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# ARTICLES

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## How to Extend German Private Investment in Developing Countries

By Prof. Dr. Clodwig Kapferer, Hamburg

**T**he comparatively small share of German private enterprise in investment in developing countries is disquieting as regards private initiative in this field. The Federal German Government thinks of the private investor as a valuable partner in promoting development and has certain hopes as to the effect of his activities. The question is therefore how private investment can best be stimulated and intensified. This paper examines some aspects of the problem. It also sounds a warning against excessive expectations for a synchronisation of governmental development policy and the attitude of private firms towards investment. It would be asking too much of private entrepreneurs to expect them to pursue aims contrary to their own interests or, from their point of view, detrimental to them. After all, a private entrepreneur is primarily motivated by self-interest.

### The View of the German Investor

Why are German firms holding back from investing in developing countries? This question immediately touches upon the issue of private investment initiative as a whole. Generally their attitude towards investment in developing countries may be described as indifference. There are a number of reasons for this, but the first fact is that the firms' capacity is largely absorbed by the problems posed by the domestic and by traditional foreign markets. Neither future prospects nor existing opportunities in developing countries are adequately thought out or even taken into consideration. The firms are content with solving the problems of the day and hitting traditional targets of expansion. It ought to be kept in mind that for German firms preoccupied with their own problems there is no such thing as the altruistic aim of promoting development through private investment.

The attitude of German firms to investment projects in developing countries shows that projects first taken up with much enthusiasm and involving repeated and costly journeys or lengthy and extremely tough negotiations eventually fail owing to the lack of interest among their directors or board members at home. The managers of a big enterprise often prefer to evade the responsibility for an unusual investment and do not even submit projects to the board of directors. This situation can no longer be

described as mere restraint. Rather does it reflect fear of investing in developing countries. It is fear of the overall risk involved and of the manifold problems arising from such investments. And it is heightened by the remoteness of most of the developing countries and by reports of difficulties such as arose in the case of Mannesmann in Brazil. Mental prejudice against these investments often outweighs the capital risk involved. German firms display much inertia in this respect which in turn makes it difficult to enlist their participation in capital aid.

### Difficulties to Solve

In principle German firms fully realise the need for private investment in developing countries. Their counter argument, however, is that they urgently need the available funds in their own country. Certainly insufficient capital resources of German enterprises play some part. But apart from this the domestic market and the countries outside the development areas—they are mainly European countries—offer them much safer opportunities for investment. The firms feel that the Government's incentives to invest in developing countries bear no relation to the risk incurred. In any case the promise of preferential treatment alone is not enough: first of all the necessary capital must be available and it must not already be earmarked for normal domestic operations. If there is no capital, even preferential treatment in the form of tax exemption will be of no use.

German firms are short of suitable personnel, and this means not only of technicians. Such first-class experts as are available—and only these can carry out investment projects in developing countries—are needed at home. If occasionally they can be spared for some weeks' work overseas it is not sufficient to get an operational unit going and to solve the manifold problems of the initial period.

Where there are partnership agreements, German firms are not the only ones who demand capital-majority for themselves. This condition makes it difficult—and in a number of developing countries the laws on industrial development even forbid it—to find partners there. And there are already enough examples of difficulties arising for management from the apportionment of holdings. One way out might be

to divide the holdings into three parts (one third German investment; one third partnership quota; the balance being placed on the free capital market through the sale of shares or the participation of third parties). It should be avoided, however, that a single partner in the developing country acquires the majority of the capital. And to prevent the use of men of straw for this purpose caution is also required when dividing a partnership into three parts.

German firms are, on the whole, inadequately informed about the general conditions, legislation and jurisdiction in developing countries; they know, for instance, little about the way tax laws are applied in practice. This explains why they often drop even well-advanced projects as soon as they get to hear about somebody's bad experience. Only a clear explanation of current practices, and not only those which are legally and judicially established, can correct this.

In small and medium-sized firms control lies in hands of one or of a very few persons. Their manifold responsibilities make these people particularly versatile entrepreneurs. But in view of their many obligations they have little time left to tackle new unusual tasks. In addition, the shortage of capital and personnel is, of course, even more pronounced in small and medium-sized firms. To realise chances which they often detect much more quickly than large enterprises do, therefore becomes much harder if not impossible. The high cost of travelling to a distant developing country—for instance in Latin America—may alone be prohibitive. Last but not least it should not be overlooked that the failure of a comparatively important investment made by a small or medium-sized enterprise may seal the firm's fate altogether. The question therefore arises what should be the minimum size of a firm that can be regarded as capable of investing in developing countries.

#### Possible Measures of Promotion

The ways and means of promotion outlined below may help to bring about an attitude among German private entrepreneurs which is desirable in the interest of our investment policy and for the purpose of intensifying private investment in developing countries:

☐ Adjusting measures of promotion to the principles of profitability of private initiative.

To private investors from industrial countries the long-term prospects of profitability must appear favourable. Otherwise they would not feel inclined to take risks and make investments. The most important incentives for investing in developing countries are the expectation of profit and safeguards against expropriation, transfer stops, etc. The private investors' readiness to accept risks should not be overrated. Therefore mere appeals to private firms to invest in developing countries would not suffice.

☐ Assessing whether the promotion of a German project is worth-while in the light of its impact on the balance of payments of the developing country.

In preparing plans for projects that are to be financed preference should be given to projects which help to

improve the balance of payments of the receiving country. Hitherto mainly large firms have participated in investment. But in most developing countries there is a shortage of investors in medium-sized or small enterprises which make export goods from domestic raw materials and thus earn foreign exchange. Such export-orientated projects capable of attracting investment by small and medium-sized firms should be prepared after a proper product-study. This shows potential investors where to start, marketing prospects and all the production and sales problems which have to be considered. It thus serves to reduce the investment risk. There seems to be a vast scope for promoting so-called "joint projects" (in which the Federal Government is interested) where for a larger-scale project the plans and measures of several investors are co-ordinated. In this way the difficulties arising from the inclusion of smaller and medium-sized firms in the investment- and development process could be overcome.

☐ Political risk

Full coverage against political risk is essential, so the investor does not have to carry his proportion of credit risks.

☐ Increased tax allowances;

☐ safeguard of transfers;

☐ abolition of double taxation.

Agreements should be speeded up for protecting German investors in developing countries against being subjected to double taxation.

☐ The inclusion of operating assets in the Government's capital aid.

The preferential treatment of capital assets which are subject to depreciation should be extended to operating assets, especially to stockpiles or their expansion. Practical and administrative difficulties arising from the inclusion of stock in the preferential treatment can be overcome. But perhaps the granting of such treatment should be made dependent on an individual examination of the impact on the country's development in each case. Industrial and commercial firms in developing countries depend on being able to finance their operating capacity. Deficient and time-consuming delivery of raw materials, semi-finished goods, accessories, etc., force manufacturing enterprises in developing countries to keep larger stocks than usual under more normal conditions, i.e. in industrial countries. The same applies to keeping larger stocks of spares, parts for assembling machines, packaging or filling and bottling materials. Commercial firms preparing and processing export products depend on considerable operating funds, since in comparison with earlier years improved technical methods—e.g. in the sorting and processing of raw materials—have to be used.

☐ Finance Institutes for Special Countries

If necessary, the establishment of joint institutes for the promotion of capital investment on a bilateral basis should be considered or existing bodies should be entrusted with this task.

### **Government- and Private Investments**

Assuming that Government capital aid and private investment counter-balance each other, we should examine whether and to what extent it is preferable to promote development aid by private rather than Government investment. This should be done by investigating countries with opposing investment structures, i.e. countries where private investment prevails and public investment is very limited (e.g. Brazil) and those where the reverse is the case (e.g. India). If the importance of private investment can be established, it should be considerably intensified by evolving corresponding government measures of promotion.

Such an investigation should examine to what proportion Government capital aid could be scaled down in the light of a rise of private investment which has been encouraged by public measures of promotion, such as tax allowances. This would compensate for losses in internal tax revenue. This is a problem of wider implications and is important for the future direction of our development policy, e.g. with regard to possible skeleton arrangements. At present the western industrial countries are exporting more public funds than private capital to developing countries. Roughly three quarters of capital aid to developing countries and to development funds of multilateral institutions result from public transactions. The obviously much greater multiplying impact of private investment may be gauged, however, from the example of Brazil where more than 800 million German Marks have been invested since the middle of the fifties.

### **Aid by Projects of Blanket Credits**

In principle, capital aid by the Federal Government is tied to specific projects. We must therefore also examine whether the scope for private investment is reduced if capital aid to individual developing countries takes the form of blanket credits. Some misgivings about this practice arise from the competitive advantage enjoyed by large firms with good connections, better information and a strong Lobby compared with small and middle-sized enterprises. In most cases blanket credits do not promote small and medium projects which are desirable for their multiplying impact on development and which have a beneficial effect on the balance of payments. On the contrary they lead to the traditional type of major project which has no direct influence on development and usually imposes a considerable strain on the future balance of payments.

### **Starting Points for the Use of Promotion Measures**

In view of the basic attitude of most German firms to investments in developing countries measures of promotion can hardly bring tangible results without some psychological action. Applied psychology can fulfil an important educational function in promoting development. Psychology has to be applied to potential investors and arouse their understanding of development problems as a whole. It must then go into the

depth of the problem of investment in developing countries. Admonition and reproof are, even when constantly repeated, not the right way of making a lasting impact on a firm's attitude. The use of such a method wears out. Much more stimulating could be examples of successful investment. Even the disclosure of examples of a firm's unsuitable attitude could help to bring about a change of mind and lead to the acceptance of an approach favoured by the Federal Government. The impact of propaganda is based on repetition. The impact of publicity rests on understanding.

Apart from reports on successful investment projects in newspapers and periodicals, effective publicity for greater private initiative in developing countries can be achieved by discussion meetings, and by the presentation of pictures and films which give a vivid impression of successful projects. The aim of publicity should be to give German firms some practical ideas of marketing opportunities; prospects of profitability; tax allowances; tariff protection in the developing country; the transfer of surplus capacities and possibilities of deliveries to customs-favoured free trade-zones. But the firms' attention should also be drawn to successful German or foreign competitors, and psychologically this may often be the most effective way.

### **Small and Medium-Sized Firms' Chances**

The special problems of small and medium-sized firms as outlined above, impede the expansion of their investment in developing countries. But the difficulties which a single enterprise often finds insuperable may be removed by bringing several firms together for joint investment projects. This would require the combination of different firms—even from different trades—in "little consortia". These would offer various advantages to the participating firms: smaller risks; reduction of cost; mutual support; greater ability to assert themselves; economy in personnel; greater facilities for sales and ancillary supplies. The individual member firms of the consortium could, as units of one joint investment project, work in the same building or in the same territory. Thus certain initial investments would only have to be made once for the whole complex. Management, too would be more concentrated—apart from technical units. Another possibility, though in a less closely form of co-operation, would be for several small or middle-sized suppliers to join the investment project of a large enterprise, which would at the same time guarantee a certain market for their products.

The preparation of such "model investments"—e.g. by drafting investment projects in specific developing countries which are suitable for "little consortia"—could be an inspiration and attraction for small and medium-sized firms. Because of their size these firms are bound to have misgivings about investing in developing countries. But the "little consortia" could overcome them and lead to tangible privately financed investment projects.