manufacturing sector play a leading role in the economy, protective policy measures were formulated and implemented in many African countries. These included macro-economic measures such as high import tariffs, price controls, low interest rates, rigid foreign exchange regimes, etc. that in many cases distorted markets and production conditions. The success of this import substitution strategy required the existence of certain basic resources and facilities such as, qualified manpower, adequate infrastructure, raw materials, technology, etc. But, in many African countries, these necessary elements were not often available. However, given that Governments had adopted these strategies they were bent on seeing them through.

9. In many African countries, industrial machinery and equipment were either installed during the pre-independence period or soon after independence. Continuous breakdown and inadequate maintenance pose serious constraints to capacity utilization since most of them are old and obsolete. The selection and procurement of this machinery and equipment were often technologically inappropriate to local conditions and sometimes not properly tested before commissioning. In some cases contractual agreements did not include such elements as guarantee for supply of spare parts and components.

2/ FAO Yearbook vol. 42, 1988.

3/ Meier, G.M. & Steel, W.F. (Edited): Industrial Adjustment in Sub-Saharan Africa, Oxford, 1989, p. 6.

10. Furthermore, at the early stage of industrialization in most African countries, industries were often established on the assumption of domestic market demand growth, export prospects for the manufactured products, availability of local raw materials and the development of supportive national infrastructure which later proved to be unattainable. The food-processing subsector was no exception in this regard.

11. Important factors in any industrial enterprise are the availability of a well qualified management and good organization of structure. Skilled, knowledgeable, qualified and experienced managers well equipped to organize people and work according to policies and programmes were a rarity. Furthermore, managers were often insufficiently supported with operational funds for achieving the objectives of the enterprise and especially in public enterprises, they were not free to make important decisions autonomously. Yet the markets are not static and industrial concerns succeed or fail depending on how quickly the management can react to environmental changes.

12. Low capacity utilization and low productivity are major reasons for the need to rehabilitate enterprises. These two problems often arise from the lack of managed maintenance systems, particularly scheduled preventive maintenance in contrast to curative maintenance and repairs after breakdown of plants. Preventive maintenance entails not only planning, but also ensuring the necessary resources for its management including availability of spare parts and trained personnel.

13. In many African countries, erratic supply of energy to industries has remained a major constraint to the operation of plants. The problem is more pronounced in the food-processing subsector where millions of US$ are lost yearly during the production process due to broken machinery and power failures. Power failures contribute substantially to low utilization of installed capacities. Reasons for these power failures are sometimes attributed to inadequately scheduled and preventive maintenance of power stations caused by lack of spare parts and qualified technicians. It has also been recognized that at the planning stages of the power equipment, allowances were not made for sizeable future expansion of consumption. The same problems arise with the supply of water for industial use.

14. Transport and communication systems play a vital role in the distribution of raw materials and manufactured outputs. This is more crucial in the case of the food-processing industry as most of the raw materials and processed foods are perishable if not delivered to their end users in the shortest possible time and by the most appropriate means of transport. Transport and telecommunication systems in most African countries do not function properly. This creates problems for both farmers and food-processors. For farmers, lack of adequate transportation facilities often means that their product goes to waste or that they resort to subsistence farming. The inability of the farmer to produce and supply may imply that the food-processing plant has to either operate below its installed capacity or close down. High costs of transportation increase production costs making products uncompetitive compared to imported ones.

15. There is also a growing need for silos and appropriate systems for storage and processing of most agricultural products. Indeed, in most African countries, crop losses are due to spoilage resulting from lack of adequate storage facilities both on farms and in factories. This problem needs to be addressed by governments.

16. At the micro-level, problems connected with lack of capital and inadequate financial policies confront the food-processing industries in a very serious manner. Problems arose at the early stage of development as governments of many African countries used low interest rates as a means of providing low cost financing for development. Low lending rates however prevented banks from covering costs and it discouraged long-term lending. The low interest rate did not promote domestic savings. In some African countries, public borrowing from commercial banks crowded out lending to the private sector. Also foreign loans and grants rarely benefited the private sector directly. For effective and meaningful rehabilitation and restructuring of the food-processing industry, in line with the on-going structural adjustment programmes in many African countries, the financial sector needs to be restructured.

17. Price control measures were introduced in a number of African countries on agricultural raw materials and manufactured outputs of many industries. The low prices of agricultural output - industrial inputs - discouraged farmers to produce, while the price control on outputs of industries reduced their profit margins and in turn their liquidity.

18. Furthermore, the deteriorating terms of trade and the world economic recession that followed in the early 1980s, made it very difficult for many African countries to pay for their imported goods at the same time as servicing their debts, because of the low demand and declining prices of their commodity exports. The debt crisis since 1982 drastically reduced voluntary commercial capital inflows to African countries. In an attempt to promote exports, many African countries were forced to devalue their currencies and liberalize trade. Many manufacturing industries, were faced with sudden unfavourable changes in relative prices, became unprofitable and could neither service their debts nor obtain other loans for their operations.

19. Furthermore, inappropriate choice of scale and design of plant or choice of products, particularly in the public sector has resulted in unsustainable costs of production. This situation has resulted in high costs, low productivity and lack of export success. At the macro level, the problems are due mainly to industrial and trade policies, as well as the shortage of indigenous industrial capabilities and low local linkages.

20. From the foregoing, it emerges that apart from technological, managerial, marketing and infrastructural constraints, the problems of the industrial sector and the food-processing subsector in particular have emanated from the fact that they have been built on a shallow base at the initial stage of the industrialization process. This has made industries very vulnerable to both external and internal pressures. Dependence on imported raw materials indicates a weak linkage to other domestic sectors, particularly agriculture and rural economy. The state-owned enterprises enjoy financial support in case of losses and are heavily protected by high tariffs and quotas that virtually eliminate external competition. As a result, infant private industries have tended to remain infant with undue exposure to financial risks.

21. In dealing with industrial rehabilitation and restructuring, it is not enough to attend to the creation of industrial capacity; it is of fundamental importance to address issues of the development of human resources, and the upgrading of technological and institutional capabilities as underlying pre-requisites for any industrial rehabilitation and restructuring programme.

III. INDUSTRIAL POLICY OPTIONS AND INSTITUTIONAL REFORMS FOR THE LONG-TERM PROFITABILITY OF THE FOOD-PROCESSING SUBSECTOR

22. Against the background of the current difficulties in which the food-processing subsector in most African countries finds itself, it is necessary for these countries to adopt wide ranging policy reforms and elaborate focussed strategies in order to reverse the trend of "deindustrialization". This requires new policy measures that will ensure self-reliance based on the integration of the industrial sector with the rest of the economy and on sub-regional and regional co-operation. The formulation and implementation of such policies and strategies can vary from country to country or from region to region according to local needs.

23. It is necessary therefore that governments should liberalize tariffs, decontrol prices, make foreign exchange easily accessible, and remove or reduce financial support to state-controlled enterprises. This policy would expose the industries to both internal and external competition, improve market discipline, facilitate movement of capital, labour and technology and encourage innovation.

24. Decontrolling prices particularly those of agricultural products will encourage farmers to produce more and supply food-processing industries, thereby increasing capacity utilization. Shifting from a controlled foreign exchange regime to a market-determined system, can help efficient industries to raise capacity utilization and improve productivity faster provided they can obtain the necessary finance.

25. The importance of increasing agricultural productivity to supply food-processing industry cannot be over-emphasised. In this regard upgrading and strengthening the existing research and development (R&D) institutions or establishing new ones where they do not yet exist is necessary in order to be in the position to perform such activities as animal selection, breeding, adapting new strains or upgrading livestock or crop through crossbreeding and hybrids. To improve agricultural productivity and regular supply of raw material to food-processing subsector, policy makers should offer attractive prices to agricultural producers. The allocation of resources needs to be selective and practicable. The raw material should, as far as possible, be based on locally-available resources .

26. In manufacturing industries, particularly food-processing enterprises, R&D provides technique and process for local adaptation, testing and developing indigeneous technologies out of the many technological alternatives available. It also facilitates standardization, quality control, scaling-down imported equipment, studying the use of alternative materials in production, designing new models and processing as well as testing and manufacturing prototypes. In this connection, the participation of industry in the governing bodies of R&D institutions and in the financing of such institutions is required. The results of such research should be documented and made available to industries and commercialized. Technological information, particularly in the food-processing subsector should be systematically distributed.

27. Many African countries have in the past invested a great percentage of their annual budget on education and training and still do so. Despite this, economic growth and productivity in enterprises have remained stagnant. One reason for this is shortage of management and technical skills. This shortage has been attributed to the inability to match supply with the manpower needs of industry, lack of systems to reward achievements, labour laws that tend to

accommodate inefficiency, etc. African countries therefore need to restructure their educational and training systems to take into account their industrial needs in such areas as top policy making, project identification, formulation, evaluation, negotiation, implementation and monitoring and last but not least preventive and curative maintenance and repair. Centres of excellence should be strengthened for training purposes at national, sub-regional or regional levels. Policy measures that will improve conditions of work, and reward for above-average performance are necessary to encourage workers to put more effort, thereby increasing output both in quantity and quality.

28. The development of physical infrastructure in most African countries is biased against the rural areas where agricultural activities are concentrated. Therefore, there is a need to increase the development of transport infrastructure particularly feeder roads that connect agricultural rural areas and the food-processing urban centres. This will reduce the cost of transportation and of waste, while increasing capacity utilization. There is also need for restructuring the energy supply systems to reduce breakdown. The use of local energy resources such as small hydro-power and renewable energy sources should also receive strong consideration.

IV. INTERNATIONAL CO-OPERATION AND FINANCING FOR INDUSTRIAL RESTRUCTURING IN AFRICA

4.1. Inter-African co-operation (co-operation at sub-regional and regional levels)

29. For an effective restructuring of the industrial sector in general and the food-processing subsector in particular, international co-operation and assistance is needed. While seeking international co-operation and assistance, co-operation among the African countries should receive priority. Inter-African co-operation is crucial, since apart from a few countries (Nigeria, Ethiopia, Guinea-Bissau, Tanzania, Uganda, Kenya, Sudan, Ghana, Mozambique, Côte d'Ivoire, Cameroon and Madagascar) the market is very small with populations of less than 10 million. The smallness of national markets seriously affect the production capacity of their industrial plants. Intra-regional co-operation to expand the market base for industrial outputs must be considered through the removal of trade barriers between Member-States and the development of regional transport and communication systems.

30. Transportation, electric power, banking, communications and insurance could be areas in which national, public, and private co-operation could be extended at both subregional and regional levels. With better integrated markets, and improved transport links, the costs of providing critical inputs and distributing products would be reduced, thereby making African products more competitive in the African as well as in the world markets.

31. As mentioned earlier, the shortage of skilled manpower to manage the manufacturing industries remains a key obstacle to industrial development. The acquisition of technical and managerial skills is a costly exercise. Bearing in mind the financial situation of the African countries, it is almost impossible for any one country to finance all the necessary high-level institutions that are required for training, research and development.

32. In order to economize, centres of excellence with different specialization may be set up in various countries to serve the whole region, thus optimizing economies of scale. Existing training infrastructure should

be strengthened before embarking on the creation of expensive new institutions and, whenever possible, use should be made of African expertise. Quality is also promoted as regional institutions tend to achieve a critical mass in staff and justify the provision of facilities and equipment which small institutions established and operated by individual countries would not afford.

33. Another important area that deserves subregional and/or regional co-operation is the development of core engineering industries. Core industries do not only supply machines and spare parts, they also train highly qualified manpower that will find employment in national industries thereby solving the problem of manpower shortage. Being a capital intensive subsector many African countries cannot afford to establish and maintain them alone, bearing in mind the financial and manpower constraints. Therefore, African countries have to pool their scarce resources to supply as feed-stocks for the other industries.

34. Many African countries have been identified as having high potential for hydro-electric energy. Co-operation among African countries is greatly needed to develop this potential. Efforts should also be initiated on research work at both sub-regional and regional levels on new sources of energy. The realization of this inter-African co-operation will depend to a large extent on the financing of the projects.

35. African countries are currently suffering from acute shortage of funds. It is therefore very important that these countries encourage co-operation between financing and non-financing institutions at the national and regional levels to finance national and subregional projects undergoing rehabilitation and restructuring. Regional development and commercial banks should be encouraged. In order to encourage trade between countries, sub-regional clearing houses should be established. Industrial project financing institutions should be strengthened to meet these new challenges.

4.2. International co-operation

36. While inter-African co-operation in restructuring the food-processing subsector receives priority, international co-operation is also essential. African countries depend on the world market for the sale of their raw and processed agricultural, industrial and mineral products and for supplies of equipment, machinery, spare parts and to a greater extent the intermediate inputs. Interdependence between Africa and the rest of the world has made policy transformation absolutely necessary in order to succeed in the current restructuring programmes.

37. An important aspect in restructuring the food-processing industry, is the supply of equipment and know-how. Here, the international co-operation needed is the transfer of the appropriate technology that is suitable for the socio-economic climate of the various African countries. In transferring technology, efforts should be made to implement training programme for the recipient African countries. New inventions, patents and technical know-how should be made readily available by industrialized countries to African countries. In return, African countries should co-operate with industrialized nations in creating a better investment climate and priority services required by foreign investment.

38. Industrialized countries should make their markets easily accessible to the industrial products of African countries through the removal of protectionist tariff and non-tariff barriers.

4.3. <u>Financing of restructuring programmes in the food-processing industry</u>

39. In order to implement all the above-mentioned policies and support action for the industrial restructuring of the food-processing industry in Africa, an enormous amount of human, material and financial resources would need to be mobilized from both domestic and external sources.

40. To increase credit facilities for restructuring, policy makers would need to create favourable fiscal and monetary policies for the encouragement of savings and the development of financial markets. Interest rates should be liberalized. Governments should provide fiscal assistance for the purchase of equipment and machinery, tax allowances for market studies and providing support facilities for marketing of finished products at national level. Credit guarantee schemes should also be supported by governments. Governments should also encourage non-financing institutions such as insurance companies and pension funds to participate in financial markets. Indeed, any restructuring programme without adequate financial resources is doomed to failure. Therefore, co-operation between financing and non-financing institutions at the national, regional and international levels remains one of the most important requirements for the restructuring of the food-processing industry in Africa.

41. Multilateral and bilateral institutions should increase their flow of capital to Africa to help rehabilitation/restructuring of the food-processing industry in order to reverse the declining trend. The international community should also help African countries to mobilize external funds through other mechanisms as external credit guarantees, supplier's credits, buy back arrangements, counter trade, leasing (saves fixed capital and costs commited in current accounts), and joint ventures (may also provide the necesary technology, top management and technical support and access to markets). They may also help with the "rehabilitation" of national and regional development finance institutions.

V. FINAL CONSIDERATIONS

42. In view of the current situation described above, the Consultation is invited to examine the following main aspects to be considered in the national policies and support actions for industrial restructuring for long-term profitability of the food-processing industrial subsector.

a) The problems facing the food-processing subsector in Africa are of plant, sectoral, subsectoral and global nature. Addressing plant specific issues without adequate treatment of national and global problems will not lead to a lasting solution. To this end, national policies and support action for industrial restructuring of food-processing have to be directed to structural transformation of a medium and long term to remedy the basic causes of industrial stagnation. Such a transformation may include as an essential ingredient the building-up of local or national industrial, technological, managerial and entrepreneurial capabilities.

b) Low capacity utilization in the food-processing subsector in Africa has been attributed to aging and obsolete machinery, improper procurement, inadequate maintenance of plant and equipment. Furthermore, import substitution strategies of most African countries' industrialization policies have made existing industries inefficient. They also depend upon imported raw materials. These trends have to be redressed. The establishment of core industries that produce machinery and spare parts may help in restructuring.

c) In view of the small population of most African countries, systematic efforts should be made to exploit the potential for expanding the market size through subregional and regional co-operation under the aegis of subregional groupings such as PTA, ECOWAS, etc. The regional approach could be a realistic way to gearing output to the world market on the basis of comparative cost advantages. To take advantage of the global market, African industries will need links with foreign partners and stronger incentives to export.

d) Previous industrial strategies in many African countries have tended to lay much emphasis on hardware - plant and machinery - while neglecting such underlying factors as the training of management and skilled manpower and the mastering of new technologies. The task facing African countries now is to restructure and strengthen the existing educational and training systems to provide the industrial sector with qualified manpower.

e) Fiscal and monetary policies of most African countries have not encouraged the development of the food-processing industrial subsector. Price control on agricultural and finished products has discouraged farmers from producing, thereby reducing the raw materials inflow to processing plants. Subsidizing publicly-owned food-processing industries have prevented those in the private sector from competing.

f) Control of interest rate has also made it unattractive for private saving, thereby reducing funds which would otherwise have been invested. The domestic saving potential must be tapped more effectively by liberalizing interest rates. For this reason, the present highly inadequate financial sector in Africa should be developed entailing the reorganization of central banks and bank supervisory authorities and fostering an independent financial sector. By so doing, the existing domestic saving gap may be eliminated in a sustainable way, increasing the self-financing of development and developing the domestic market.

g) The inability to purchase equipment, spare parts, and needed essential raw materials has often been attributed to administrative control of foreign exchange. To bring food-processing plants back to full capacity utilization, efforts should be made for the food-processing industry to have easier access to foreign exchange.

h) In their industrial rehabilitation efforts, governments of developing countries should give due consideration to maintenance policies and provide inducements to enterprises to instal managed maintenance systems.

i) Transport and communication systems pose a major obstacle to the food-processing subsector. Improving this sector of the economy will go a long way to improving agricultural production and the output of the food-processing subsector. African countries should devise an effective means of improving all modes of transport and the communication systems. The development of intra-African transport and communication systems could increase the market potential of the region.

j) Many food-processing plants remain idle or incur damages because of power failures. The question of a cheap and regular supply of energy to industrial plants should be taken as a major priority. African countries should look beyond their borders and co-operate with neighbours in joint development of cheap energy supply.

k) In view of the technical and financial constraints facing many African countries, it has become very difficult for Africa to implement a successful industrial restructuring programme. International co-operation, both bilateral and multilateral is urgently needed to achieve this objective.

l) The international community is called upon to increase the provision of financial and technical assistance to development, commercial and rural banking systems in Africa to enable them to provide loans and services to food-processing enterprises efficiently, profitably and on a timely basis within the framework of the on-going structural adjustment programmes.