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Private Investment in Africa

In recent years it has become increasingly clear that it is impossible to improve the economic and social development of "young nations" solely by capital investment and technical aid from industrially developed countries. Even ambitious five year plans are not, by themselves, adequate. What is important in development is that all production factors should be available and that these should be homogeneously and rationally linked in the various economic units. State enterprise is rarely equipped to do this—particularly not in less developed countries. This is where the private investor is needed. He can contribute not only his capital and his technical knowhow, but also his initiative, his capacity to take decisions, to organise efficiently and to operate an enterprise economically. However, if he wants to increase his participation in private enterprise, he is faced with a series of difficulties and obstacles. This is where INTERECONOMICS comes in asking three experts to deal with investment questions* in African countries.

Perspectives of German Business Activities

Any examination of investment activity by German firms in Africa may be limited, at present, to determining the total amount of such investments and its distribution over the various countries, sectors and projects. Moreover, such an examination should also emphasise the major factors determining the entrepreneur's outlook, his inclination towards, and prospects for, investment. Knowledge of these various factors is a prerequisite to his judgement of future investment potential. The first step must be to analyse the concept of private investment.

Special Characteristics of Private Investment

In modern usage, "private investment" means only direct private investment where, for instance, an industrial enterprise or a bank makes available funds in the form of liable or loan capital, i.e. for an immediately productive purpose.

* On the subject of foreign investment in general, see also vol. 8, 1967 (2nd year) Interview and Editorial.

There are essentially four forms of private investment:

□ Direct investment from one firm to another;

□ Credits to finance deliveries which may also—although only in the short term—involve funds being made available;

□ So-called portfolio investments—i.e. a bank can place loans raised by foreign firms on the domestic capital market, thus financing investments in one country through the capital market and private investors of another country;

□ Private investments in the form of stand-by credits may be given by banks to central banks for a limited period of time; such credits contribute to the general financing of third countries, their main purpose being to underpin currency reserves.

We are concerned here solely with the first form of private investment, i.e. direct investment in Africa by German firms.

A quantitative survey of private investment activity by German

firms shows, first, that since 1950 the total amount of contributions made by the Federal Republic to developing countries was barely \$ 8,000 million. Of this, 48 per cent came from the public sector, i.e. this was derived essentially from tax proceeds, whilst 52 per cent emanated from the private sector.

The flow of private capital investment to developing countries in Africa alone has risen constantly over the last three years. In 1964, private capital sums amounted to \$ 85 million, compared with \$ 99 million in 1965 and \$ 119 million at end-September 1966.

But these figures do not give a precise picture over the period of long-term private investment in Africa by German firms, since they take no account of losses or gains in value after transfer.

We are primarily concerned here with aspects of German direct investment affecting capital assets in the private sector. Long-term capital export by German public institutions—mainly those funds

made available through the Reconstruction Loan Corporation (Kreditanstalt für Wiederaufbau), which are not intended to influence foreign firms—are not considered as direct investment. Neither can private assets, where the investor's interest is solely profitability and the security of the capital invested, be numbered among such direct investments. In general, this type of investment comprises investments in fixed-interest bonds, disposed stock ownership, and short-term financial investments of all kinds; also long-term loans considered solely as employed cash reserves such as the acquisition of real estate for non-commercial purposes.

The Development of Private Investment Activity

Compared with total German private capital investments in developing countries which, at end-1966, were running at \$ 725 million, the \$ 119 million invested in Africa amount to barely 16 per cent of the total. This is not a very impressive percentage compared with German investment in South America, which is where the majority of German investments are made; nor is it in comparison with other countries. Still, the figures for Africa show a rising curve; this applies also to the developing African countries associated with EEC, including Madagascar, where private investment has risen over the last 3 years from \$ 19 million to \$ 21.5 million.

This revival of investment activity is also reflected in the development of the German Development Company (Deutsche Entwicklungsgesellschaft [DEG]). Of the 31 projects with which the Company was concerned (up to 1966), 19 projects, with a total investment of over DM 220 million, were concerned with Africa. The main centres of investment are in Kenya, Tanzania and Nigeria. These projects include DEG participation in three East African development corporations: the DFCK in Kenya, TDFL in Tanzania and the development corporation in Uganda. Via

these three institutes DEG participates directly in the financing of a further 50 enterprises.

The volume of German investment in Africa is relatively small in relation to the size of the African continent and its commercial potential, and also in relation to private investment by Britain and France. There are several reasons for this: first, it must be remembered that Germany lost the whole of its external assets as a consequence of two world wars, so that, after 1945, it had to start from scratch; secondly, the strong economic ties between former British and French territories, which gained their independence after World War II, and their former rulers, is of considerable significance. It is still true that, in many other countries, the private sector of the economy has much closer links with African countries than does the German economy.

With regard to the regional distribution of German private investment in Africa, certain centres have emerged in both East and West Africa; they are clearly reflected in the activity of the Development Company in Africa. The distribution of German private investment by countries is as follows (statistics from the Bundesbank):

Liberia	US \$ 39 million
Libya	US \$ 14 million
Algeria	US \$ 12.7 million
Ethiopia	US \$ 12.6 million
Guinea	US \$ 7.3 million
Nigeria	US \$ 5.7 million

In analysing ascertained figures, it is also of interest to break these down by investment type, size of single investments and economic sectors. The only figures available here are those global figures for German investment in developing countries, but it is reasonable to assume that these are also representative of investment in Africa:

□ By type of investment: 2/3rds of investments were participations (roughly 1/2 of total investment was in majority participations); about 1/4 was loans.

□ By size: German direct investment abroad is spread over about 5,100 investors; however, 24 large firms hold almost one half of all foreign investments;

□ By economic sectors: the overall picture is dominated by the capital goods industries and the chemical industry; all other sectors together account for roughly one half of private investment. Since there are marked differences from country to country, a regional breakdown would be of no value.

Factors Determining Private Investment

A purely quantitative assessment of German investment activity in Africa would be incomplete without an attempt at a qualitative evaluation of the figures and of the motives inducing German firms to invest in Africa.

The difficulty here is the absence of statistical data on the efficiency of German investment in Africa. Profitability figures, operational figures, data on technicalities or productivity figures from the primary, secondary or tertiary sectors of a developing country are not, in this case, a proper basis for assessing the efficiency of private investments. Even were such figures available, it would not be possible to draw valid conclusions from them because the variations from country to country in particular sectors, and even differences in the size of firms, would mean that the results applied only to individual firms. The decision to invest and the success

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or otherwise of a firm is determined by a whole range of factors, all of which contain most different elements.

Some progress can be made, however, by considering what single factors influenced the decision by an investor to invest in Africa. Past experience here can open up perspectives for the future. We can explain the obstacles and incentives and how—by overcoming or exploiting these—investment activity can be stimulated and steered.

A government decides its investment policy on the basis of politico-economic concepts, economic priorities or social economic considerations. The private investor, however, acts in a different way. The only decisive factor for him is whether an investment will be profitable. Such profitability thinking is characteristic of private investments. An entrepreneur who is accustomed to operate in a free economy acts on the basis of economic principle and according to the profit outlook. Therefore he

also expects to make a profit from his overseas investments because "business without profit is madness". The private investor will, therefore, consider whether his investment in capital, technical know-how and entrepreneurial initiative is likely to be more successful in Europe, or in developing countries such as the African states. His decision to invest will depend essentially upon his estimate of the risks to be run and the chances of profit. In order to assess these factors, he must have a precise knowledge of the particular developing country's economic situation. Much will depend upon the judgment of his local partner who will normally be more familiar with the market than any foreign investor: often this partner has previously acted as his export agent. It is absolutely essential to service and prepare the market and estimate correctly the quantitative and qualitative requirements of the market. Market size is of particular importance because it determines production capacity.

It is also of the utmost importance for the investor to be well-informed about the investment climate in any particular country. It must be appreciated in advance that practically all developing countries are competing against each other to attract private capital and in order to do so they must offer favourable conditions. Political stability, economic security and a stable currency are of cardinal importance here. The West German Government, it is true, offers the German investor a certain amount of assistance by concluding capital promotion contracts, special depreciation allowances and guarantees for insuring against the so-called "political risks"; but experience has shown that such assistance alone is inadequate to promote private investment. Nationalisation, or the threat of this, invariably stops the influx of private capital. By contrast, the greater the security of economic and political conditions in a country, the more that country can count upon attracting private capital. *Dr Herbert Mittendorff, Cologne*

The Role of the European Development Fund

The last analysis of the position of development aid published by OECD shows, on the whole, a definite rise in private investment. This is borne out by the table next page.

What is remarkable in this development, where 1965 was particularly encouraging, is the rise in investment. This is due, in the first place, to an increase in new investment. It seems premature at this stage to deduce from this increase any lasting or even rising trend. Future development is difficult to forecast, since the scanty material at our disposal permits no really sound prognosis.

The influx of private capital from EEC countries to the 18 associated African states and Madagascar probably amounted be-

tween 1960 and 1965 to about \$ 100 million annually—exact statistics are not available. This means that these states received about one seventh of the private capital which flowed from EEC countries into developing countries. Of this, rather more than half was derived from reinvested profits. A number of indications lead us to expect this rising trend to continue.

Differential Investment Incentives

One of the main obstacles to German private investment in the associated African states is probably the small size of the markets—apart from other problems mentioned above. In spite of local customs unions, African markets are far too cut up by political frontiers. Distribution costs are

also high, because of scattered and weak concentrations of purchasing power. The creation of production units capable of replacing imports is also handicapped: concentrations of demand and purchasing power occur mostly near the coasts and can quite easily be satisfied from overseas at low sea transport costs. Additionally, the exchange rate for CFA francs is advantageous for the import of industrial goods and domestic production finds it difficult to compete with these. The threshold of profitability for new domestic production units is, therefore, comparatively high. Markets in the associated states are often too marginal to stimulate interest amongst European or American manufacturers and encourage them to shift their production capacities to Africa.