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**SMALL ENTERPRISE LOANS THROUGH THE BANCO INDUSTRIAL DEL PERU:
AN EVALUATION OF THE FONDO DE DESARROLLO RURAL
WITH CASE STUDIES FROM JUNIN AND CUZCO**

**by Charlotte I. Miller, Ph.D.
Anthropologist**

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I. Introduction

This report serves two basic functions: (1) the analysis of the social soundness of additional funding to the Rural Development Fund (FDR), and (2) the evaluation of the social impact of loans of the FDR. The study emphasizes the functioning of FDR in the departments of Cuzco and Junin.

II. Summary: Social Soundness Analysis for Additional Funding for the FDR

The social soundness of additional funding for the FDR can be analyzed by looking at three major areas: the socio-cultural feasibility, spread effects and social consequences of the program. This section summarizes the findings of the evaluation of the social impact of the FDR which appears below in greater detail. However, in order to analyze the social soundness of the program, it is necessary to review the purposes and goals of the program in order to make a determination. The FDR loan program administered by BIP has several purposes: to strengthen and develop Peru's rural enterprises, to create new jobs, to generate and distribute income and to stimulate economic activity within Peru's poorest regions. There is no doubt on reviewing the ways in which the program operates that these goals are being partially achieved.

A. Socio-cultural Feasibility

Given the constraints of bureaucratic centralization which strongly influence the functioning of a bank-administered loan program, it is inevitable that the vast majority of the direct beneficiaries of this program are not rural residents, nor are their enterprises located in rural settings. For the most part, the funded enterprises are located in provincial towns and cities, with the majority of the owners coming from the middle class of urban residents of the region. It should be pointed out, however, that a regional middle class is much poorer in resources and other indices of level of living than a national middle class, in Peru's case, located in Lima. The program is administered in the areas of Peru which need economic stimulation the most. Webb has reported on income distribution in Peru that the poorest quartile of workers are mostly subsistence farmers living in sierra provinces. "Of these, 80 percent are subsistence farmers, and 63 percent live in the Mancha India. Another 13 percent are nonfarm wage earners and independents in sierra towns." (Lowenthal, ed. 1975: 87.) As will be further elaborated below, farmers do benefit from the loan program because a significant minority of borrowers are also subsistence farmers, and among artisans almost all are engaged in agriculture. The very poor and the totally illiterate do not participate in the program, nor do the wealthy and highly educated.

Most beneficiaries are happy to have the opportunity to build capital investments, despite the annoyances of paperwork and delays. They express beliefs that the loan program will benefit both themselves and their children. The less educated borrowers tend to be more intimidated by the bureaucracy, while the more educated seem to become enraged at it. Paperwork and documentation needs seem to be a major constraint for the very small borrower. More sophisticated loan recipients find the drain on time to be a major but inevitable drawback to efficiency. Indeed, Hunt predicted that this would be an outcome of post-revolutionary industrial legislation. He said that "the danger of the system lies particularly in its bringing discouragement to small investors, both foreign and domestic, who lack special influence and who might never be rescued from bureaucratic snags through special intervention." (Lowenthal, ed. 1975; 348.)

An additional constraint is the tax structure which favors small operations with less than 5 workers. For a small industry to expand to even 10 workers is extremely prohibitive. Roberts reports that small-scale activity does not encourage the accumulation of capital because "The State restricts the operation and profitability of the formal enterprises; also the high cost of overheads, such as credit, in a highly centralized and underdeveloped country restricts both formal and informal enterprise. Informal enterprises by sharing the profits and risks and through an intensive use of labor also contribute to the distribution rather than the accumulation of income." (1974:89.) This factor, however, is in a way beneficial to small operations, although it does not encourage continual investment. The current structure of regulations seems to strongly favor only state-run and social property enterprises. ??

B. Spread Effects

? The recipients of loans are, in the experience of this program, the best promoters of the FDR. Most loan recipients reported hearing about the program from another recipient in the same type of business, for example, a restaurant owner from another restaurant owner. However, bad experiences also have spread effects. For instance, artisans who have been poorly treated in some bureaucratic situation are quick to tell their neighbors and relatives, which serves further to discourage their participation in the program.

C. Social Consequences

The benefits of the program seem to accrue to the borrowers, their families and their employees, rather than to other groups. No one reports of raised rents due to increased affluence, although some artisans complained that dealing with the bank raised prices for products they bought with the loans. In addition, in some types of

enterprises capital machinery and some inputs must be purchased from suppliers in Lima, therefore giving some benefit to the coastal economy. In terms of changes in power, the loan program seems to strengthen the provincial middle class, a weak sector in terms of power traditionally.

Many of the loans do not serve the purpose of the FDR to create new jobs, although they do serve the laudable function of preventing the bankruptcy of small firms which are particularly susceptible to current economic instability. There is no doubt that the loans help to generate and distribute income and stimulate economic activity in highland and high jungle regions.

It is nevertheless evident that this program is of critical economic help to borrowers and indirect beneficiaries in the departments where it has been implemented: Puno, Cuzco, Ayacucho and Junin, and it can be expected to be of benefit in the departments in which it has recently begun to be implemented: Huancavelica, Cajamarca, Abancay and Huánuco. Furthermore, a loan program of this type being administered by a government bank under the current constraints of austerity measures cannot avoid benefiting provincial towns and cities more than the countryside and still find sufficiently qualified borrowers to participate in the program. } ?

III. Methodology

This report utilizes aggregate data on the Fund from AID's and BIP's files in Lima. In addition, visits were made to the branch offices of BIP in Huancayo and Cuzco to obtain data on borrowers in those departments. Field visits were made to 14 borrowers in Junin and 13 borrowers in Cuzco, from which four in Junin and three in Cuzco were selected for in-depth interviews. These borrowers were selected to be representative of the category of borrowers most frequently found in that department. In addition, key informants in Huancayo and Cuzco who are unconnected to either BIP or the borrowers were interviewed concerning the dissemination of information about the Fund and the functioning of individual small businesses in the community. Relevant social science literature was reviewed concerning socio-economic conditions in Peru in general and in Cuzco and Junin in particular.

IV. Global Data

Existing data in the files includes the number of enterprises and amounts financed per sector per region. The six sectors used by BIP to organize the data are handicrafts, industry, services, tourism, retail trade and agri-business (mostly poultry and fish hatcheries). In addition, the types of enterprises financed are further broken down under each sector by department. Furthermore, the number of requests and total amount requested per city or town is also available by department.

In addition to this aggregate data, the individual files in the banks contain some information of socio-cultural interest. However, between the two branch offices visited by the author there was no consistency in maintaining the files. In Huancayo, for example, all files on loans to individuals contained photocopies of their voters' registration certificates, which show place of birth, date of birth, marital status and level of education as of date of registration. However, for corporate entities, cooperatives and social property enterprises (EPS) there is no information about these factors in the files. In Cuzco, the photocopy of the voters' registration certificate was not found in any file, since it was merely examined at the time of loan application and returned to the owner. Other documents were sometimes found in files which gave interesting socio-cultural data such as probates of wills, deeds to property and permissions to do business from husband to wife but, again, these were not present in all files.

V. Evaluation of Social Impact of Existing FDR Funding

In evaluating the way in which the FDR functions, this report looks at the following factors: impact on families and individuals, the role of women, perceived problems of borrowers, multiple economic activities, marketing and other business relationships, transportation, migration, employment generation, labor recruitment, and skill transfer. Observations on the behavior of BIP personnel and promotion of the FDR are discussed as well.

A. Impact on Families and Individuals

For almost all of the borrowers visited, the loan served to benefit the family of the recipient in various ways. Frequently, businesses funded by FDR provide employment for family members, although this type of employment may not be as advantageous as working for a non-relative since the preference for family workers stems from a desire to avoid tax and social-labor regulations. Thus, family members do not receive social security benefits. Roberts reports that the preference for family workers is widespread in small businesses in Huancayo (1974:78). He attributes the lack of desire for expansion in small businesses to the burdens of such post-revolutionary business regulations.

When the author questioned the promotional staffs in the Cuzco and Huancayo offices of BIP on this subject, they estimated that perhaps 50% or more of owners of small businesses did not want to expand for precisely this reason. Family members are looked upon as trustworthy associates, and family members are also preferred because they are presumed to protect the family's corporate interest in the property. The enterprises funded by the FDR often provide employment for husband, wife and children and sometimes for nephews, cousins, siblings and parents. Examples of the employment of more distant relations were not found.

The types of employment provided to family members were varied: administrator, partner, manual laborer, designer, mechanic, secretary-receptionist, driver, darkroom technician, and salesperson. In handicraft enterprises the parents begin to teach skills to young children who continue to work at the craft until they set up a separate shop. Some handicraft workshops have a system of apprenticeship similar to that found in the skilled trades where a non-relative will attach himself to the workshop operator for the purpose of learning a trade. This phenomenon is widespread in Sicuani*, where many residents are beneficiaries of the FDR. (Orlove 1977: 128-134.)

However, even in the trades such as baking and mechanic work families received employment in funded enterprises -- although not directly in the skilled trade occupation.

Families were also important resources for supporting individuals in their loan requests. In several cases, parents offered mortgages to back their children's loans. Parents and children, husbands and wives, or brothers-in-law formed cooperative agreements or partnerships to do business together. Often, one family member's business supports another's. For instance, one may make a product and another market it. Families are also important sources of information concerning such essentials as the loan program itself, business operations, and feasibility studies.

B. The Role of Women

It is clear from a review of the files that a small percentage of the loans under FDR are actually made to women. In Huancayo for instance, out of 348 signed loan agreements as of April 1978, 46 (13.2%) were in the names of women. However, this figure is somewhat deceptive when viewed in the light of the preceding information on the family benefit proceeding from loan awards. Indeed, in a number of cases, women would administer a business for which the loan appeared in a man's name, as in the case of a photocopy business in Cuzco and a Turkish bath in Huancayo.

In handicrafts, especially weaving, silversmithing and gourd-carving, women are equally involved in production and marketing activities. Certain types of businesses had little female participation: line processing, machine shops, baking, animal skin processing and carpentry. However, even these businesses had women involved in administration, marketing and secretarial or bookkeeping functions. It should be noted that certain businesses had little male participation as well: knitting, sewing and clothes-making.

* According to BIP records as of August 31, 1977, 65 of the 454 loan applications in Cuzco came from Sicuani, second only to Cuzco in number of applications.

Under the Peruvian legal system, the property of husband and wife is considered to be owned by both. Therefore, the husband's or wife's signature usually appears in the file in the case of an application from a married person when community property is used as collateral for a loan. Due to the tax structure and social and labor legislation, many successful entrepreneurs invest profits in their homes, luxury goods and educational expenses for their children rather than reinvesting it in the business. As a result, even women who work only in their homes benefit from these loans because of improved living conditions.

Some businesses appeared in the names of women, but were actually run by their husbands, usually the wife in a supporting role. These cases seemed to be due to legal constraints on the number of economic activities a loan recipient may have. In one case, a gas bottling plant, the woman was dedicated to the paperwork of the business, but her husband was considered in charge of day-to-day operations. In another case, a restaurant, the woman supervised the kitchen, but her husband took care of the bookkeeping, dining room supervision and the supplies. In both cases, the man was legally prevented from borrowing the money, in one case, because he was a practicing dentist, and in the other, because he was a beneficiary of the reforma agraria.

C. Perceived Problems of Borrowers

The loan recipients have many different problems which they see as prohibiting their enterprises from running more smoothly or being more lucrative. The most common problems were the inability to acquire needed machinery or raw materials, the difficulty of marketing products, and documentation.

Many owners of enterprises in the industrial and handicrafts sectors complained of the lack of sufficient working capital to purchase raw materials. These borrowers ranged from machine shop operators to weavers. Several cases were found where the bank had denied funding for requested machinery. The recipients complained that they could not produce products to necessary specifications for the intended market without the denied equipment (i.e. in a cooperative shoe factory). Many cases were found where loan recipients were denied funding for the purchase of motor vehicles due to the AID restrictions on the purchase of Peruvian assembled vehicles and Peruvian government restrictions on importation of foreign vehicles. In several cases, the businesses were renting vehicles at high rates instead of purchasing them (in a lime plant and a gas plant). In certain industries, such as ceramics manufacture, the acquisition of imported inputs is a limiting factor. The small businessman has difficulty getting the right to import and the knowledge of what foreign products would be suited to his production.

Another type of supply problem was found in a gas bottling plant. The owner stated that PetroPeru was giving preference to purchasers from Lima over those from the interior during a propane shortage despite a written guarantee from PetroPeru that a certain minimum quantity would be supplied monthly to this business. As a result, operations of the plant were paralyzed for weeks between deliveries.

Marketing was a source of problems for many borrowers. Isolated rural and village artisans, especially weavers, reported that they were unable to obtain good prices for their products which would reflect the value of their labor and raw materials. One artisan reported that all his family's production for a six month period had been stolen on a marketing trip to Lima and that the bank then tried to foreclose on their looms and other household effects. Others complained because loans were given for production purposes, but not for marketing help, such as improvement of market stalls or shops. In the case of rural and village artisans, these constraints encourage patron-client ties of debt peonage with more wealthy intermediaries.

Another major area of difficulty is documentation. A combination of traditional Peruvian law, post-revolutionary progressive industrial legislation and usual banking practices requires a mountain of paperwork for most loans, especially for the industrial sector. Inchthick file folders on each loan were not uncommon. Bank officials in Huancayo usually required following legal documents to be seen or copied and filed for bank records: municipal license to do business, certificate industrial registry, paid receipts for machinery and equipment owned by the borrower, the last rental receipt for the place of business, public registration of machines for production purposes, voter registration certificate, draft card, income tax payment certificate, good conduct certificate from the investigatory police, civil marriage certificate and the certificate of industrial priority of the business.

Corporate entities needed to submit copies of their statutes of incorporation and the registration of the notarized copy of the proceedings of a meeting of the board of directors or a meeting of stockholders.

Businesses already in operation are required to present accounting documents such as books showing latest balance, the books showing the balance sheets for the last two years, the records of payment of social security and retirement taxes for insured workers, monthly sales graphs for the last two years, records of payment of taxes as of the date of application, the cost-estimated value of raw materials on hand, and figures on outstanding accounts payable.

In addition, the potential borrower must supply prospectuses on equipment to be purchased, information on machines which still have amounts owed on them, a list of the characteristics and state of preservation of machines owned outright and being used in the business, a descriptive

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statement of the proposed activity, analysis of marketing costs, blue prints of real estate to be constructed or mortgaged, budget for construction of building and budget for construction of machinery. }

Finally, a prospective borrower must provide other documents in the case that real estate is offered as collateral to a loan; title, deed, title search, property tax certificate and register of self-declaration of property value for tax purposes.

In order to actually begin operating, a prospective entrepreneur will have to obtain many other permits, letters and authorizations from government entities. In cases of beneficiaries visited, enterprises needed permission from the Ministry of Agriculture to convert agricultural lands to industrial use, building permits from the Ministry of Housing and Construction and municipal governments, permission from the Ministry of Industry and Tourism to construct an industrial site and, later, to operate a new industry, registry as a qualified artisan, certificate of exemption from taxes as a small mining operation (Ministry of Economy and Finance), and permission to extract mineral deposits for a certain period of time.

State-owned utilities required advance payment for installation of special electrical hookups and telephone service. Delays often resulted in higher costs due to inflation, and initial loan amounts were not sufficient to cover increases. In some cases, additional funds were applied for and granted to cover inflation due to delays. In others, businesses were not able to operate in the manner projected in feasibility studies. Some businesses complained about the bank's inflexibility with regard to grace periods in circumstances like these.

For rural residents, the problems posed by documentation severely limit their participation in the FDR program. Their limited education coupled with their generalized mistrust and fear of public officials and bureaucrats makes the process of obtaining the required papers insurmountable. Documents are not available in the villages where they live and repeated trips must be made to the department capital to get them. They become easily discouraged with waiting and discourteous treatment. Sometimes, they simply give up.

Another complaint from small artisans is that billing the bank for machines and raw materials often inflates prices. For instance, one weaver said that by bargaining directly with a carpenter who makes looms he would receive a much lower price than when the carpenter simply sends his bill to the bank. The carpenter feels the bank is buying the loom, not the artisan, and therefore the bank can afford to pay more. In the case of raw materials, when one deals with harders selling polts for wool many of them simply do not know how to make out a receipt and are afraid to do so. It is not like buying nails at a hardware store in town.

It is clear that the problems perceived by the borrowers are varied and complex. Many are due to the peculiarities of the present Peruvian socio-political regulatory system. Some are due to traditional, conservative banking practices. Others are due to conditions of the regional or national economy, in which many goods are often in short supply.

D. Multiple Economic Activities

Many beneficiaries of the FDR program do not solely rely on the funded enterprise for income.

There are two types of additional economic activities frequently found among FDR beneficiaries; those which are complementary and those which represent diversification. The most common type of complementary economic activity is retail sales. In the cases of many urban artisans, they often built stores into their homes (which also housed their workshops). Factory owners producing clothes, sweaters, furniture and ceramics also were found to establish retail outlets for their products, although frequently they were also able to market products through wholesales channels. Another example of complementary economic activity is that of a restaurant owner who grew potatoes for cooking and selling in the restaurant.

Diversified economic activity in the form of agriculture was practiced by many beneficiaries. Crops were grown for home consumption with the surplus being sold or traded. Agriculture was found among rural and village artisans, as well as urban retailers and skilled trades people; these categories include weavers, felt artisans, silver-smiths, gourd carvers, owners of photocopy establishments, knitting shop operators and dressmakers. Ownership of small parcels of agriculturally productive land was more commonly found in Huancayo than in Cuzco, probably due to the traditional pattern of small landholding in the Mantaro Valley. There was other kinds of diversifying economic activities found among loan recipients including ownership of a private kindergarten (by an urban artisan) and ceramic production (by a sweater maker).

The strategy of multiple economic activities is extremely important to small enterprises in the Peruvian sierra. One never knows when one source of income will be temporarily cut off by economic or political conditions. For example, the kindergarten of one artisan in Cuzco was closed for months by public support for a national teachers' strike. Paper for photo-copies was in short supply for months, as were photographic supplies for a photographer. Imported glazes for ceramics run out quickly. A large ceramic factory owner said that because of money exchange and supply problems he tried to keep on hand more than a year's supply of glazes. A small artisan cannot afford that kind of investment and needs the economic security of multiple activities.

E. Marketing and other Business Relationships

Borrowers utilize kinship, friendship and ritual to help market their products and to maintain their enterprises. In rural artisan activities, however, intermediaries play an important role. Sale of merchandise through reliable outlets is closely linked to success of small industrial, artisan, and service businesses. Some producers worked in conjunction with family members who owned local stores or who lived in Lima to sell items. One woman who made and dressed colonial and mestizo dolls relied on her sister in Lima to find customers for the expensive, handcrafted products. Another borrower received some help from a sister in Lima to market sweaters.

Borrowers also sell directly to customers, using part of the workshop as a store, as in the cases of bakeries, seamstress shops, a ceramic factory, and various artisan workshops. Some enterprises have delivery services where wholesale and retail customers receive the product at their place of business or home, as illustrated in the cases of bakeries, the gas bottling plant, chicken hatchery, and food processors.

Artisans who gain access to marketing tend to become intermediaries for those who are less mobile. A technician in the artisan sector of the Ministry of Industry and Tourism criticized the FDR program for lending largely to intermediaries. It is often the artisan turned intermediary who has knowledge of urban markets and institutions necessary to complete the loan application and documentation process. The Ministry itself, admitted the technician, is very slow in issuing artisan registry certificates and aids in discouraging through lengthy delays the small, independent artisan. Loans sometimes function to create larger amounts of products than the simple marketing mechanisms used by these small enterprises can bear. This phenomenon is particularly found in more isolated villages where transportation and location are often important limiting factors to enlarging a market.

Other business relationships were found in funded enterprises which influenced the relative success or failure of the business. In businesses where the owner quickly developed patron-client ties to the workers through the granting of favors or participation in ritual kinship ties, worker-employer conflicts were less reported. Owners who were sensitive to the concerns of their neighbors about problems created by a new enterprise, and who quickly compensated them for damages, found greater success with their business. The importance of family help mentioned previously cannot be underestimated. Friendship ties often are crucial to the success of gaining a market.

For example, a lime processing enterprise funded near Huancayo illustrates how success is aided by attention to patron-client ties, concerns of neighbors, family assistance and friendship. The partners in this business have been asked to serve as godparents several times for the children of their workers. In the quarry area, they use only local