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**UNITED STATES INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
AGENCY FOR INTERNATIONAL DEVELOPMENT
Washington, D. C. 20523**

HONDURAS

PROJECT PAPER

SMALL BUSINESS DEVELOPMENT

AID/LAC/P-174

Project Number: 522-0205

UNCLASSIFIED

PDAAP 224

AGENCY FOR INTERNATIONAL DEVELOPMENT PROJECT DATA SHEET	1. TRANSACTION CODE <input type="checkbox"/> A = Add <input type="checkbox"/> C = Change <input type="checkbox"/> D = Delete	Amendment Number _____ DOCUMENT CODE 3
2. COUNTRY/ENTITY HONDURAS	3. PROJECT NUMBER 522-0205	
4. BUREAU/OFFICE LAC	5. PROJECT TITLE (maximum 40 characters) <input type="checkbox"/> Small Business Development	

6. PROJECT ASSISTANCE COMPLETION DATE (PACD) MM DD YY 03 31 87	7. ESTIMATED DATE OF OBLIGATION (Under 'B' below, enter 1, 2, 3, or 4) A. Initial FY 84 B. Quarter <input type="checkbox"/> C. Final FY 84
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8. COSTS (\$000 OR EQUIVALENT \$1 =)						
A. FUNDING SOURCE	FIRST FY 84			LIFE OF PROJECT		
	B. FX	C. L/C	D. Total	E. FX	F. L/C	G. Total
AID Appropriated Total	600		600	600		600
(Grant)	(600)		(600)	(600)		(600)
(Loan)						
Other U.S.						
1.						
2.						
Host Country	6,900		6,900	6,900		6,900
Other Donor(s)						
TOTALS	7,500		7,500	7,500		7,500

9. SCHEDULE OF AID FUNDING (\$000)									
A. APPROPRIATION	B. PRIMARY PURPOSE CODE	C. PRIMARY TECH. CODE		D. OBLIGATIONS TO DATE		E. AMOUNT APPROVED THIS ACTION		F. LIFE OF PROJECT	
		1. Grant	2. Loan	1. Grant	2. Loan	1. Grant	2. Loan	1. Grant	2. Loan
(1) SD						600		600	
(2)									
(3)									
(4)									
TOTALS						600		600	

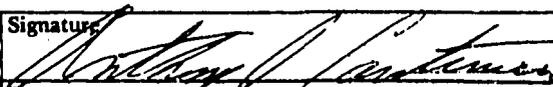
10. SECONDARY TECHNICAL CODES (maximum 6 codes of 3 positions each) 110 111 831	11. SECONDARY PURPOSE CODES
12. SPECIAL CONCERNS CODES (maximum 7 codes of 4 positions each) A. Code PVON B. Amount 600	

13. PROJECT PURPOSE (maximum 480 characters)

To develop a source of accessible financial and technical assistance for Honduras' small and medium-scale entrepreneurs.

14. SCHEDULED EVALUATIONS Interim MM YY MM YY Final MM YY 03 86 03 87	15. SOURCE/ORIGIN OF GOODS AND SERVICES <input checked="" type="checkbox"/> 000 <input type="checkbox"/> 941 <input type="checkbox"/> Local <input type="checkbox"/> Other (Specify)
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16. AMENDMENTS/NATURE OF CHANGE PROPOSED (This is page 1 of a _____ page PP Amendment.)

17. APPROVED BY	Signature:  Title: Anthony J. Cauterucci Mission Director	Date Signed: 4/13/84 MM DD YY	18. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION MM DD YY
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Project Authorization

Name of Country: Honduras
Name of Project: Small Business Development
Number of Project: 522-0205

1. Pursuant to Section 106 of the Foreign Assistance Act of 1961, as amended, I hereby authorize the Small Business Development Project for Honduras involving planned obligations of not to exceed \$600,000 in grant funds during Fiscal Year 1984 subject to the availability of funds in accordance with the A.I.D. OYB/allotment process, to help in financing foreign exchange and local currency costs for the project. The planned life of the project is 3 years from the date of initial obligation.

2. The project consists of the development of an accessible source of financial and technical assistance for small and medium scale entrepreneurs in Honduras.

3. The Project Agreement which may be negotiated and executed by the officer to whom such authority is delegated in accordance with A.I.D. regulations and Delegations of Authority shall be subject to the following essential terms and covenants and major conditions, together with such other terms and conditions as A.I.D. may deem appropriate.

4. a. Source and Origin of Commodities, Nationality of Services

Commodities financed by A.I.D. under the project shall have their source and origin in the cooperating country or the United States, except as A.I.D. may otherwise agree in writing. Except for ocean shipping, the suppliers of commodities or services shall have the cooperating country or the United States as their place of nationality, except as A.I.D. may otherwise agree in writing. Ocean shipping financed by A.I.D. under the Grant shall, except as A.I.D. may otherwise agree in writing, be financed only on flag vessels of the United States.

b. Condition Precedent to Disbursement

Prior to any disbursement, or the issuance of any commitment documents of Grant funds, except for contracting of the Small Business Adviser and the Finance Company Adviser, the Cooperating Country shall cause to be furnished in form and substance satisfactory to A.I.D., evidence that: (1) the System Coordinator has presented a plan for the first two years of implementation of the Small Business Assistance System and appointed a Project Manager acceptable to AID; and (2) the shareholders of FIA have formally committed themselves to create and capitalize the Financiera Industrial y Agropecuaria, S.A.

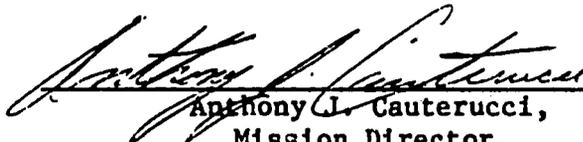
c. Covenants

The Cooperating Country shall covenant that:

(1) The Government of Honduras shall make available to FONDEI Eight Million Lempiras (L. 8 million) which FONDEI will lend to the Financiera Industrial y Agricola, Sociedad Anonima de Capital Variable (FIA, S.A. de C.v.) on terms and conditions acceptable to A.I.D.; and

(2) FONDEI and the System Coordinator for the Business Assistance System shall present to AID, by the end of the sixth month of the second year of Project implementation a plan for the continued financing of the Business Assistance System, and put said plan into effect prior to the Project Activities Completion Date specified in the Project Agreement.

(3) FONDEI and A.I.D. shall meet periodically to review the adequacy of the System Coordinator's management of the Business Assistance System, and agree on any changes in the implementation arrangements for the project that may be needed.



Anthony J. Cauterucci,
Mission Director,
USAID/Honduras

4/13/84

Date

Clearances:

Cont: PAmos _____ date 3/27
PCR: EZallman 7/24 date 3/27
DMD: RNicholson 3/20 date 4/11

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Project Paper
Honduras: Small Business Development
(Project No. 522-0205)

I. Background

A. Role of Small and Medium Size Firms in the Economy

Small business development is an important means for achieving higher income and employment opportunities for people in developing countries. In general, small businesses are relatively efficient in their use of capital and credit, and provide a significant source of employment for workers with minimal formal education and training. In Honduras, enterprises in all sectors are predominantly small scale operations. The small scale of Honduran firms is best illustrated by data from the 1975 Census of Industrial and Handicraft establishments, which are summarized below. The firm sizes were ordered by gross production for purposes of compiling these data.

Size of Firm	No. of Firms	Cum. %	Production (\$ Millions)	Fixed Assets	Number of Employees	Assets per Worker (\$)
Large	5	-0-	135	94	3,103	30,300
Medium	95	0.2	252	129	14,673	8,800
Small	749	2.0	107	80	18,987	4,200
Subtotal	849	2.2	494	303	36,763	8,250
Artisan	36,973	97.8	N/A	N/A	50,137	N/A
Total	37,822	100.0			86,900	

In terms of number of employees, industrial firm sizes in 1975 were as follows:

<u>Number of Employees</u>	<u>Number of Firms</u>
100 and over	81
50 to 99	94
20 to 49	196
5 to 19	478
1 to 4	36,973

The Mission has no reason to believe that there have been any major changes in the overall pattern of industrial firm size. A recent survey carried out by the Ministry of Labor estimated that there were 20,000 firms in the service sector in Honduras in 1982.

Based on the above data, the CBI Implementation Plan, and the additional data that have become available since that document was drafted, the Mission has developed an estimate of the number of small and medium enterprises, the labor force, and the assets per worker for small and medium scale enterprises in

Honduras (See Table I). The classification of small and medium for this purpose is based on assets per worker as the most relevant criterion for purposes of this project.

Table 1: Small and Medium Enterprises, 1982^{1/}

<u>Sector</u>	<u>No. of Firms</u>	<u>Labor Force</u>	<u>Assets/Worker</u>
Medium Scale Industry	120	18,800	\$ 19,300
Small Scale Industry	960	24,300	9,300
Artisan Industry	47,350	64,000	2,500
Service	<u>20,000</u>	<u>146,000</u>	<u>4,650</u>
Total	68,430	252,100	\$ 5,650 (Ave.)

The above small and medium scale enterprises are the project's principal focus, but they are not the only small businesses in Honduras. In addition, there are an estimated 175,000 small and medium scale farm units (up to 30 hectares) and 14,000 commercial operations. Together with the small and medium enterprises they account for 96% of all businesses and 78% of the labor force in Honduras in 1982.

B. Problems of Small and Medium Scale Enterprises

To identify the problems of small and medium scale enterprises in Honduras, interviews were carried out with several private and public organizations that deal on regular basis with individual business firms of all sizes located in different parts of the country. Additional information was used from AID funded studies entitled Rural Small Industry Study (Michigan State University, 1979); Review of the Honduran Banking System (Torres, 1982); and Locational Patterns of Small Rural Enterprise Activity in Honduras (Roeser, 1982); a Honduran National University (UNAH) study entitled Analysis of Small and Medium Size Industries in Honduras (1981); and a study by the GOH's Industrial Development Center (CDI) entitled Training needs of Small Business Entrepreneurs affiliated to the Development Institute of Honduras. The interviews and studies identified the major problems and needs as low availability and access to credit sources; and a limited understanding of administration, marketing, technical know-how, and the legal environment.

^{1/} Methodological Note: The number of medium, small and artisan industrial enterprises and employees were estimated by multiplying 1974 census figures by estimated population growth from 1974 to 1982 (28%). The assets per worker for small and medium industries from the Census were multiplied by a factor of 2.2, which is the estimated inflation from 1974-1982 based on the Consumer Price Index. The assets per worker for artisan industries were extrapolated from a 1978 survey of rural industries (\$160/worker) and the above small scale industry figures. Service sector enterprises are Ministry of Labor estimates. The assets per worker of these firms are scaled from the small/medium industry figures based on data from other developing countries.

1. Access to Credit

The access of small and medium scale enterprises in Honduras to credit is constrained by a variety of factors, the most important of which appear to be:

a. The inability of small and medium scale entrepreneurs to convince bankers of their creditworthiness, which is partially a result of poor past repayment performance.

b. Bank credit policies that require lending primarily on the basis of the borrower's collateral rather than the commercial viability of the business.

c. Difficulties encountered by small and medium scale enterprises in meeting formal banking regulations for loan approval - e.g. lack of understanding of loan application procedures, lack of audited financial statements, inability to project cash flows.

d. Credit terms which are too short to permit sound financial development of the firm.

e. Excessive delays and red tape involved in obtaining credit from government and government financed sources of credit.

f. Interest rate limits imposed by the Central Bank, which make it unprofitable for banks to lend to most small and medium scale enterprises.

g. Recently, the apparent desire of the banks to limit their credit exposure under perceived conditions of economic uncertainty and high business risks.

Honduras' 15 private banks generally offer credit on no more than 1 year terms, and to a small number of selected clients which are the largest business firms in the country. Those firms have a credit history, are capable of meeting local banks' collateral requirements and also, in many cases, have had direct access to foreign sources of credit to fulfill their long term and working capital needs. In some cases, they have also made extensive use of the credit offered by the public financial institutions, and of the GOH guarantees to obtain foreign loans.

Medium scale enterprises are often able to gain credit on one year terms. Small enterprises, on the other hand, are unable to establish a credit history with the banks. In the best of the cases, they obtain small personal loans, on a short term basis, which are used to finance working capital and even capital investments, and for which mortgaging personal assets is normal. When the entrepreneur or the business itself lacks mortgageable assets that the banks will accept (basically urban property, equipment and machinery), their growth is inhibited as they either operate without credit at a low level of production, or resort to corner street lenders, who charge very high interest

rates on short term funds. These rates are reportedly as high as 7% a month and, in some cases, collections are made daily.

The UNAH study "Analysis of Small and Medium Industries of Honduras - 1981", shows that businesses finance their operations mainly with their own funds. The figures contained in that study, organized by sources of financing and size of firms, are the following:

Source of Funds	Size of Firms		Average
	Small (%)	Medium (%)	
Own Funds	87.8	80.3	84.1
Suppliers	6.0	8.8	7.4
Private Banks	4.2	9.1	6.6
Public Banks	0.3	0.1	0.2
Lenders	0.3	0.4	0.3
Others	1.4	1.3	1.4
TOTAL	100.0	100.0	100.0

By contrast, large industrial firms are highly leveraged. It is not unusual for them to operate with equity of 10% to 20%.

2. Administrative Knowledge

Knowledge and application of basic management tools such as written accounting systems and inventory controls is not common at the level of small business, though people who have survived for several years in these business generally have developed informal systems through hard experience. The Michigan State Study indicated that 14% of small rural enterprises kept written records and 15% kept bank accounts. Almost two thirds of those who kept no written records perceived no need for them.^{1/} The corresponding figures are undoubtedly higher in larger businesses and in those located in urban areas. In general, however, the evidence indicates that small entrepreneurs do not have complete knowledge of their assets and liabilities, costs of production, or profit margins. Small entrepreneurs generally do not prepare work plans. In the MSU Study, two thirds of the entrepreneurs did not formulate a work plan, 22% formulated plans on a daily basis and only 12% on a weekly longer basis.^{2/} Too often small entrepreneurs do not realize what they don't know. They often define their most pressing need as credit, but their reasons why they need it, together with a look at their underutilized assets (usually the most expensive ones) indicate they are not utilizing what they have as productively as they could. These insufficiencies in management knowledge are obviously less apparent in medium scale businesses and in commercial enterprises. For example, in the UNAH study to determine technical assistance needs of small and medium scale enterprises, 55% of the medium size operations expressed a need for assistance in financial systems and controls.

1. Kelley JC/Coronado L., "A profile of Rural Small Industries in Selected Areas of Honduras." USAID/Honduras June 1979, Pg. 9

2. Ibid, Pg. 13, Table 70

Honduran small and medium scale enterprises need direct technical assistance and training in administrative systems and controls. Moreover, small scale operations need the type of assistance which will enable entrepreneurs to become more aware of the usefulness of such systems and controls. With this knowledge they will have a basis for planning for expansion and analyzing investment decisions.

3. Marketing and Technical Knowledge

The experience to date of small business assistance programs in Honduras and the previously cited studies indicate that the problems of marketing and technical know how are closely interrelated. Both small and medium entrepreneurs recognize their need for technical assistance in production and marketing. Their primary concern in the area of production is increasing their productivity. In one survey, 65% of the small and 70% of the medium sized business interviewed indicated a need for technical assistance for improving production process.^{1/} The observation of advisors working in this sector is that significant productivity gains could be achieved without further mechanization merely by adjusting plant layout.

Problems in obtaining raw materials also figure significantly in the problems mentioned by entrepreneurs. In the MSU study, almost half of small rural enterprises experienced difficulties in obtaining raw materials. The quality of raw materials was cited by 40% of the firms studied, and availability was cited by 33%.^{2/} Recently, Honduras' shortage of foreign exchange has affected the ability of most enterprises to obtain suitable raw materials.

Many small entrepreneurs do not have the resources to buy raw materials in large quantities and at reduced prices. This combined with inefficient and limited productive capacity, limited understanding of product markets and limited awareness of marketing techniques, results in them paying high prices for inputs and often receiving the least for their products. A better understanding of sources of supply, distribution channels and marketing opportunities would enable entrepreneurs to take advantage of improved management and production practices and compete more effectively in the internal and possibly in the export market.

4. Legal Constraints

Generally, only the large and some medium scale enterprises are organized as incorporated businesses or partnerships in accordance with Honduras' Commercial Code. Those firms which are legally incorporated must document their assets, liabilities and capital structure. Most businesses are operated as sole proprietorships (Comerciante Individual), which is the simplest legal business organization form. Normally, these unincorporated businesses do not

1. Marin de Pere RI, et al, Determinacion de Necesidades de Asistencia Técnica de la Pequena y Mediana Industria en Honduras UNAH 1981, Pg. 283

2. Opcit, Kelley, Pg. 12

list assets in the business name but rather as personal assets. Most businesses, particularly those at the bottom of the scale, operate with the minimum permissible legal registration requirement. This consists of registering with the local government the name of the owner of the business and the place where business is conducted. While not incorporating the business legally avoids double taxation of income, it also limits access to credit, since it forces the financial institutions to offer loans on personal rather than business basis. Public financial institutions are also out of reach for unincorporated small and medium scale enterprises, since they require proof of legal incorporation in their loan approval procedures.

C. Efforts to Assist Small and Medium Scale Enterprises

1. GOH Attention to Small Business Problems

The GOH has provided assistance to small and medium scale enterprises through both direct and indirect means. Direct assistance has taken the form of credit and technical assistance. Limited credit resources have been made available through the National Development Bank (BANADESA), and the Industrial Development Center (CDI). These resources are available only for specific purposes such as agriculture and industry. Due to high delinquency rates and pressure for GOH resources in other areas, they appear unlikely to grow. The GOH has also provided significant assistance for long term investment lending under the World Bank financed Industrial Lending Fund (FONDEI) which finances credit through the private banks. FONDEI is administered by the Central Bank of Honduras (CBH). Technical assistance has been provided through the GOH's extension services, CDI, the National University and the Professional Formation Institute (INFOP).

The GOH's indirect support has been in the form of incentives to encourage the development of small and medium size industrial firms. In November, 1978 the GOH approved Decree No. 681 which provides for exemptions of import taxes and consular fees on imported raw materials and equipment needed in the production of goods. This legislation basically extended to small businesses some of the incentives which have been available to larger firms for many years.

2. Private Sector Support

The Private Sector's support for small and medium enterprises historically has been weak. Several private development foundations were started with external funding in the sixties and seventies, but none is still active. In the last few years, however, a number of PVO's expanded their services to small and medium scale enterprises and two new PVO's started providing credit and technical assistance with external resources.

In all these programs are reaching a small number of the approximately 68,000 small and medium scale enterprises. Given the problems and importance of these enterprises in the economy, growing unemployment, the recent stagnation of large scale industry, the traditional inefficiency and ineffectiveness of government assistance, and expanding private sector interest in helping small

and medium scale enterprises, a new, private sector administered, commercially based approach is needed to improve small business development in Honduras, generate additional employment, and further the country's economic development.

II. Project Description

A. Goal and Purpose

The Goal of the project will be to increase production and employment in small and medium scale enterprises. Goal achievement will be measured by the increased values added to production and employment of enterprises assisted through the project. Specifically, value added will be over \$6.3 million during the three years of project implementation and over \$2.3 million in the final year. Over the first eight years of the project, value added will be almost \$25 million. Direct employment will increase by at least 500 full time job equivalents and indirect employment by another 500 during implementation as a result of project financed activities. The corresponding figures after eight years will be at least 985 and 1,000, respectively.

The Purpose of the project will be to develop a source of accessible financial and technical assistance for Honduras' small and medium scale entrepreneurs. End of Project Status indicators will be an established, well managed small business finance company with a loan portfolio equal to \$12.7 million, and competent and appropriate technical assistance being provided to small entrepreneurs. Accessibility of the financial assistance to small and medium entrepreneurs will be ensured by having the finance company operate as a free market lending source within an otherwise controlled and regulated financial intermediation system, and by adoption of a marketing strategy which directs financing to this group of borrowers. Progressively greater attention to new clients and smaller borrowers will be assured because the finance company's pricing structure will encourage larger clients to move to bank financing as soon as they qualify for it. Accessibility of technical assistance will be assured by developing a system which is designed to constantly evaluate the needs of small and medium businesses and provide the kind of assistance they need through the institutions best able to provide it.

B. Target Group

The target group consists of two subgroups: presently unemployed and underemployed workers and new labor force entrants; and the country's estimated 68,000 small and medium scale enterprises. The 840,000 workers who make up the first group consist of approximately 200,000 members of the Honduran labor force who are now unemployed, approximately 400,000 more underemployed workers, and the approximately 240,000 workers with no more than primary education who will enter the labor market during the first eight years of the project. In general, the present unemployed and underemployed are urban and rural workers who are members of families with an estimated annual income of \$1,800, or \$300 per capita. Typically, the urban target group members will have no more than a sixth grade education and live in a slum area. In rural areas, they will generally have no more than a third grade

education and earn a living by production of basic grains, working as a day laborer, and cottage production activities.

The term small and medium scale enterprises refers to private firms which have a composite of characteristics which distinguish them from each other and from large scale firms. The principal characteristics are the number of employees and assets per worker, nature and amount of assets, production technology, and market orientation. These characteristics may be generalized as follows:

<u>Characteristic</u>	<u>Small</u>	<u>Medium</u>
Number of Employees	5- 20	20 - 100
Assets per Worker (Ave.)	\$1,000-\$5,000	\$5,000-\$15,000
Total Assets	\$5,000-\$100,000	\$100,000 - \$1,000,000
Title to Assets	Personal	Business
Production Technology	Traditional	Intermediate
Production Mode	Custom Work	Mass Production
Type of Production Employees	Craftsmen	Operatives
Market Orientation	To Order	For Resale

Most enterprises show a mixture of these characteristics, and none could be classified with certainty using any single criterion. However, for purposes of administering the project activities, an easily verifiable operating definition is essential. For purposes of this project, small and medium scale enterprises are defined as those having total assets of up to US\$100,000 and from \$100,000 to \$1,000,000, respectively. The reason for choosing this characteristic is essentially for ease of administering the credit component of the project.

Target group enterprises will include industrial, agricultural, and service sector operations. Industry includes agro-industry and service includes construction companies. Most of them are unincorporated businesses. In general, their fixed assets per worker will be no more than \$5,000 and \$11,200 per worker^{1/} in small and medium scale industries, respectively, and about half those amounts in service enterprises. A small number of the country's 175,000 small scale agricultural operations will benefit indirectly through loans made to agroindustries.

C. Project Activities

1. Financial Assistance for Small Enterprises

Five Honduran banks have agreed to organize and capitalize a commercial

^{1/} The average assets per worker of medium industries in Table 1 on page 2 was estimated at \$19,300. Those data included an estimated 70 medium size firms with an estimated 765 workers in intermediate industries such as paper, carton, cardboard, rubber, chemicals, petroleum derivatives, non-metallic minerals and others which have an estimated investment per worker of \$35,300. The amount of capital these industries require makes them improbable beneficiaries of this project given the loan size limit of \$500,000. The remaining medium scale industries have an average assets per worker of \$11,200.

finance company called Financiera Industrial y Agropecuaria, S.A (FIA). FIA will be chartered as a commercial corporation, not as a bank. It's charter will allow it to take on loans; provide credit, services, and financial advice to borrowers; make equity investments, and enter into all types of financial transactions. Under this project, it will provide credit to small and medium scale enterprises exclusively. FIA's charter will enable it to increase its authorized capital from an initial \$500,000 to as much as \$2.5 million. The minimum capital of \$500,000 will be subscribed by the founding banks and paid in during Project implementation. The banks are in the process of obtaining FIA's legal charter, electing a Board of Directors, and appointing a General Manager. Operations will begin shortly after signing of the Project Agreement.

FIA will be a private, development-oriented, financial institution, and will be professionally managed by a small staff hired from the local banking community. It will make loans and provide services which entrepreneurs are unable to obtain through Honduras' banking system. It will be non-bank commercial source of credit which will function between the market now attended by the banks and the numerous small, non-bank financial institutions and individuals who provide limited credit and services to the target group. As a non-bank institution, FIA will not hold deposits, and will not be subject to the interest rate ceilings and reserve requirements established by the Central Bank.^{1/} It will follow appraisal banking principles and will be more liberal with collateral and guaranty requirements than commercial banks.

Under the Project, FIA's clients will be small and medium scale private enterprises mainly in the industrial and service sectors^{2/} with total assets of no more than \$1.0 million, who need financing for projects which require terms, payment plans and other conditions that commercial banks will not meet. To ensure the greatest possible benefit for the project's target group as well as its long-term financial success, FIA will not use Project funds to make loans to government institutions or mixed capital enterprises, finance housing mortgages, refinance existing debt, or finance equity purchases or capital account transactions. It will not pay dividends during its first three years of operation, and will build up reserves equal to a minimum of 5% of its loan portfolio, prior to payment of any dividends to shareholders.

FIA's initial lending resources will be the equivalent of \$6.5 million. Of this amount, the equivalent of \$4 million will be provided from the proceeds of a loan from the Government of Honduras, which will be financed with funds

1/ FIA will be subject to Honduras' usury law, whose regulations establish a maximum interest rate of 18% on collateralized loans and 24% per annum on unsecured loans. The law is not enforced. The Mission has requested the GOH to raise maximum interest rate to 5% above the Central Bank ceiling on bank loans. As a practical matter, however, even without this modification, FIA's activities will not be constrained by GOH law or regulation.

2/ Loans to commercial enterprises have not been excluded to permit FIA to finance the retail operations of the Honduran Federation of Industrial Cooperatives. However, little commercial lending is anticipated as the private banks are providing sufficient credit to that sector.

derived under an AID project. These funds (GOH funds) will be lent to FIA through the Industrial Development Fund (FONDEI) Office of the Central Bank on 20 year terms at the highest Central Bank discount rate for loans made by commercial banks. This rate is the best proxy for the real cost of additional funds for lending purposes to the banking system. FIA's repayment to FONDEI will start after an 8 year grace period. A counterpart contribution equivalent to \$2.5 million in lending resources will consist of \$2 million in loans from the shareholder banks to FIA and \$500,000 from initial sale of FIA stock to its shareholders.

Under the project, FIA will provide investment and working capital loans to its clients on a negotiated basis with respect to both terms and interest rates. The interest rate will in no case be less than 8% above the Central Bank Discount rate applicable to its loan from FONDEI. The terms of FIA loans will not exceed the terms on which it borrows money. On loans of more than one year, FIA will charge a variable interest rate, which will be adjusted on a yearly basis in accordance with the change in the Central Bank discount rate^{2/}. Loans financed with Project resources will have a maximum loan size of \$500,000. FIA's credit policies, marketing strategy, organization and operations are described in detail in the Institutional Analysis Section.

Under the Project, FIA will make direct loans to small and medium scale clients, and cofinance loans generated by shareholder banks. At the outset, its major market is expected to be in providing medium term investment financing for small and medium size industrial firms, and working capital for small industrial and service operations. Its initial clients will be mainly medium size firms who have been bank clients but who need longer term credit than that offered by the banks or whose collateral is insufficient for additional bank borrowing. Over time, FIA's clients will increasingly come from the small entrepreneurs who are helped to meet its eligibility criteria with assistance provided under the technical assistance program (Activity 2, below). To ensure increased lending to small clients once it has established itself financially, FIA has agreed to increase yearly the percentage of its clients who are small businesses, as defined in the preceding section. The percentage of loans to small clients will increase from 50% at the end of the first year to 80% by the end of the third year of project implementation. At least 50% of FIA's new clients in the third year of implementation will have been assisted under the technical assistance activity.

a. Direct Loans (\$3 million GOH; \$500,000 Banks)

FIA will provide direct loans to small and medium entrepreneurs who are referred to by its shareholder banks, institutions participating in the

1/ Should multiple rates be established at any time in the future, the highest rate applicable to industrial loans will be charged.

2/ Should Honduras experience a period of rapid inflation, the variable rate system will have to be re-examined in light of the effects on the financial condition of FIA and its borrowers and may be changed to best meet the needs of both.

technical assistance system, and its previous clients. FIA will approve loans on the basis of its appraisal of the applicant's project, personal references and collateral. Borrowers will repay FIA directly and FIA will accept the entire risk on these loans. In most cases, borrowers will receive technical assistance and supervision from the technical assistance organizations during implementation of their projects. Approximately 140 loans with an average amount of \$50,000 are expected to be financed with the first use of Project funds. Most of these loans will be made in the second and third years of project implementation.

b. Cofinanced Loans (\$1 million GOH; \$2 million Banks)

FIA will also cofinance loans with its shareholder banks. The objective of this activity is to induce the banks to lend on longer terms than those permitted under their normal banking practices and internal regulations, and to test the market for FIA paper. Each bank will have drawing rights for cofinanced loans in proportion to its share of FIA's capital. Should a bank not wish to use its drawing rights, they will be redistributed equally to the other shareholders.

Entrepreneurs requesting medium term bank loans will submit loan applications to their respective banks. If the project is acceptable to the shareholder bank, but the bank is not willing to make the loan directly, it will send the client and the bank's analysis of the loan to FIA for consideration of cofinancing. If FIA accepts the loan, it will make the loan and charge the bank for 2/3 of the principal. FIA will make disbursement to the client, and service the loan through the originating bank. FIA will pay the bank 2/3 of each capital payment received plus an interest rate equal to the Central Bank discount rate plus 6% on 2/3 of the outstanding balance of the loan. FIA may agree to accept later maturities of the loan, thus in effect providing a long grace period with its funds. FIA and the originating bank will share the risk on these loans in proportion to their initial financing. No more than the equivalent of \$1 million of GOH funds will be used for this activity, and the funds not used for cofinancing operations will be available for direct lending. The proportion of FIA and Bank financing on loans not financed with Project funds will be determined by FIA's Board of Directors.

FIA will return Project financed loans which are delinquent for more than 60 days to the bank, which will immediately refund 1/3 of the remaining unpaid principal to FIA. Any bank which refuses to refund a delinquent loan will have no further access to the cofinancing facility, and FIA will withhold payments owed to the bank on other cofinanced loans until the debt plus accrued interest is recovered. Approximately 30 loans with an average amount of \$200,000 are expected to be financed with the first use of Project funds. Almost all of them will be approved during the first year of operations.

c. Mobilization of Additional Lending Resources

Shortly after initiating operations, FIA will begin to seek additional sources of capital for direct lending, discounting of medium term bank loans, and

additional cofinancing operations. The potential sources of additional lending resources include individuals, insurance companies, pension funds, international banks, and international financing institutions such as the International Finance Corporation (World Bank affiliate) and the Interamerican Development Bank. Domestic resources will be sought by issuing commercial paper backed by FIA's portfolio of cofinanced loans. AID/PRE is considering providing a \$2.5 million loan to FIA to provide access to dollar lending resources.

As the funds that the shareholder banks lend to FIA are relatively high-cost funds and are simply transfers of liquidity from one part of the domestic banking system to another, the banks will be allowed to withdraw \$1 of their loans to FIA for every \$2 in additional resources FIA mobilizes from sources other than domestic banks. This incentive is intended to encourage FIA to mobilize additional resources and improve its lending margins as quickly as possible.

d. Technical Assistance to FIA

FIA will need technical assistance in four areas: development of appraisal banking techniques; development of a long range marketing strategy; assistance in finding new sources of long term financing; and general assistance in finance company management. Grant funds will finance 15 months services of an experienced small business finance company manager at an estimated cost of \$130,000.

2. Technical Assistance for Small Entrepreneurs

At the outset, some, or perhaps most, of FIA's initial clients will be entrepreneurs who normally receive credit from banks, but who have projects for which they cannot obtain suitable financing due to short terms, high collateral demands or other requirements of the banks. By providing credit to these clients, FIA will quickly develop a good loan portfolio at minimum cost and begin to generate income. It will increasingly draw its new clients from entrepreneurs who have not received bank credit previously. Most of them will need assistance to enable them to meet FIA's requirements. Through the project, a system will be developed for identifying these entrepreneurs and providing technical assistance to them.

a. Assistance Needs of Small Businesses

The Background section described the deficiencies in the management and technical skills in small and medium scale enterprises, specifically in the areas of record keeping, planning, marketing and market analysis, management and production controls, legal organization, and rationalization of the productive process in the case of industry. Technical assistance to help them address these problems, will be provided through:

i. Training and/or management assistance in management tools which will give the entrepreneur (and FIA's credit officer) an overview of the performance of the business.

ii. Training and/or management assistance in business planning, including market analysis, production or service and financial projections (income and expenses and cash flow, including loan repayment).

iii. Technical information from internal and external sources about available machinery, production processes, raw materials, product quality control, etc.

iv. Legal assistance in incorporating the business, and formalizing or documenting business assets.

v. Valuation of Assets.

As entrepreneurs are often refused credit because they are not known to a lender or to someone the lender knows and trusts, assistance will also be provided in developing personal and business references.

b. Existing Business Assistance Services

At present in Honduras there are some 23 private organizations plus five government agencies that provide some form of assistance (credit, management, technical, training) to small and medium scale businesses. Many of them initiated their activities in this area within the last 3-4 years, and some of the organizations themselves were started during this time. Table 2 shows the organizations now providing assistance to small businesses in Honduras. More detail on the kind and amount of services provided by these institutions is included in Annex D.1. Between them, they provide services to all areas of the country, and have the potential to reach a large number of entrepreneurs. However, the type and quality of their services and their outreach capability vary widely. Some of them are capable of providing quality services in certain areas right now, others will need a good bit of assistance to enable them to really be helpful to small entrepreneurs. Some of them have field staffs and some handle only walk in traffic. Given these factors, and the history of institutional development efforts here, improving the capability of institutions that have already started providing such services is eminently more sensible than the creation of one or more new institutions. It builds on the interest they have already shown in helping small businesses and affords a way of operationalizing the services quickly and efficiently.

c. The Business Assistance System

The Business Assistance System that will be developed through the project will start by supporting institutions that have shown their interest and capability in providing services needed by small businesses. Their capability to provide additional services and improve the quality of services will be developed over time by a System Coordinator. The Coordinator will select participating institutions, train their personnel, coordinate and evaluate their activities, and provide linkages to FIA and external sources of assistance. The System Coordinator will be the National Association of Industrialists (ANDI).

Table 2: Assistance to Small Business in Honduras

Organization	<u>Type of Assistance</u>					
	<u>Mgmt.</u>	<u>Tech.</u>	<u>Train.</u>	<u>Legal</u>	<u>Infor.</u>	<u>General</u>
<u>PVO's:</u>						
Honduran Development Inst.	X	X		X		
Industrial Cooperative Fed.	X	X	X	X		
Peace Corps	X	X				
Development Advisers					X	
Inter. Exec. Serv. Corps	X	X				
Cent. Amer. Bus. Inst.			X			X
Cooperative Promotion Inst.			X	X		
Tegucigalpa C. of C.			X		X	X
San Pedro Sula C. of C.			X		X	X
La Ceiba C. of C.					X	X
Modern Executives			X			
Univ. of San Pedro Sula			X			X
Jose C. Valle U. (Teguc.)			X			X
Assoc. of Execs and Managers				X		
Industrialists Assoc.				X		
Hond-Amer. C. of C.				X		X
Private Enter. Council						X
<u>Private Firms:</u>						
Fortin, Lagos and Assoc.	X	X	X			
Mendieta Y Assoc.	X	X	X			
Morales, Palao, Williams	X					
Rivera y Associates		X				
Conrad		X				
Dale Carnegie			X			
<u>GOV Agencies:</u>						
Prof. Formation Inst.	X	X	X			
Indust. Devel. Center	X	X				
Univ. of Honduras	X	X	X		X	
Central Bank		X		X	X	
National Forestry Corp.		X				

Over time, the institutions will form a system which will enable small entrepreneurs to receive assistance from a number of easily accessible organizations. They will be able to access the participating organizations by requesting services directly, or being referred to them by FIA or ANDI. If an organization, after assessing the client's potential as an entrepreneur, believes he can be helped by outside assistance, it will assign a case worker (field agent) to provide such assistance, or arrange for it to be provided by another field agent or another organization having greater expertise in specific areas of need. In addition to helping the client develop his project and financing application, courses and direct technical assistance will be provided as needed in simple bookkeeping systems, asset management, product design, production, sales, business management and labor relations. For

clients who are successful in obtaining financing, the participating institutions will provide follow-up to ensure that loans funds are being properly used and additional assistance needs are diagnosed and attended.

The capability of the organizations listed in Table I were analyzed by a consultant during project development. Based on his analysis, business assistance services will be provided at the outset through a network which includes two existing management assistance organizations, and three existing information assistance organizations. Through the project, the System Coordinator will assist these organizations to further increase the quality of the services they now provide and to provide a fuller complement of services. Additional organizations will be helped to become qualified service providers in areas where their interests and the needs of small businesses make this desirable. A description of the qualified service providers and the next most likely to be qualified institutions included in Annex D.1. The criteria for selection of qualified service providers and the System Coordinator are discussed in the Institutional Analysis Section. As some time has passed since the consultant's study was prepared, a review of the present capability of the organizations selected will be carried out prior to their participation as service providers. A CP to this effect has been included in the Project Authorization. The following assumes that the institutions originally selected continue to have the capability to participate in the project.

i. Management Assistance Organizations

The initial management assistance organizations will be the Honduran Development Institute (IDH) and the Honduran Federation of Industrial Cooperatives (FEHCIL). These are two former OPG recipients of AID that appear to be maturing rapidly into well managed institutions with real expertise in small business development. Fortunately, they provide services on a nationwide basis. IDH will work with individual small businesses, and FEHCIL with cooperatives. Their main contact with small entrepreneurs will be through field agents. Between them, they have 7 agents at present. At least four more will be added during project implementation. At present they develop their clients through walk-in requests for assistance and referrals from present clients. Under the project they will also receive referrals from FIA and the TA system coordinator. At present, IDH and FEHCIL also provide direct financing for their clients. Under the project they will continue to provide financing and will in turn send successful, graduating clients to FIA.

The management assistance organizations will provide small business borrowers with assistance in loan analysis; proposal preparation; incorporating, and valuating, and legally documenting assets to be offered as collateral; and basic management and operations, including identifying markets and appropriate marketing techniques. If they cannot help resolve a specific problem, they may request specialized help from other organizations such as the information assistance agencies, the International Executive Service Corps (IESC), the Honduran Professional Formation Institute (INFOP), the GOH's Industrial Development Center (CDI), The Central Bank's Industrial Information Center (CIIBANTRAL), or private technical consulting firms paid for by TA System

funds in whole or in part, depending on the financial capacity of the firm and the entrepreneur.

Additional management assistance organizations will be qualified during implementation of the project. The most likely organizations to be qualified during implementation are: the Tegucigalpa and San Pedro Sula Chambers of Commerce, the National Association of Small and Medium Industries (ANMPI). Development Advisers (ASEPADE) and two technical assistance programs of the National Autonomous University of Honduras (UNAH) may also qualify. A target for the end of the project will be the development of a total of five qualified management assistance organizations with a total of 19 field agents participating in the program. Their efforts will be complemented by Peace Corps volunteers. The Peace Corps now has volunteers working with IDH and FEHCIL and plans to place volunteers with some of the other organizations as well.

ii. Information Assistance Organizations

The three information assistance agencies at the outset will be the Tegucigalpa and Cortes (San Pedro Sula) Chambers of Commerce and the National Association of Small and Medium Industrialists (ANMPI). They are providing information to small businesses now largely through their officers and members, but do not have field agents, or significant experience in providing credit or direct management assistance to small businesses. Under the project, they will continue to provide legal, technical, economic, market and management information which will complement the direct management and technical assistance provided by the management assistance organizations. As field agents funded through the Business Assistance System, are added to their staffs, they will increasingly serve as screening agents for FIA by assisting entrepreneurs to review and package their projects. This assistance will include legal assistance, project analysis, completing loan application forms, business and personal reference checks through their membership networks, basic management assistance, and follow up assistance as needed to clients that have received loans. By the end of the project, these institutions are expected to be fully qualified management assistance organizations.

Providing these services to members and non-members will help these organizations to expand their information base and solidify their institutional base. This expansion will enable them to better serve their primary purpose of representing small and medium scale businesses and private sector. This will better enable them to provide to the System Coordinator information on the assistance needs of small business and feedback on the services provided to meet those needs.

iii. Training Courses and Seminars

The above direct services will be complemented by a series of courses and seminars for small businesses in such areas as business administration, marketing and distribution, financial planning, inventory controls, production technologies, product development, personnel management, human relations, and

group bulk purchasing. Resources for the courses and seminars will be from the management assistance organizations; more specialized domestic organizations such as Cooperative Development Institute (IFC), ANDI, Dale Carnegie, INFOP, the National Autonomous University of Honduras (UNAH), the Private University of San Pedro Sula (USPS), Ejecutivos Modernos, the Honduran Managers and Administrators Association (GEMAH), Fortin Lagos y Asociados; and from outside of Honduras. At present there are few training course materials well adapted to the realities of Honduran small businesses. The TA System Coordinator will be responsible for developing them. A trainer will be brought in to give the training courses. The trainer's costs are estimated at \$60,000 over the first three years of the project. In addition, training visits for ANDI and service providing agency personnel to other nearby countries having good small business development programs (e.g. Dominican Republic, Mexico, Colombia) will be financed at a cost of \$40,000. These costs will be Grant financed.

d. The TA System Coordinator

As system coordinator, ANDI will continuously assess the management, information, and technical assistance needs of small and medium enterprises, finance the assistance activities of the institutions it qualifies as service providers, continuously evaluate the effectiveness of those institutions and increase resources for the most effective operations, qualify new organizations to participate in the system, train the personnel of and ensure coordination among all service providing agencies. ANDI's efforts will be concentrated on improving the effectiveness of the services to small businesses, strengthening individual organizations and building stable working relationships between them. It will ensure that the Business Assistance System continues to focus mainly on small businesses.

ANDI will serve as the common link between all the organizations in the Business Assistance System as well as with FIA. It will arrange technical assistance to those organizations as needed, especially during the startup phase. It will receive requests for assistance from the Business Assistance System organizations and FIA for themselves or for their clients. It will provide assistance in program design and management and will conduct annual evaluations of the participating assistance organizations to assess the effectiveness of their services, and their organization development. It will provide training to assistance organizations' field and management staff in areas affecting project development. ANDI will develop a series of seminars/workshops which will bring management, and/or field staff of assistance organizations and FIA together to review experiences, coordinate activities and acquire knowledge about new developments in the field. In addition, the coordinator will allocate and control the flow of project generated financial resources to service providers. A more detailed list of ANDI's responsibilities is included in the Institutional Analysis.

A preliminary workplan for implementation of the System has been prepared (See Annex D.2). In order to ensure that the System is working properly and that the Business Assistance System funds are being well spent, ANDI will prepare

for AID and FONDEI approval a yearly workplan setting forth its targets for institutional development and services during the first two years of project implementation. If needed, this requirement will be extended by USAID/Honduras for a third year.

Outside technical assistance will be needed to ensure proper development of the system. This assistance will consist of advisory services to ANDI in setting up and managing the Business Assistance System, training personnel of the management and information assistance organizations, and developing training courses oriented to small businesses. AID will contract a full time Small Business Adviser financed with Grant funds to provide these services. The contract will be for twenty six person months at an estimated cost of \$220,000. Of this amount, \$160,000 will be financed from the Grant. The remaining funding has already been provided from PD&S funds.

e. Financing of the Business Assistance Activity

The current discount rate applicable to FONDEI's loan to FIA is 11% per annum. Thus, FONDEI will earn a sizable spread on the credit funds. FONDEI will charge 1% for servicing FIA's loan and pay the remaining 10% into a Business Assistance System Fund which will be drawn down by ANDI to finance the costs of operating the System. The Fund's resources will be used to pay all reasonable and necessary costs of providing assistance services to small businesses. The major expense will be the costs of the qualified service providers field agents. These costs include personnel and fringe benefits, travel and per diem, consultant costs, books, training materials, training costs, vehicles, office equipment, and overhead. Other allowable costs include technical assistance for individual firms, and the expenses of the System Coordinator. No financing will be provided for the salaries and benefits of field agents who are GOH employees or contractors.

During the first two years, the Fund's income will be too low to enable the System to operate effectively. During this time, COH funds derived from an AID project will finance certain costs that are essential for getting the system going. These costs, which total \$400,000, are detailed in Annex D.4. Approximately \$160,000 will be needed ANDI's expenses for the first two years. The remainder will be needed for the costs of service providing agency personnel. Starting in the third year, ANDI's costs will be financed from the Fund, and will be limited to a flat percentage of the Fund income on a yearly basis. It is expected that this amount, which will be negotiated between FONDEI and ANDI during the second year of implementation, will not be in excess of 25% of the Fund's yearly income.

Also, during the first two years, the System will require foreign exchange for foreign technical assistance for individual companies, and vehicles for field personnel of the qualified service providers. The cost of these goods and services is estimated at \$200,000. The recurring portion of the costs which require foreign exchange is for foreign technical assistance and the trainer referred to in II.C.2.c(iii) above. Arrangements will have to be worked out to ensure access to foreign exchange for these costs after AID Grant financing

ends if the present shortage of hard currencies continues to exist at that time. Fortunately, a key technical assistance source, the IESC, accepts payment in local currency for its services.

The level of services that can be provided for the Business Assistance System under the present Central Bank discount rate is approximately L.1,000,000. To allow for reduction of the discount rate to better reflect likely interest rates over the longer term, the budget for the Business Assistance System (see Annex D.4.) assumes a yearly Fund income of L.800,000. At the present Central Bank discount rate this earnings level will be reached in the third year of project implementation. Assuming no change in the Central Bank discount rate, the Fund income will be fixed from year three to eight, at which point it will begin to decline as FIA begins principal repayments on the AID Loan. However, the costs of operating the system will continue to rise. There are several options for generating additional revenues to ensure that the system continues to operate successfully. They are discussed in the Section III.B.4, below.

D. Summary Financial Plan

The GOH, acting through the Ministry of Finance and Public Credit, will be the Grantee. The Ministry will designate the Industrial Development Fund (FONDEI) of the Central Bank as the implementing institution for the Project. AID will disburse Grant funds directly to ANDI, Grant funded advisers, and other providers of goods and services. The Project's financial plan, based on the planned three year implementation period is as follows:

DESCRIPTION:	SOURCE OF FUNDS (\$000)				TOTAL
	GOH	AID	BANKS		
	Funds	Grant	Loan	Capital	
Financial Assistance to Small and Medium Scale Enterprises:					
Direct Loans	4,000	140	2,000	500	6,640
Cofinanced Loans	3,000			500	3,500
Technical Assistance to FIA	1,000		2,000		3,000
		140			140
Business Assistance System:	400	460			860
Advisor to ANDI		160			160
Trainer, Orientation visits		100			100
TA to firms, Vehicles		200			200
ANDI expenses for 2 years	160				160
Service providing agency costs	240				240
Total	4,400	600	2,000	500	7,500

III. Project Analyses

A. Institutional

1. Need for a New Financial Institution

It is Mission policy to work through existing institutions to the maximum degree possible in implementing AID financed activities. Private sector institutions are preferred over public sector organizations. The criteria for selecting an institution to carry out the credit activity were basically that it be capable of administering credit on an unsubsidized basis, have the potential for mobilizing commercial resources for small and medium businesses beyond those AID provides through the Project, and be likely to reach the target group. Several options were considered in designing the project. First, the creation of one or more Central Bank discount lines for private banks and/or public sector credit institutions was considered. This alternative had the advantage of requiring little additional institutional development effort and the great probability of a high level of fund recovery. However, it had the distinct disadvantages of competing with the World Bank financed Industrial Development Fund (FONDEI), and would have required changes in bank credit policies that, were they agreed to in the first place, would likely be discontinued without additional external financing (which under present Central Bank rules would allow for negotiated rates to clients). The possibility that the banks would mobilize additional domestic resources for small and medium enterprises once AID funds were fully utilized was considered improbable under the existing Central Bank regulations. Likewise, the possibility that the GOH would provide discount lines with a higher margin to stimulate lending to riskier clients would mean that the GOH would have to subsidize this operation, which would be contrary to Mission policy and unfeasible given the GOH's present financial condition. Public sector institutions were ruled out due to their dismal record of loan collections, history of political influence in loan administration, and high dependence on budgetary resources or soft loan money from the IFI's.

A second alternative was working through one or more existing PVO's to develop a market oriented credit program. This had the definite advantage of almost certainly reaching the target group. However, it was ruled out given the lack of any organizations now capable of administering a good sized program, the Mission's desire for impact, and the improbability that even a well run PVO would be able to attract commercial resources in the future.

Finally, a new organization to serve small and medium scale enterprises on a commercial basis was considered. This alternative has the advantage of permitting the development of an institution designed precisely to meet the above criteria. On the other hand, it carries all the risks that are inherent in developing any new institution. Despite the risks this solution was considered the best in view of the above criteria and target group needs.

The finance company that will be initiated through the project will be a unique institution. To ensure adequate credit administration it will be managed and staffed by experienced bankers. It will introduce appraisal banking techniques into a collateral based, commercial lending system. It will institutionalize a good size free market credit operation in a regulated banking system. By virtue of its role as borrower of the AID funds, the GOH will give its explicit blessing to a free market experiment in the financial intermediation system - a small, but important GOH policy change. Since it will be owned by well established banks who see it as a necessary complement to their existing operations, it will have both responsible owners who will suffer financially and in terms of their reputations if it were to fail, and a natural market niche. There are three Honduran banks, one of which will be a FIA shareholder, who own and successfully operate finance companies at present. The organizational form is known to Honduran banks and the institutional development task is essentially one of adapting this organizational form to a new purpose. Instead of financing automobiles and machinery, loans will be made for productive purposes, in which the shareholders have experience through their banks. The Mission recognizes that several non-bank owned finance companies have failed in the past in Honduras, and believes that the design of FIA takes into account the reasons why they failed and minimizes the risk of a recurrence. A full discussion of this is included in Annex D.5.

2. FIA Institutional Analysis

This Section describes in more detail FIA's ownership, organization, credit policies, and operations, as they have been discussed with the shareholder banks and as they are expected to appear in FIA's bylaws and credit regulations, once they are approved. To ensure their general consistency with the understandings outlined in this Section, AID will approve FIA's bylaws and credit regulations as a Condition Precedent to Disbursement of GOH funds.

a. Ownership Arrangements

The five banks who have agreed to become FIA shareholders and key data about each of them are:

Bank	(\$Millions)		No. of Offices
	<u>Assets</u>	<u>Capital</u>	
Banco de Occidente	71.3	3.2	26
Banco de los Trabajadores	46.0	6.7	14
Banco Mercantil	18.1	3.1	2
Banco Hondureno del Cafe	12.6	3.1	2
Financiera Centroamericana	26.2	2.1	6
Total	174.2	18.2	50
% of Total Banking System	15	15	

Source: Central Bank of Honduras. Financial data are as of 8/31/82.

Of the \$18.2 in capital, \$12 million is in the form of shares purchased by the bank shareholders. Thus, FIA's subscribed capital of \$500,000 will amount to 4.0% of banks' paid in capital. That is a significant commitment to a single investment. Furthermore, as the purchase of FIA shares involves converting a performing asset into a non-performing asset (until initiation of dividend payouts), the banks will forego additional income at a time when their profit margins are squeezed.

The Boards of Directors of the five banks have approved their participation in FIA, and authorized their Chief Executive Officers to purchase FIA shares. A local insurance company, the Aseguradora Hondurena has indicated an interest in becoming a shareholder in the near future. Additional banks that may wish to become shareholders at some time in the future are Banco Continental, Banco Sogerin, Banco la Capitalizadora Hondurena, and Banco El Ahorro Hondureno. FIA's charter allows for the entrance of additional financial institutions as shareholders, and provides also for issuance of preferred shares. These shares will be issued at such time as FIA is firmly established and needs additional equity to expand operations. Issuance of preferred shares would allow FIA to raise additional lending capital at lower cost than additional borrowing. The voting rights of preferred shareholders would be determined prior to issuance of the shares. It is the intention of FIA's founding members to retain voting control in both the General Assembly, and to not allow non-bank shareholders on the Board of Directors. These views may change with time and circumstances.

Each of the founding shareholders will make an initial purchase of 500 shares common stock with a par value of \$50 per share prior to first disbursement. The remaining shares will be purchased as needed to maintain a debt to equity ratio of no more than 13:1. In the future, this ratio will be maintained by increasing reserves from undistributed profits, and by additional capital contributions whenever capital plus reserves falls below the amount required on the basis of FIA's debt structure. The 13:1 ratio is slightly lower than the ratio of approximately 20:1 for the Honduran banking system as a whole, and is considered reasonable in view of the somewhat riskier nature of FIA's loans.

The shares may be sold or transferred as provided for under Honduran law. The Honduran Commercial Code gives first right to purchase shares to existing owners. FIA's founding shareholders believe that control of the organization by commercial banks and other financial institutions operating under conditions of equal participation is necessary to its long term success. They intend to have these shareholders maintain equal voting shares as a result of share sale transactions. Thus, additional common stock issuance and membership on the Board of Directors is likely to be only to other banks and insurance companies that FIA's founding members accept as compatible shareholders. Eventually, issuance of additional common stock or preferred stock will be needed to provide for a broader base of operations and ensure maintenance of the above debt/equity ratio. Once profitable operations are attained and adequate reserves created, FIA is expected to reward its shareholders by following a reasonable dividend policy. However, to ensure

its long term capitalization, dividends will not be distributed during the first 3 years of operations, and after that no more than 50% of yearly earnings will be paid out in dividends.

b. FIA Organization

The founding shareholders will constitute FIA's general assembly, and they will all be represented on the Board of Directors. Voting in the General Assembly will be on the basis of shares owned. The General Assembly will meet once a year during the first three months of the year in accordance with Honduran law.

The shareholder banks will be represented in the Board of Directors by their Presidents or General Managers, and voting will be by majority of Directors. To provide for additional expertise in small business operations and problems, FIA will appoint an additional director with significant experience in small business. The length of this director's appointment and the selection process will be included in FIA's bylaws. AID will approve the person who serves in this capacity during the first two years of project implementation. Provision has been made in FIA's draft charter for increasing to nine the number of members of the Board of Directors.

The Board of Directors will appoint FIA's chief executive officer, who will have the title of General Manager. The General Manager will be a non-voting member of the Board of Directors. The General Manager will hire such staff as FIA needs and ensure the professional management of the organization. The General Manager will have at least five years of progressively responsible finance experience three of which will be at least at the level of assistant bank manager or branch manager. Loan officers will have at least three years previous experience in that capacity.

FIA's first office will be in Tegucigalpa. A second office will be opened in San Pedro Sula as soon as the level of operations makes it economically feasible. Additional offices may be opened later on. At the outset, FIA should not need more than 5 or 6 employees: the General Manager, one or two loan officers, a bookkeeper, a secretary and a driver/officeperson. Additional personnel will be added as the volume of business grows. In general, loan officers will have a case load of 20-30 loans each. Accordingly, if the number of clients projected for FIA during the implementation period is reached, FIA will need approximately 7 loan officers by the end of the project.

c. FIA Credit Policies

1. Eligible Borrowers

Under the project, FIA's borrowers will be sole proprietorships, partnerships, corporations, and cooperatives who are engaged in, or wish to start industries and service sector operations. Commercial borrowers will not be excluded, but few loans are expected in the commercial sector, as bank financing is

generally adequate in that sector. FIA will not make loans to government agencies or enterprises with majority or minority government ownership.

ii. Eligible Projects

Loans may be for operations, expansion of and new investment in productive capacity. Under the Project, credit may not be used to finance housing mortgages or equity purchases, or refinance debts to other banks or credit institutions. Borrowers will finance at least 10% of the total project cost. FIA will not make equity investments.

iii. Loan Amount

Under the Project, the maximum loan amount will be \$500,000 or up to 80% of total assets of the borrower, whichever is less. No single borrower will receive a loan or combination of loans which exceeds the following amount of FIA's total capital (paid-in capital plus retained earnings): 100% by the end of the first year of implementation; 75% by the end of the second year; and 50% by the end of the third.

iv. Loan Terms

The maximum loan terms will be 3 years for working capital with up to one year grace period on principal repayments, and 7 years for fixed asset investments with up to two years grace. Repayment terms will be tailored to the needs of the enterprise and the borrower, and may include annual, semi-annual, quarterly or monthly based on the amount and timing of cash generation expected by the borrower. Given the nature of small businesses, which often depend heavily on the health of the owner/manager, FIA will consider extending payments and refinancing loans where justified.

v. Interest Rate

At the outset, the interest rate will be not less than 8% above the Central Bank Discount rate. On loans of more than one year, FIA will charge a variable interest rate, which will be adjusted on a yearly basis in accordance with the change in the Central Bank discount rate. As FIA's cost of initial capital will also be pegged to the Central Bank Discount Rate, this innovative system will ensure that, at least during the first few years of its operations, FIA can avoid getting stuck with unprofitable loans when interest rates rise, and enable it to keep its market when the cost of funds declines. FIA will adjust its margins over time on the basis of actual lending experience. It will establish higher rates for riskier clients, and/or charge commissions on those loans.

vi. Uses of Loan Funds

Loan funds may be used for investment and working capital purposes. Uses of funds will include operating costs; raw materials; professional services; leasehold improvements; machinery, equipment, and spare parts; and under

carefully controlled conditions, vehicles and buildings. Purchase of land and vehicles will be allowed only where the client clearly demonstrates that they are needed for business purposes, and will be productively employed.

vii. Collateral/Guarantees

FIA will normally require collateral and guarantees equal to 100% of the loan amount. Assets purchased with loan funds and other assets will be accepted at up to 80% of estimated market value. Thus, the overall collateral required will be 125%. However, the requirement for collateral will vary with the degree of borrower investment in the business, and may be lower than the above figures for heavily capitalized borrowers. FIA will review this policy periodically to ensure that viable small enterprise activities are not being excluded from financing solely due to lack of collateral. By way of comparison, Honduran banks generally require collateral of 200% or more and they generally only accept urban land and buildings as collateral. FIA will follow more ample policies regarding the kinds of assets it will accept as collateral. Below are the kinds of assets and the supporting documentation that will be required for FIA to accept the asset as collateral.

<u>Asset</u>	<u>Qualification</u>
1. Land	Formalized title, clear of any liens.
2. Building	Proof of ownership, assessed value, clear of any liens.
3. Equipment	Proof of ownership, assessed value, clear of any liens.
4. Inventories—finished goods, in process, and raw materials	Formal assignment of chattel mortgage.
5. Receivables	Stamped sight drafts of purchaser with recourse to borrower.
6. Sales Contracts	Legally executed contracts.
7. Patents or other assets which have some market value, e.g. trademarks, copyrights, stocks, bonds	To be determined depending on nature of asset.
8. Time Deposits	Assignment of same.

viii. Disbursement and Collection Procedures

FIA will disburse loans directly to the borrowers or to suppliers depending on the nature of the project and the degree of sophistication of the client. Should FIA obtain dollar resources from AID or other sources in the future, it will provide dollar loans through an offshore subsidiary. Loans made with local currency, including the Project funds, will be denominated in Lempiras, in accordance with Honduran law.

Borrowers will make payment to FIA's account at the shareholder bank closest to their place of operations. A payment book will be issued to the borrower to enable the receiving bank to properly record the transaction. Honduras has

a correspondent bank system which enables payments made through any bank to be credited to an account anywhere in the banking system. Thus, in those cases in which it is inconvenient for a FIA borrower to make payment at a shareholder bank, an account will be created in the bank most convenient to the borrower, and credited to FIA through the correspondent bank system.

At the outset, FIA will contract with its shareholder banks for special collection services for borrowers who become delinquent in their loan payments. FIA may develop its own problem loan department at some time in the future, should it be more cost-effective than contracting with its shareholder banks for such services.

ix. Reflows

The loan repayments on direct loans will be used to finance new loans of a similar nature. The reflows on cofinanced loans may be used either for similar loans or for direct loans.

d. FIA Operations

i. Loan Application Process

Formal loan applications to FIA will consist of an application form, a proposal or feasibility study, and one or more letters of recommendation. These documents will provide basic information about the business (if there is an existing business), the proposed project, and the key persons involved. The form in which the client is expected to submit this information will vary depending upon the size and complexity and sophistication of the enterprise and the project to be financed. The loan application form will request basic information about the business, the loan request and the legal status of assets that might be used for collateral on the loan. A sample form is included in the Consultant's report on Design of the Business Assistance System, which is in the LAC/DR bulk files.

The contents of the proposal/feasibility study will depend on the size and complexity of the project. Special attention will be placed on those factors which are deemed to be the most crucial to the success of the project. In a simple case, a small working capital loan, for example, a one paragraph statement of the intended use of the funds should be sufficient. If, for example, a new (to Honduras) and more sophisticated technology is to be employed in the production process, the efficient operation of which is key to the cost savings of the equipment, then more information about the technology and the ability of the client to operate, maintain, and repair it would be included.

The following is an outline of the contents of the proposal/feasibility study.

- i. Summary of Project - what will be done and what is needed to do it

ii. Market study

- a) Demand
- b) Competition
- c) Strategy - channels of distribution, target market, promotion, etc.

iii. Technical Feasibility

- a) Production process
- b) Management and labor available for production process
- c) Input analysis - availability of necessary raw materials, utilities, labor, management
- d) Financial Feasibility - cash flow, income statements, proposed financing and repayment schedules

The Letter of Reference should be a personal as well as business reference provided by an organization to whom the individual and the business activity is well known, such as FEHCIL, IDH, Chambers of Commerce or ANMPI. Reference should be given not only on the entrepreneur's honesty and integrity, but the ability to manage the enterprise and level of commitment to the project. Until FIA establishes its own reference network, it will have to rely on others. For this reason FIA will encourage potential clients to approach them through a third party who knows them and the programs.

ii. Client Access to FIA

Small businesses applications will come to FIA through four channels: management assistance organizations; information assistance agencies; directly; or through one of FIA's shareholder banks. The procedures for gaining access to FIA through these channels are summarized in the following paragraphs.

The management assistance organizations will assist potential FIA clients to prepare applications, establish necessary management and production or service controls, and plan and prepare for the execution of their project. They will be responsible for screening the clients they send to FIA, and will only send those clients whom they have judged to be well equipped to manage the project and utilize the credit they request from FIA. When an applicant comes to FIA through the management assistance organization, he will arrive with a complete application package: the financier's application form; the proposal/feasibility study; and the reference letter. The letter will include a brief summary of the client's credit history with the management assistance organization (if that organization has previously provided credit to the client), the organization's knowledge of the client and a description of the followup they will provide to the client after the loan is made. Someone from the organization may accompany the client to FIA. However, the client will be encouraged to deal directly with FIA staff. This contact is necessary for FIA to make its own judgement about the client and the project's creditworthiness, and it also exposes the client to the financial institution.

The information assistance organizations will screen clients in a manner similar to that of the management assistance organizations, by knowing who he is and what his technical, administrative and financial capabilities are. They may not be able to assist in some aspects of the proposal or feasibility study until they employ appropriately trained personnel. At a minimum, however, they should be able to assist small businesses to prepare their applications for credit, refer them for additional assistance services, and give accurate references on the honesty, integrity and capability of the key individuals involved. The information assistance organizations should be willing to provide informal follow-up after the loan is made. Visits could be made in the normal course of keeping in touch with their existing and potential new members. The TA System Coordinator will assist in the establishment of working agreements between the FIA and the information assistance organizations which will define their functions in pre-selecting clients and providing personal and business references for them.

When clients arrive at FIA directly, a credit officer will attend to him. Through conversation the credit officers will ascertain to what degree the person already is able to deal directly with FIA, or which, if either, of the preceding two assistance channels would be most appropriate and best meet the client's needs. Then the credit officer would either refer the person to the appropriate assistance organization or make the introduction in person to ensure that client is attended. This process would normally be followed with small scale entrepreneurs. Medium scale entrepreneurs often have the knowledge and experience of planning and record keeping they need to fill in an application and prepare the project proposal independently. However, there will be cases in which assistance in this is required, and in any case, there will still be a need for personal and business references.

In the case of clients referred by FIA shareholders, the credit officer will call the shareholder's representative on the FIA Board of Directors and ask if the bank is willing to provide a positive reference on the client's ability and financial responsibility. If a positive reference is obtained, FIA may accept the loan application directly. If a positive reference is not provided by the shareholder bank, or should FIA determine that the client needs assistance in one or more aspects of his project, the client will be referred to the System Coordinator or directly to one of the qualified service providers.

iii. Loan Approval Process

Upon receipt of a loan application, the Credit Officer will discuss the project with the client, make a personal assessment of the client, and clarify entries on the application. He will review the application and proposal and will make any necessary inquiries to confirm the accuracy of the information given. A visit will be made to the enterprise (wherever feasible) to see the business first hand, to demonstrate to the client a real interest in the enterprise and to confirm assets listed on the application.

FIA's principal criteria for loan approval will be its appraisal of the value

of the project. Instead of reviewing balance sheets and collateral primarily, the principal focus of the appraisal will be if the project will generate sufficient cash to pay off the loan. The entrepreneur's capability, responsibility and honesty will also be important criteria. Finally, collateral will also be considered in case the need arises to pursue collection vigorously.

The Credit Officer will then make a recommendation on the credit request and submit that together with the application to the FIA General Manager. The Manager will initially have authority to approve credits up to \$50,000. As FIA's systems prove functional then the Manager's authority will be raised, perhaps to \$200,000. Above this level, loan committee approval will be required. The Loan Committee will consist of the manager and two or three members of FIA's Board of Directors. Participation of Board members in the loan approval process will provide them both exposure to appraisal banking techniques and the kinds of small loans FIA is making, at least in the early stages of the project.

3. Business Assistance System

The criteria used in selecting the qualified service providers, and the functions of and criteria used in selecting the System coordinator will be discussed in this Section.

a. Criteria for Selection of Management Assistance Organizations

The criteria established for selection of management assistance organizations are that the institution have:

- i. several years experience in working with small businesses;
- ii. staff who are providing management assistance and training directly or indirectly to small businesses;
- iii. experience in providing credit to small businesses;
- iv. provided to small businesses supportive services, such as bulk purchasing of raw materials, which improve the efficiency, productivity or profitability of those firms; and
- v. developed administrative systems and organizational structures which enable them to track the services they are providing and their costs.

The two qualified management assistance organizations meet all of the above criteria. Additional organizations incorporated into the system at a later date will be evaluated according to these same criteria.

c. Selection of the System Coordinator

The responsibilities as System Coordinator will be:

1. Inventory of technical assistance resources: human; system & infrastructure; materials & methods; financial. In Honduras, Central America and elsewhere. Know requirements and procedures for obtaining external assistance.
- ii. Develop evaluation and monitoring system; feedback system on technical assistance needs and services.
- iii. Ongoing identification of the technical assistance needs of small and medium scale enterprises thru a feedback system.
- iv. Identify technical assistance needed to develop technical assistance providers and FIA and sources of such assistance.
- v. Establish agreements with technical assistance resources in Honduras:
 - Define services to be provided
 - Define procedures for requesting services
 - Define procedures for providing services and followup
 - Define evaluation & monitoring process/responsibilities
 - Define payment guidelines and procedures
 - Define reporting requirements
 - Draft agreement; clear with A.I.D.; sign agreement.
- vi. Control payment system for technical assistance services funded from interest differential at Central Bank.
- vii. Coordinate with Peace Corps placement of volunteers in technical assistance system organizations.
- viii. Solicit and contract external technical assistance: write scopes of work; solicit proposals; coordinate review; negotiate and finalize contracts.
- ix. Coordinate delivery of external technical assistance services.
- x. Develop and coordinate series of seminars for in-service training of technical assistance system and FIA personnel.
- xi. Administer evaluation and monitoring system in coordination with FIA.
- xii. Prepare quarterly, semi-annual, and annual reports on the technical assistance system making recommendations on any necessary

structural or technical changes in system and any other improvements. Quarterly report will include a summary review of services provided and the cost the of services.

The same principle applied above was applied to the selection of the System Coordinator: use already existing organizations and resources if possible. Based on the coordinator's functions, the following criteria were established for selection of the institution:

- i. Knowledgeable of the particular needs of small businesses or at least have experience in needs assessment.
- ii. Awareness of the programs and services presently available to small businesses in Honduras.
- iii. The organization or its individual staff members have had exposure to a wide variety of the many small business assistance and development programs in other countries in Central and South America and elsewhere.
- iv. Experience coordinating the activities of two or more organizations.
- v. Experience in program and/or service evaluation.
- vi. The organization itself does not provide any assistance services to small and medium enterprises, so as to avoid possible conflicts of interest in the allocation of program resources.
- vii. The organization has an administrative system which meets A.I.D. standards, so that it can adequately track the use of the System's financial resources, both the AID Grant and the Fund income.

The three institutions which were evaluated in depth for the role of System Coordinator were: the Honduras branch of the Central American Institute of Business Administration (INCAE), Development Advisers (ASEPADE), and the National Association of Small and Medium Industrialists (ANMPI). It was determined that INCAE best meets the above criteria. The consultant's evaluation of the institutions is in the LAC/DR bulk files. After a year of discussions between INCAE and the Mission, INCAE decided it did not wish to accept the role of System Coordinator. In the meantime, ANDI had developed new leadership and placed small and medium scale business development at the top of its list of priorities for program development. It recently named a full time executive director who is a former Minister of Economics, now a University Professor in Business Administration. These changed circumstances have caused the Mission to select ANDI as the system Coordinator. A covenant will be included to allow the Mission and FONDEI to change the system coordinator if, for any reason, ANDI does not handle the function properly.

In addition to the criteria for selection of the coordinator organization,

criteria were developed for on which to base the selection of the person who will be the coordinator. Much of the success of the system will depend on the person who carries out coordinator's functions. These criteria are: First, the person should have knowledge of good small business assistance programs in the region as well as in Honduras. Second, the person should have background and experience in business management and finance, as well as in program management and training, all of these preferably related to small business. Third, the person should have good communication skills since much will depend on sharing of information. Personal qualities, such as ability to relate to all kinds of people and self-confidence will also be important. Because of the importance of this individual to the success of the project, AID will reserve the right to approve the candidate selected by ANDI to serve as Coordinator.

B. Financial Analysis

1. Credit Demand

To gain as full a picture as possible, the Mission examined the credit demand picture from several perspectives. First, global demand among small and medium industries was analyzed based on a recent Central Bank study. Second, a survey of entrepreneurs was carried out to identify projects for which they could not obtain bank financing. Third, FIA's shareholder banks were asked to identify projects for which financing had been sought but was not provided by the banks due to conflict between borrower requirements and bank policies or liquidity. Finally, the foregoing were analyzed in light of present economic and political conditions in Honduras. The affordability issue is discussed in the Social Analysis Section.

a. Global Demand

The closest approximation to a global credit demand analysis is the results of two Central Bank surveys carried out in 1981 and 1983. In the former, investment credit needs for 1981 were estimated at \$89 million.^{1/} In the latter, which was a survey of 257 small to medium size industrial firms who are mainly FONDEI borrowers, working capital needs were estimated at \$66 million.^{2/} FONDEI estimates that it will meet the full need for investment credit among the medium-large size firms, and 58% of the working capital required. The remainder will be met by commercial banks (10%) and the firms' own resources (52%).

Some of the above credit demand, especially the working capital requirement by medium size firms (\$34 million), would be potential credit demand for FIA. However, these data do not take into account the credit demand from firms in other sectors of the Honduran economy. While they provide an indication of overall credit demand in the industrial sector, some of which would be potential demand for FIA loans, the data do not reflect the full demand among

^{1/} Banco Central de Honduras. Necesidades de financiamiento del sector industrial. Dept. de Investigaciones Industriales. May 1981.

^{2/} Banco Central de Honduras. Necesidades adicionales de capital de trabajo. Dept. de Investigaciones Industriales. Tegucigalpa, 1983.)

the project's target group enterprises. To gain a better picture of what that demand might be, a small survey of entrepreneurs and the judgement of the shareholder banks were sought.

b. Survey of Entrepreneurs

During intensive review, the Mission personnel and a consultant contracted by the Honduran Bankers Association interviewed some 30 entrepreneurs in San Pedro Sula and Tegucigalpa, to identify projects that FIA might be asked to finance. The individuals interviewed in San Pedro Sula were all experienced, medium scale entrepreneurs. The interviewees in Tegucigalpa included both medium scale entrepreneurs and small entrepreneurs associated with ANMPI. The entrepreneurs were visited and asked to discuss ideas for additional investments they have planned. Then they were asked if they expected to finance all or part of the investment, what kind of financing they would need, and where they expected to obtain it. About half indicated they would be able to obtain most or all the financing needed from their bank. Those that did not believe they could obtain bank financing were provided with a brief description of FIA and asked about their interest in borrowing from FIA. Table 3 summarizes the credit demand that from respondents who believe FIA would be an appropriate source of financing. A listing of the projects proposed, which are illustrative of the kind of activities FIA will finance, is included in Annex D.6.

Table 3: Credit Demand of 30 Firms Interviewed

Location of Project	No. of Projects	Investment Required (\$000)
<u>Tegucigalpa</u>		
New Projects	12	4,050.0
Expansion or Working Capital	5	1,195.0
<u>San Pedro Sula</u>		
New Projects	8	3,344.0
Expansion or Working Capital	7	5,645.0
<u>Other Places 1/</u>		
New Projects	0	0
Expansion or Working Capital	5	77.0
Total	37	14,311.0

After subtracting 20% for the probable equity investment by the entrepreneurs, and assuming that some of the working capital needs of medium scale entrepreneurs would be met by their banks directly, it is estimated that about \$5 million, would be demand for credit from FIA. The responses of the entrepreneurs served as the basis for estimating the average loan sizes for

1/ Includes entrepreneurs identified by IDH as being ready to graduate to commercial credit sources

direct and cofinanced loans, and for orienting FIA's marketing strategy towards medium term financing, more liberal collateral requirements, and project appraisal approval criteria.

The above demand is based on responses mainly from medium scale businesses. As such, it is not necessarily illustrative of the demand among the bulk of Honduras' 68,000 small and medium scale entrepreneurs. Estimating demand among this group is much harder. However, there are some indications of strong demand. The Agricultural Credit Subsector Assessment carried out by Ohio State University in 1981, for example, indicated a high level of financing to this group through input suppliers, processors of agricultural products, and individual money lenders. The total credit supplied through these channels may be as high as \$30,000,000. Virtually all of these credit users would be potential FIA clients as they are undoubtedly paying more than FIA would charge for very short term loans. If only 2% of the 68,000 small and medium entrepreneurs required financing of \$5,000 on the average, the demand would be \$6,800,000. The survey and additional assumptions further indicate that there is a sizable demand for credit from FIA, especially for medium term loans.

c. Projects Identified by Shareholder Banks

Representatives of the shareholder banks confirmed, on the basis of their experience, that there is a high demand for medium term credit. They identified potential projects for \$1.5 million from among their present clients. The projects are also included in Annex D.6. Most of these projects would be potential candidates for cofinanced loans. Most importantly, the shareholder banks, on the basis of their experience, anticipate no problems in placing most of FIA's resources quickly into good quality, medium term loans. They are willing to put up a sizable share of the lending resources to back this belief.

d. Other Factors Affecting Credit Demand

There is no doubt that the present economic and political conditions in Honduras will have a strong effect on converting the above potential demand into effective demand for FIA lending resources. On one hand, the shortage of foreign exchange and resulting sharp decrease in the importation of consumer goods has opened up excellent opportunities for increased domestic production of everything from clothing to processed food and household goods. The projects identified in Annex D.6 are mainly for substitution of imported products for which high demand can be expected in the next few years at least. On the other hand, many of the country's traditional investors have stopped or significantly slowed down on new investments in recent months due to the unsettled political situation. This is evidenced by a slowness in presentation of new loan applications to FONDEI. At the same time, the general managers of FIA's shareholder banks believe that the small and medium entrepreneurs towards whom the project is aimed are not deterred from making new investments by these factors. In general, they don't have resources

outside the country, and don't have the option of moving out should the political situation unexpectedly change for the worse.

e. Conclusion

Weighing the global demand figures, the illustrative projects, and the other factors identified above, the Mission has concluded that there is more than sufficient effective demand for FIA resources. In fact, the project is all the more important to Honduras' development precisely because it aims resources at those most likely to invest in Honduras future at a time when significant opportunities exist because of the economic difficulties the country is experiencing.

2. Competitiveness with Other Sources of Financing

FIA is expected to have very little competition within the market window in which it is expected to operate. The major potential source of competition is loans financed through private banks with resources from the World Bank financed Industrial Development Fund (FONDEI). These funds are available for investment in fixed assets and working capital in new or expanding industrial projects. The Central Bank staff which administers FONDEI approves each loan prior to approval by the participating bank on the basis of a feasibility study carried out by a FONDEI approved consultant. The investment funds have terms of 2 to 15 years with up to 3 years grace. Working capital loans have terms of up to 3 years with one year of grace. At least 60% of each loan must go for investment. The interest rate is a flat 17%, which is slightly below the current market rate. In addition, the borrower pays 1%-2% for the feasibility study and a 3/4% commitment fee on unused funds. As of January, 1983, of the \$30 million available from a World Bank loan made last year, FONDEI had committed \$7 million to medium size loans (average loan size: \$250,000) and \$2 million to small loans (average: \$100,000).

FIA will not be competitive with the World Bank financed facility for several reasons. First and most important, FONDEI loans are cheaper to the borrower (at present, at least) due to longer terms and lower interest rates. Entrepreneurs who are able to obtain such financing will obviously do so. Second, as collateral requirements on FONDEI loans are established by the participating banks, the project's target group is excluded by definition. Third, the rigidities imposed by the limitations on the percentage of funds for working capital, and the feasibility study requirement effectively exclude a number of potentially good clients. Finally, the high effective costs of lending to small borrowers due to FONDEI documentation and supervision requirements effectively precludes the banks from lending to this group. With FONDEI also responsible for implementation of this project, their compatibility will be assured. Projects that FONDEI does not finance directly will be referred to FIA for analysis. Further complementarity is assured as about 20% of FONDEI's clients borrow additional working capital from other sources, such as suppliers, private money lenders or personal loans. These borrowers are all potential FIA clients, as by definition they have exhausted their borrowing capability from the private banks. Finally, by having FONDEI

manage both projects, significant lessons can be learned by the GOH, as well as AID and the World Bank about the advantages of the two approaches to industrial lending.

Other potential sources of competition for FIA could be the credit unions, PVO's who administer credit programs, other financieras, and individual money lenders. However, each of these sources have limitations which severely limit their level of lending and the potential competition they will offer to FIA. The credit unions have significant administrative and financial management problems, which are being addressed through the FACACH OPG (Project 522-0177) and the Agricultural Credit Project (522-0178). They have traditionally depended on soft loans from outside sources which has limited their lending capital. The PVO's administering credit programs are small and undercapitalized and tend to have insufficient operating margins and high delinquency rates. They usually concentrate on specific client groups (e.g. cooperatives, members of specific religious groups) and also depend heavily on donated or low cost funds. The financieras now operating are limited purpose institutions which finance vehicles and equipment for specific importers. They are not likely to grow much given the present low level of imports in these areas. Finally, there are some 1,100 registered money lenders and many more unregistered ones. They charge interest rates of from about 25% to 75% per year, depending on the lender, the terms, the client and the competition. FIA will operate below these rates and should provide an attractive alternative to the money lenders for those entrepreneurs that meet its requirements.

3. FIA Profitability

FIA's market orientation and greater flexibility of operations in comparison to commercial banks will permit it operate profitably. It will be able to relate perceived risk to interest charged at the outset, and real loss experience to interest charged over the longer run. By virtue of being shareholders, the owner banks will find it in their interest to ensure FIA's profitability. This should encourage them to lend FIA money when needed, and to refer to FIA otherwise creditworthy entrepreneurs who do not meet their collateral and other requirements, or who require amounts too small to make direct lending to them profitable under prevailing Central Bank policies. Knowing that their profits will suffer if FIA takes on uncreditworthy clients should discourage them from referring unreliable customers. Finally, by taking maximum advantage of existing bank infrastructure, FIA will be a low cost operation. It will be able to obtain references, contract for loan analysis and collections services, and perhaps eventually use space in the offices of its shareholder banks in smaller towns where opening a separate office is not financially feasible.

A cash flow has been prepared for FIA (see Annex D.7). Based on the assumptions stated therein, FIA is expected to be profitable starting in the first year and produce an average yearly return on equity of 16%. The discounted cash flow also indicates that FIA has an Internal Rate of Return of around 23-24%, which makes it a viable financial concern given the estimated

average cost of capital of 15% for FIA.

4. Financial Viability of the Business Assistance System

In the Project Description it was noted that the Business Assistance System would begin to suffer a revenue shortfall in the fourth year of implementation. There are several options for addressing this problem. First, the level of services could be reduced. Second, the service providing agencies could begin to charge clients for the assistance they provide. Third, FIA and the service providers could finance the assistance by capitalizing the value of the services in FIA loans generated by the service providers. Fourth, the service providers themselves could absorb part or all of the cost of providing the services. Fifth, the Fund income could be increased by having the GOH provide additional capital to FIA under the same arrangements as have been made for this project. Finally, the GOH may decide to directly support the system with budgetary resources. As a continued need for services is foreseen, and as it is highly desirable for the System to remain free of government influence, the first and last options are considered undesirable. While it is highly desirable, the fifth option involves too many uncertainties to be considered a reasonably secure source of additional income for the System. Accordingly, the additional income will have to come from one or more of the second, third, and fourth alternatives.

From the target group's point of view, receiving the services without direct or indirect charge would be the most desirable solution. Two of the expected qualified service providers, the Chambers of Commerce of Tegucigalpa and San Pedro Sula, have significant income from membership fees and contributions. ANMPI has the potential to expand the number of dues paying members by providing services through the project and increasing its aggressiveness in collecting dues from present non-paying members. These institutions, and others like them that may eventually be qualified through the System, will be expected to absorb an increasing share of the costs of their field and information agents starting in year four of the project. They will undoubtedly encourage target group members to whom they have provided services to begin to pay dues to their organizations. Thus, they would have the potential to make their services a self financing proposition over the longer run. The smaller PVO's such as IDH and FEHCIL derive their income from administration of their credit resources and from donations. They cannot be expected to finance the costs of additional field agents from their own resources. Accordingly, if necessary to ensure continued growth of the Business Assistance System, in the fourth year of the project, FIA will begin to charge a supervision fee on all new loans generated by these institutions, and the institutions will begin to charge their clients for services other than loan supervision. The precise amounts and funds flow arrangements will be worked out by AID, FIA, and the TA System Coordinator in the third year of implementation. A covenant has been included in the Project Authorization to require the presentation of a plan for maintenance of the system starting in the third year of project implementation.

C. Economic Analysis

1. Income and Employment Effects of the FIA Loan Program

The income and employment effects of FIA loans are estimated in Table 4, below. In summary, the program is projected to create almost \$25 million in value added and direct and indirect employment of about 2000 during the first eight years of the program. The calculations assume that FIA will mobilize no additional lending resources during this period - a very conservative assumption. Furthermore, the value added and employment effects have been calculated on the basis of ratios for the industrial sector, which in general has a higher imported cost component and lower generation of direct employment than service and other sectors. To the degree that FIA increases its capitalization and that service sector operations are financed both value added and direct employment over the eight year period would be higher than projected below.

a. Value Added

The ratio of gross fixed capital to gross value added at factor cost derived from the 1975 industrial census is estimated to be an average of 1.9 for small industries and 2.1 for medium.^{1/} Assuming there has been no significant change in these relationships, and that the loans financed under the project reflect industry averages, the incremental annual increase in value added resulting from FIA loans is estimated to be about \$1.7 million in the first year of operations and the annual increments total over \$4.6 million for the first eight years, as shown in Table 4.

Table 4: Incremental Annual Increase in Value Added
(\$ Millions, constant 1984 prices)

<u>Year</u>	<u>Small Industry</u>		<u>Medium Industry</u>		<u>Total Value Added</u>
	<u>Fixed Investment</u>	<u>Value Added Generated</u>	<u>Fixed Investment</u>	<u>Value Added Generated</u>	
1	2,650	1,395	750	357	1,752
2	750	395			
3	450	237			
4	50	27			
5	975	513			
6	1,925	1,013			
7	1,125	592			
8	225	118			
Total	8,150	4,290	750	357	4,647

^{1/} Data for medium scale intermediate industries were not included because it is anticipated that FIA will not be financing these typically high capital intensive industries. They include those listed in footnote 1 on page 8.

The cumulative increase over the eight years is almost \$25 million as shown in Table 5, below.

Table 5: Annual Contribution to Industrial Value Added
(Cumulative, \$000)

<u>Year</u>	<u>1</u>	<u>2</u>	<u>3</u>	<u>4</u>	<u>5</u>	<u>6</u>	<u>7</u>	<u>8</u>	<u>Cum. Total</u>
1	1,752								1,752
2	1,752	395							2,147
3	1,752	395	237						2,384
4	1,752	395	237	27					2,411
5	1,752	395	237	27	513				2,924
6	1,752	395	237	27	513	1,013			3,937
7	1,752	395	237	27	513	1,013	592		4,529
8	1,752	395	237	27	513	1,013	592	118	4,647
									<u>24,731</u>

b. Employment Generating Effects

The direct employment resulting from the program is derived from the relationship in the 1975 industrial census of an average of \$3,525 gross fixed investment per worker for small scale industries and \$7,055 for medium. The fixed investment resulting from FIA loans is estimated in 1984 prices. To calculate employment effects, the 1975 figures were inflated to 1984 prices using an implicit price index constructed from a Central Bank series on private sector gross fixed investment. A factor of 2.5 was used to convert 1975 to 1984 prices reflecting an annual average increase in the price level of slightly less than 11%. For 1983 and 1984 an annual rate of 8% is assumed.

Direct employment created by the loan program is projected to be over 300 in the first year of the program and a total of almost 1000 over the first eight years as shown in Table 6 below. At least another 1000 jobs can be expected to be created indirectly as a result of the initial increase in income and employment.

Table 6: Projected Increase in Direct Employment

<u>Year</u>	<u>Small Industry</u>		<u>Medium Industry</u>		<u>Total Jobs</u>
	<u>Fixed Invest.</u>	<u>Employment</u>	<u>Fixed Invest.</u>	<u>Employment</u>	
	<u>(\$000)</u>	<u>(\$8,812/Job)</u>	<u>(\$000)</u>	<u>(\$12,775/Job)</u>	
1	2,650	301	750	59	360
2	750	85			85
3	450	51			51
4	50	6			6
5	975	111			111
6	1,925	218			218
7	1,125	128			128
8	225	26			26
TOTAL	<u>8,150</u>	<u>926</u>	<u>750</u>	<u>59</u>	<u>985</u>

D. Social Analysis

1. FIA Accessibility to the Target Group Enterprises

FIA's accessibility to the the target group is essentially a question of whether the Business Assistance System will be effective in helping small and medium enterprises meet all of FIA's requirements, and whether those enterprises will have a voice in the finance company. The two activities of the project have been designed as a whole, and a mechanism (the System Coordinator) has been included to ensure the technical assistance system will continue to improve its performance in the management, information, and technical areas. The inclusion of an outside director on FIA's Board will help to ensure that small business concerns about FIA are heard and that the problems of small businesses are considered both in policy making and in approving larger loans. These safeguards should ensure reasonable access by target group employees to FIA.

There is one requirement - collateral - that may not be fully addressed. Prudent lending practices simply require that untested borrowers provide collateral for their loans. In an attempt to further evaluate the degree to which this requirement might serve as a barrier to obtaining credit from FIA, 10 small businessmen in Tegucigalpa were interviewed. The purpose was to identify assets that could be used as collateral. The interviews showed that most of the small businesses evaluated had the kinds of assets that FIA could accept as collateral for its loans. A summary of the results is included in Annex D.8. The survey was unable to fully evaluate the degree to which the documentation for these assets was in a form that FIA could accept, nor the degree to which their valuation would be sufficient in relation to the financing desired by the respondents. Certain items, for example, machinery, raw materials and receivables, were not always backed up by paper that could be used as collateral. Others, such as land and residences were almost always appropriately documented. The technical assistance system will help partially resolve the collateral problems by assisting small businesses to legally perfect the instruments and obtain the asset valuations needed to improve their effective level of collateral.

Despite this assistance, it must be noted that there will be cases where collateral will be insufficient in relation to the financing needed, despite FIA's less stringent requirements in comparison to other lenders. Accordingly, there may be some target group enterprises that are unable to gain access to FIA due to lack of collateral. The group most likely to be affected by lack of collateral is small rural industries. However, since the survey in Tegucigalpa disclosed that the majority of small enterprises have assets that can be used as collateral, the restriction posed by the collateral problem is not expected to be a serious deterrent to target group accessibility to FIA.

2. Affordability of credit offered by FIA

FIA's effective interest rates will be between 19% and 23% at the outset of

the project. Is this level of interest affordable by small and medium enterprises? The answer will, of course, depend on the profitability of the borrower's project. There are many investments that can bear this interest rate and more. The Agricultural Credit Subsector Assessment prepared by Ohio State University (OSU) in 1982 demonstrated that there is demand at rates as high as 36%, which is the effective rate now charged by some credit unions. The Rural Enterprise study carried out by Michigan State imputed a presumed capital cost of 20% in its study of the profitability of small rural enterprises and found a number that were quite profitable at that level. The commercial banks in Honduras are now charging effective interest rates of up to 23% for large borrowers and 26% for small borrowers and the terms on these loans rarely exceed one year. Finance companies are charging rates of around 24-25%. At the extreme, street corner and village money lenders make small loans available usually on very short terms at rates of between 25% and 75%. Volume is low at the higher rates.

Where FIA's rates are higher than alternative sources, the longer terms will more than compensate for that in the most important aspect of small business operations: cash flow. In addition, FIA's project appraisal method of loan approval will further help to ensure that it finances only projects that can bear the interest rates it charges. Finally, since interest rates are at relatively high levels in Honduras at present, FIA's variable rate policy should lead to a lowering of interest charges over time.

3. Accessibility of the Business Assistance System to the Target Group Enterprises

Many of the organizations that provide assistance to small and medium scale businesses identified in Annex F.1 were formed within the last 3-4 years. The activities of older organizations which are related to small and medium enterprise are also relatively new - most were started within the last two years. This indicates an increasing consciousness of the importance of the small and medium scale enterprise in the economic and social well-being of the country. The process that each institution has followed of building new activities on the base of its other activities indicates recognition of the needs of this sector. The proliferation of private sector activities indicates two other trends: one, an emerging confidence in the private sector in its role as an engine of national development; and two, a recognition that these might be more efficient and effective ways to accelerate private sector development than through government programs.

The main contact point between these organizations and the target group enterprises is the field agents of the management assistance organizations. How accessible will they be to these beneficiaries? Table 7 describes services presently available to target group enterprises and those that will be available by the end of the project.

The 12 additional promoters will be supported through the Business Assistance Fund. Their efforts will be complemented by GOH promoters who will be trained through the system, but whose costs will be borne by the GOH. At present,

Table 7: Fields Agents and Clients

Service Provider	At Present		End of Project	
	Agents	Clients	Agents	Clients
IDH	4	150	6	250
FEHCIL ^{1/}	3	22	5	35
ANMPI	0	0	2	60
Cortes C of C.	0	0	2	60
Other	0	0	4	120
Total	<u>7</u>	<u>172</u>	<u>19</u>	<u>525</u>

there are 8 INFOP advisers, 12 CDI field agents working in small business development. In addition, there are some 30 PCV's working with the service providing agencies and individual businesses and cooperatives.

FIA will make loans to approximately 60 new small business clients each year starting in the second year of the project. The Business Assistance System will be able to reach about five times that number of new clients each year, even assuming that half the above client load consists of entrepreneurs who have already received credit and are being assisted to implement their projects. As IDH, FEHCIL, and the GOH agencies have a nationwide focus in their assistance activities, there will be some degree of geographic coverage as well.

4. Impact

Honduras is undergoing a difficult period in its economic development. The worldwide recession, shortage of foreign exchange, and low prices for the country's principal products are causing production drops, low profits, and mounting unemployment. The project's major impact is expected to be in increasing production, and most importantly, employment. Unemployment in the urban areas and underemployment in the rural areas, are the single most important social problem in Honduras. Mejia ^{2/} has summarized the results of different unemployment studies and estimates done by different agencies for the 1970-82 period. ^{1/} These results are presented in Annex D.8. The data clearly indicate that unemployment has increased from 8.4 to 8.9% in the 1970-75 period, and from 8.9 to 14.6% in the 1975-1980 period. The problem became even more acute from 1980 to 1982, jumping from 14.4 to 20.6%.

Employment generation is the highest short-term priority for the USAID Mission in Honduras. This project will directly address the problem by creating 1,000 direct and about 2,000 indirect jobs over an eight-year period. If all of these jobs are in the industrial sector, the total industrial employment in

^{1/} FEHCIL's clients are cooperatives. The number of families reached is approximately 10 times the number of clients.

^{2/} C. Mejia. Estado Actual de la Información Sobre el Empleo en Honduras. PCR/AID/H: 1982.

the country will increase by 6% in comparison to the total 1981 industrial employment. As the real employment level is expected to exceed these levels, even after discounting for some jobs in other sectors, the impact could be even greater.

IV. Project Implementation

A. Implementation Arrangements

1. FONDEI Loan to FIA

The GOH has agreed to provide the local currency equivalent of \$4 million to FONDEI for relending. FONDEI and FIA are in the process of negotiating an Implementation Agreement, which will be reviewed by AID prior to signature. The Implementation Agreement will formalize the FONDEI loan to FIA on the terms and conditions discussed in the PP, and will bind FIA to carry out the Project in accordance with the terms and conditions set forth in the Project Description. These terms and conditions are repeated below.

The Implementation Agreement will provide that FONDEI disburse the GOH funds to FIA on the basis of written requests. Disbursements will be made against disbursements to clients and for advances. FONDEI will bill FIA monthly for the principal and interest charges on the loan. The interest charged will be from the date of the FONDEI disbursement to FIA. FIA will pay FONDEI's bill within ten days of receipt. FONDEI will credit FIA's payments, less a 1% service charge to cover FONDEI loan servicing costs, to the account the System Coordinator establishes for the Business Assistance System Fund. FONDEI will advise the System Coordinator of deposits made to the Business Assistance System Fund account. The System Coordinator will have signature authority over the Business Assistance System Fund account. The System Coordinator's Project Manager will draw checks against this fund for expenses of the Business Assistance System.

Both the System Coordinator and FIA will submit financial reports to AID and FONDEI. The System Coordinator's report will include as well a brief summary of the activities carried out under the Business Assistance System in relation with the workplan approved by A.I.D. (during the first two years, at least). Both FIA and the System Coordinator will retain the services of an independent certified public accountant acceptable to AID. The auditors will be responsible for submitting yearly audit reports direct to AID and the GOH.

The Implementation Agreement will also establish the following Conditions Precedent for disbursement by FONDEI:

a. FIA shall provide to A.I.D. evidence that five banks have pledged to purchase equal numbers of shares for a total of L.1 million, and each has made an initial purchase of at least L. 50,000.

b. FIA has appointed a Chief Executive Officer acceptable to A.I.D.

c. FIA has adopted credit regulations for the project which are acceptable to A.I.D.

d. FIA has appointed to its Board of Directors a representative of the Small Business Sector, who is not a director, officer, or employee of any bank authorized to operate in Honduras.

In the Implementation Agreement, FIA will covenant that:

a. FIA and its shareholders will make maximum efforts to mobilize additional lending resources for FIA; lend FIA sufficient funds as needed on commercial terms to ensure that FIA's total lending resources, including the FONDEI loan funds, do not fall below L.12,000,000; and ensure that FIA's debt to equity ratio does not rise above 13:1.

b. FIA and its shareholders will request prior AID approval of any sale of stock which would have the effect of permitting any one shareholder or group of interrelated shareholders to obtain majority ownership of FIA.

2. AID Grant

A Limited Scope Grant Agreement will be signed between AID and FONDEI to obligate the Project funds. The Agreement will have a full project description annex taken from this PP, and will provide that AID obtain all goods and services needed for implementation of Grant funded activities, except for technical assistance for local firms and arranging orientation courses for ANDI and service providing agency personnel. ANDI will be responsible for arranging the TA and the orientation visits. AID will make disbursements of Grant funds directly to the suppliers it contracts and ANDI will request AID direct disbursement for the services it obtains.

The USAID/H Contracting Officer will carry out the following Grant-financed procurement actions using the direct payment method of financing:

Goods/Services Required	Date Needed	RFP/IFB Date	Est. Cost	Type of Solicitation
Small Business Adviser	5/84	2/84	\$ 160,000	Intern. comp.
Finance Company Adviser	6/84	3/84	140,000	Intern. comp.
2 Jeep-type Vehicles	6/84	3/84	24,000	Local comp.
3 Motorcycles	6/84	3/84	9,000	Local comp.
2 Jeep-type Vehicles	12/84	9/84	26,000	Local comp.
Trainer for Courses	1/85	9/84	60,000	Intern. comp.
Other Vehicles	3/85	12/84	41,000	Local comp.
Invitational Travel			40,000	
T.A. to Firms			100,000	Local comp.
Total			\$ 600,000	

A Condition Precedent to Disbursement, except for the Finance Company and Small Business Advisers, will be that ANDI present a plan for the first two

years of implementation of the Small Business Assistance System and appoint a Project Manager acceptable to AID, and that the shareholders of FIA have formally committed themselves to create and capitalize the Financiera Industrial y Agropecuaria, S.A.

Three covenants will be included:

a. that the GOH make available to FONDEI the L. 8 million for lending to FIA under terms and conditions acceptable to AID;

b. that FONDEI and the System Coordinator will present to AID, by the end of the sixth month of the second year of Project implementation a plan for the continued financing of the Business Assistance System. The plan will be put into effect by the Project Activities Completion Date specified in the Project Agreement;

c. that FONDEI and A.I.D. shall meet periodically to review the adequacy of the System Coordinator's management of the Business Assistance System, and agree on any changes in the implementation arrangements for the project that may be needed.

B. Monitoring

Given the small amount of AID funds involved, the Project is expected to require very little monitoring. Review of ANDI and FIA quarterly reports and occasional conversations with the project funded advisers, FONDEI, ANDI and FIA should be sufficient. A Contracted Private Sector Adviser in the Office of Program and Capital Resources will carry out these responsibilities. The adviser will work under the direction of a Project Development Officer. Should a USDH Private Sector Officer join the Mission Staff at any time in the future, the monitoring responsibility will be transferred to the Private Sector Officer. Should it be determined at a subsequent date that more intensive monitoring is required, Project funds may be used for financing the contract of a Private Sector Adviser, subject to availability of funds.

C. Evaluation

The project will be evaluated near the end of the second year by an outside consultant experienced in small business credit and technical assistance systems. The costs of the evaluation will be financed from PD&S funds.

D. Audits

USAID will request the Inspector General's Office to audit the Project. In the event that the IG cannot carry out the audit, the Mission will use PD&S funds to contract a local audit firm to carry out the audit to verify the receipt and use of services and commodities provided to the Project.

Annexes:

- A. Logical Framework
- B. PID Approval Message
- C. Statutory Checklist
- D. **Technical Annexes:**
 - 1. Consultant's Report on Technical Assistance Agencies
 - 2. TA System Implementation Plan
 - 3. ANDI Budget
 - 4. Business Assistance System Budget
 - 5. Difference between FIA and other Finance Companies
 - 6. Illustrative FIA Projects
 - 7. FIA Cash Flow
 - 8. Small Business Collateral
 - 9. Social Soundness Analysis

Best Available Document

Annex A

PROJECT TITLE SUMMARY LOGICAL FRAMEWORK

Title/Number: Small Business Development (Project # 270105)

Total U.S. Funding: \$4.6 million
 from: FY83 funds

Life of Project: 3 years
 Date Prepared: 2/25/84

NARRATIVE SUMMARY	OBJECTIVE VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS																
<u>PROGRAM AND SECTOR GOAL:</u> Increase production and employment in small and medium size enterprises	<u>MEASURES OF GOAL ACHIEVEMENT:</u> 2,000 jobs created during 8 years \$25 million in value added to production during 1st eight years	Impact Evaluation	No further deterioration of economic or political conditions in Honduras																
<u>PROJECT PURPOSE:</u> Develop a source of accessible financial and technical assistance for Honduras' small entrepreneurs	<u>END OF PROJECT STATUS:</u> Financiera operating profitably with a portfolio of \$12.7 million 5 TA sources and a TA management system providing effective TA to over 500 small businesses	Audited SBF statements Project Evaluation available and effective	Competent Management selected Peace Corps Assistance																
<u>OUTPUTS:</u> Credit for small enterprises Technical Assistance	<u>MAGNITUDE OF OUTPUTS:</u> 170 loans to Small/Med. Enterprises \$6.5 million in credit provided 525 enterprises benefitted	FIA records Records of TA providing institutions																	
<u>INPUTS (\$Millions):</u> Small Business Finance Co. Technical Assistance System TOTAL	<table border="1"> <thead> <tr> <th>AID</th> <th>GOH</th> <th>Banks</th> <th>TOTAL</th> </tr> </thead> <tbody> <tr> <td></td> <td>4.0</td> <td>2.5</td> <td>6.5</td> </tr> <tr> <td>0.6</td> <td>0.4</td> <td>0.0</td> <td>1.0</td> </tr> <tr> <td>0.6</td> <td>4.4</td> <td>2.5</td> <td>7.5</td> </tr> </tbody> </table>	AID	GOH	Banks	TOTAL		4.0	2.5	6.5	0.6	0.4	0.0	1.0	0.6	4.4	2.5	7.5	USAID Controller, Cent. Bank and SBF records	
AID	GOH	Banks	TOTAL																
	4.0	2.5	6.5																
0.6	0.4	0.0	1.0																
0.6	4.4	2.5	7.5																

TELEGRAM

STATE

9519

ANNEX B

AMERICAN EMBASSY TEGUCIGALPA

NNNNV ESCC
 PF FLESTE
 DE FLEPC #9519 0130140
 ZN UUUU ZZH
 P 130031Z JAN 83
 FF SECSTATE WASHDC
 TC AEMBASSY TEGUCIGALPA PRIORITY 1720
 BT
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CML
RF
RSO
IKDA
IRON

AIDAC

E.O. 12356: N/A

TAGS:

SUBJECT: SMALL BUSINESS DEVELOPMENT PID (522-0905)²

REF: TEGUCIGALPA 9606

1. THE SUBJECT PID WAS REVIEWED AT A DAEC MEETING ON DECEMBER 17 AND DECEMBER 18. THE PID WAS APPROVED, AND THE MISSION IS COMMENDED FOR ITS IMAGINATIVE APPROACH TO A DIFFICULT DEVELOPMENT PROBLEM.

2. THE CORPORATE STRUCTURE OF THE INSTITUTION TO BE CREATED; ITS RELATIONSHIP TO ITS PARENT BANKS; THE LEGAL AND FINANCIAL ASPECTS OF ITS FORMATION, CAPITALIZATION, AND OPERATIONS; AND ITS ABILITY TO ATTRACT AND SERVICE A SMALL BUSINESSMAN CUSTOMER GROUP ON A FINANCIALLY SOUND BASIS CONSTITUTE A DESIGN PROBLEM OF UNUSUAL COMPLEXITY.

TO ASSURE A SATISFACTORY RESOLUTION OF THIS FUNDAMENTAL DESIGN PROBLEM AT AN EARLY POINT IN THE INTENSIVE

REVIEW, WE PROPOSE TO SEND A TEAM TO ASSIST IN YOUR ANALYSIS OF INSTITUTIONAL, FINANCIAL, AND TECHNICAL ASSISTANCE ALTERNATIVES. THIS TEAM MAY BE COMPOSED OF BRUCE DOUGLASS (PRE), CHARLES CONNOLLY (LAC/DR), AND/OR AN EXTERNAL CONSULTANT. PLEASE ADVISE IF THIS ASSISTANCE AND TEAM COMPOSITION WOULD BE ACCEPTABLE. DURING THE DAEC REVIEW THE FOLLOWING ISSUES WERE DISCUSSED WHICH SHOULD BE ADDRESSED DURING THE INTENSIVE REVIEW:

3. THE TARGET GROUP SHOULD BE SIMPLY AND CLEARLY DEFINED. THE DAEC SUGGESTS THAT THE FINANCIERA FOCUS ON INDUSTRIAL, AGRIBUSINESS, AND SERVICE ENTERPRISES.

4. A COMPREHENSIVE CREDIT DEMAND ANALYSIS SHOULD ADDRESS, INTER ALIA; THE USES OF CREDIT (E.G. INVESTMENT AND WORKING CAPITAL CREDITS), THE LEVEL OF DEMAND FOR FUNDS AT HIGHER INTEREST RATES, INTEREST RATES AT WHICH SMALL BORROWERS ARE WILLING TO BORROW, CURRENT SOURCES/TERMS/CONDITIONS OF CREDIT RECEIVED BY SMALL BUSINESSMEN, AND WHETHER THE LEVEL OF DEMAND AT THE RATES PROPOSED IN THE PID IS ADEQUATE TO MAKE A FINANCIERA VIABLE.

5. ONE OF A.I.D.'S PRIMARY CONCERNS WITH THE DEVELOPMENT OF NEW ICI INSTITUTIONS IS THE POTENTIAL

IMPACT OF THESE ENTITIES ON BASIC HUMAN NEEDS OBJECTIVES. MISSION SHOULD THEREFORE SEEK BORROWER SELECTION CRITERIA AND OTHER SBF POLICIES THAT WILL FOCUS THE SBF'S LENDING IN A WAY THAT WILL ASSURE AN EMPLOYMENT/PRODUCTION IMPACT.

6. THE DAEC RAISED QUESTIONS CONCERNING THE NEED FOR THE CENTRAL BANK AND PRIVATE BANKS AS INTERMEDIARIES. COULD THE FINANCIERA BE THE DIRECT RECIPIENT OF THE A.T.C. LOAN? COULD A COH, CB, OR COMMERCIAL BANK GUARANTY BE OBTAINED?

5

AID ACTION
PCP
DD /
DDM /
RIA /
PCR
OET
HGT /
HRD /
HRD-U
HRD-II
HRD-E
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CONT /
C&R
DTIC
IR/HR
CHRON /
RI /

UNCLASSIFIED

7. GIVEN THE EXPECTED SUBSIDY FOR TECHNICAL ASSISTANCE FROM THE INTEREST-RATE DIFFERENTIAL RECEIVED BY THE CENTRAL-BANK, THE MISSION SHOULD CONSIDER CUTTING BACK THE TA GRANT COMPONENT.

8. IF THE SBF WILL LEND PRIMARILY TO RURAL ENTERPRISES, GIVEN THE SCARCITY OF SDA FUNDING THIS FISCAL YEAR THE DAEC REQUESTS THAT THE MISSION CONSIDER FUNDING A PORTION OF THIS PROJECT FROM ARON FUNDS. TO

65
THE DEGREE ONLY LOCAL CURRENCY IS REQUIRED, COULD THIS PROJECT BE FINANCED BY ESF GENERATIONS?

9. BECAUSE OF THE CONCERNS DESCRIBED ABOVE AND THE UNUSUAL COMPLEXITY OF THE FINANCIAL ISSUES INVOLVED IN THIS PROJECT, THE BUREAU REQUESTS THE MISSION SUBMIT THE PP TO AIC/W FOR FINAL REVIEW AND APPROVAL. SHULTZ
BT

#9519

5C(1) - COUNTRY CHECKLIST

Listed below are statutory criteria applicable generally to FAA funds, and criteria applicable to individual fund sources: Development Assistance and Economic Support Fund.

A. GENERAL CRITERIA FOR COUNTRY ELIGIBILITY

CR Sec. 133. Notwithstanding any other provision of this joint resolution, none of the funds appropriated under section 101(b) of this joint resolution may be available for any country during any 3-month period beginning on or after October 1, 1982, immediately following the certification of the President to the Congress that such country is not taking adequate steps to cooperate with the United States to prevent narcotic drugs and other controlled substances (as listed in the schedules in section 202 of the Comprehensive Drug Abuse and Prevention Control Act of 1971 (21 U.S.C. 812)) which are produced, processed, or transported in such country from entering the United States unlawfully."

1. FAA Sec. 481. Has it been determined that the government of the recipient country has failed to take adequate steps to prevent narcotic drugs and other controlled substances (as defined by the Comprehensive Drug Abuse Prevention and Control Act of 1970) produced or processed, in whole or in part, in such country, or transported through such country, from being sold illegally within the jurisdiction of such country to U.S. Government personnel or their dependents, or from entering the U.S. unlawfully?

1. No such determination has been made.

2. FAA Sec. 620(c). If assistance is to a government, is the government liable as debtor or unconditional guarantor on any debt to a U.S. citizen for goods or services furnished or ordered where (a) such citizen has exhausted available legal remedies and (b) the debt is not denied or contested by such government?
3. FAA Sec. 620(e)(1). If assistance is to a government, has it (including government agencies or subdivisions) taken any action which has the effect of nationalizing, expropriating, or otherwise seizing ownership or control of property of U.S. citizens or entities beneficially owned by them without taking steps to discharge its obligations toward such citizens or entities?
4. FAA Sec. 532(c), 520(a) 620(f), 620D; FY 1982 Appropriation Act Secs. 512 and 513. Is recipient country a Communist country? Will assistance be provided to Angola, Cambodia, Cuba, Laos, Vietnam, Syria, Libya, Iraq, or South Yemen? Will assistance be provide to Afghanistan or Mozambique without a waiver?
5. ISDCA of 1981 Secs. 724, 727 and 730. For specific restrictions on assistance to Nicaragua, see Sec. 724 of the ISDCA of 1981. For specific restrictions on assistance to El Salvador, see Secs. 727 and 730 of the ISDCA of 1981.
2. The GOH is not liable as a debtor under these conditions.
3. There is no evidence of such action.
4. Honduras is not a communist country nor will any assistance be provided to any of the listed countries.
5. Assistance is not to Nicaragua or El Salvador.

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6. FAA Sec. 620 (j). Has the country permitted, or failed to take adequate measures to prevent, the damage or destruction by mob action of U.S. property?
7. FAA Sec. 620(1). Has the country failed to enter into an agreement with OPIC?
8. FAA Sec. 620(o); Fishermen's Protective Act of 1967, as amended, Sec. 5. (a) Has the country seized, or imposed any penalty or sanction against, any U.S. fishing activities in international waters?

(b) If so, has any deduction required by the Fishermen's Protective Act been made?
9. FAA Sec. 620(q); FY 1982 Appropriation Act Sec. 517. (a) Has the government of the recipient country been in default for more than six months on interest or principal of any A.I.D. loan to the country? (b) Has the country been in default for more than one year on interest or principal on any U.S. loan under a program for which the appropriation bill appropriates funds?
10. FAA Sec 620(s). If contemplated assistance is development loan or from Economic Support Fund, has the Administrator taken into account the amount of foreign exchange or other resources which the country has spent on military equipment? (Reference may be to the annual "Taking
6. In the past there have been incidents where the GOH was unsuccessful in containing demonstrations against the US Embassy; but this has not been the case for over thirteen years.
7. The OPIC Investment Guaranty Program is in effect in Honduras.
8. (a) Honduras has not seized or imposed penalties or sanctions against US fishing activities.

(b) NA
9. (a) No.
(b) No.
10. Yes, taken into account by the Administrator at the time of approval of the Agency OYB.

into Consideration" memo: "Yes, taken into account by the Administrator at time of approval of Agency OYB." This approval by the Administrator of the Operational Year Budget can be the basis for an affirmative answer during the fiscal year unless significant changes in circumstances occur.)

11. FAA Sec. 620(t). Has the country severed diplomatic relations with the United States? If so, have they been resumed and have new bilateral assistance agreements been negotiated and entered into since such resumption?
 12. FAA Sec. 620(u). What is the payment status of the country's U.N. obligations? If the country is in arrears, were such arrearages taken into account by the A.I.D. Administrator in determining the current A.I.D. Operational Year Budget? (Reference may be made to the Taking into Consideration memo.)
 13. FAA Sec. 620A; FY 1982 Appropriation Act Sec. 520. Has the country aided or abetted, by granting sanctuary from prosecution to, any individual or group which has committed an act of international terrorism? Has the country aided or abetted, by granting sanctuary from prosecution to, any individual or group which has committed a war crime?
11. No. Honduras has not severed diplomatic relations with the United States.
 12. Honduras is not in arrears to the extent described in Article 19 of the U.N. Charter. This was taken into account by the Administrator at the time of approval of the Agency OYB.
 13. No. Honduras has not aided or abetted or given sanctuary to any individual or group which has committed an act of international terrorism or a war crime.

14. FAA Sec. 666. Does the country object, on the basis of race, religion, national origin or sex, to the presence of any officer or employee of the U.S. who is present in such country to carry out economic development programs under the FAA?
14. No, Honduras does not object, on the basis of race, religion, national origin, or sex, to the presence of any officer or employee of the USG.
15. FAA Sec. 669, 670. Has the country, after August 3, 1977, delivered or received nuclear enrichment or reprocessing, equipment, materials, or technology, without specified arrangements or safeguards? Has it transferred a nuclear explosive device to a non-nuclear weapon state, or if such a state, either received or detonated a nuclear explosive device, after August 3, 1977? (FAA Sec. 620E permits a special waiver of Sec. 669 for Pakistan.)
15. No.
16. ISDCA of 1981 Sec. 720. Was the country represented at the Meeting of Ministers of Foreign Affairs and Heads of Delegations of the Non-Aligned Countries to the 36th General Session of the General Assembly of the U.N. of Sept. 25 and 28, 1981, and failed to disassociate itself from the communique issued? If so, has the President taken it into account? (Reference may be made to the Taking into Consideration memo.)
16. This has been taken into consideration by the Administrator at the time of approval of the Agency OYB.
17. ISDCA of 1981 Sec. 721. See special requirements for assistance to Haiti.
17. Assistance is not to Haiti.

FUNDING SOURCE CRITERIA FOR COUNTRY
ELIGIBILITY

1. Development Assistance Country
Criteria.

a. FAA Sec. 116. Has the Department of State determined that this government has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, can it be demonstrated that contemplated assistance will directly benefit the needy?

1.a. The Department of State has not determined that Honduras violates human rights.

2. Economic Support Fund Country
Criteria

2. Not Applicable.

a. FAA Sec. 502B. Has it been determined that the country has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, has the country made such significant improvement in its human rights record that furnishing such assistance is in the national interest?

b. ISDCA of 1981, Ec. 725(b). If ESF is to be furnished to Argentina, has the President certified that (1) the Govt. of Argentina has made significant progress in human rights; and (2) that the provision of such assistance is in the national interests of the U.S.?

c. ISDCA of 1981, Sec. 726(b). If ESF assistance is to be furnished to Chile, has the President certified that (1) the Govt. of Chile has made

significant progress in human rights; (2) it is in the national interest of the U.S.; and (3) the Govt. of Chile is not aiding international terrorism and has taken steps to bring to justice those indicted in connection with the murder of Orlando Letelier?

5C(2) PROJECT CHECKLIST

Listed below are statutory criteria applicable to projects. This section is divided into two parts. Part A includes Criteria applicable to all projects. Part B applies to projects funded from specific sources only: B.1. applies to all projects funded with Development Assistance Funds, B.2. applies to projects funded with Development Assistance loans, and B.3. applies to projects funded from ESF.

CROSS REFERENCES: IS COUNTRY CHECKLIST UP TO DATE? HAS STANDARD ITEM CHECKLIST BEEN REVIEWED FOR THIS PROJECT?

A. GENERAL CRITERIA FOR PROJECT

CR Sec. 133. Notwithstanding any other provision of this joint resolution, none of the funds appropriated under section 101(b) of this joint resolution may be available for any country during any 3-month period beginning on or after October 1, 1982, immediately following the certification of the President to the Congress that such country is not taking adequate steps to cooperate with the United States to prevent narcotic drugs and other controlled substances (as listed in the schedules in section 202 of the Comprehensive Drug Abuse and Prevention Control Act of 1971 (21 U.S.C. 812)) which are produced, processed, or transported in such country from entering the United States unlawfully."

1. FY 1982 Appropriation Act Sec. 523; FAA Sec. 634A; Sec. 653(b).
 - (a) Describe how authorizing and appropriations committees of Senate and House have been or will be notified concerning the project; (b) is assistance within OYB (Operational Year Budget) of the country or international organization allocation reported to Congress (or not more than \$1 million over the amount)?
 2. FAA Sec. 611(a) (1). Prior to obligation in excess of \$100,000 will there be (a) engineering, financial or other plans necessary to carry out the assistance and (b) a reasonably firm estimate of the cost of the U.S. of the assistance?
 3. FAA Sec. 611(a)(2). If further legislative action is required within recipient country, what is basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of purpose of the assistance?
 4. FAA Sec. 611(b); FY 1982 Appropriation Act Sec. 501. If for water or water-related land resource construction, has project met the standards and criteria as set forth in the Principles and Standards for Planning Water and Related Land Resources, dated October 25, 1973? (See A.I.D. Handbook 3 for new guidelines.)
1. (a). Congress has been informed of AID's 'ntention to obligate funds in a Congressional Notification sent in January 1984.
 2. (a) Yes
(b) Yes
 3. No further legislative action required.
 4. NA

5. FAA Sec. 611(e). If project is capital assistance (e.g., construction), and all U.S. assistance for it will exceed \$1 million, has Mission Director certified and Regional Assistant Administrator taken into consideration the country's capability effectively to maintain and utilize the project?
5. N/A
6. FAA Sec. 209. Is project susceptible to execution as part of regional or multilateral project? If so, why is project not so executed? Information and conclusion whether assistance will encourage regional development programs.
6. Project activities are not appropriate for a regional or multilateral project.
7. FAA Sec. 601(a). Information and conclusions whether project will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; and (c) encourage development and use of cooperatives, and credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture and commerce; and (f) strengthen free labor unions.
7. The project will be implemented through the private sector and foster private initiative through providing financial and technical assistance to small and medium scale entrepreneurs. Depending on the sub-projects financed, an increase in international trade as well as reduction of monopolistic practices may result.
8. FAA Sec. 601(b). Information and conclusions on how project will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise.)
8. U.S. Suppliers are expected to provide almost all the goods and services financed with A.I.D. funds.

9. FAA Sec. 612(b), 636(h); FY 1982 Appropriation Act Sec. 507. Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the U.S. are utilized in lieu of dollars.
 10. FAA Sec. 612(d). Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?
 11. FAA Sec. 601(e). Will the project utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise?
 12. FY 1982 Appropriation Act Sec. 521. If assistance is for the production of any commodity for export, is the commodity likely to be in surplus on world markets at the time the resulting productive capacity becomes operative, and is such assistance likely to cause substantial injury to U.S. producers of the same, similar or competing commodity?
 13. Faa 118(c) and (d). Does the project comply with the environmental procedures set forth in A.I.D. Regulation 16? Does the project or program take into consideration the problem of the destruction of tropical forests?
9. Honduras has agreed to provide counterpart financing of local costs for the bulk of the project cost.
 10. The U.S. does not own excess Honduran currency.
 11. Except where otherwise allowed, competitive procedures will be used to award all contracts.
 12. No commodities will be produce with the assistance.
 13. A.I.D. Environmental Regulations have been followed. The Project received a Negative Determination in the Threshold Decision.

14. FAA 121(d). If a Sahel project, has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditures of project funds (dollars or local currency generated therefrom)?

14. NA

FUNDING CRITERIA FOR PROJECT

1. Development Assistance Project Criteria.

a. FAA Sec. 102(b), 111, 113, 281(a). Extent to which activity will (a) effectively involve the poor in development, by extending access to economy at local level, increasing labor-intensive production and the use of appropriate technology, spreading investment out from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using the appropriate U.S. institutions; (b) help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward a better life, and otherwise encourage democratic private and local governmental institutions; (c) support the self-help efforts of developing countries; (d) promote the participation of women in the national economies of developing countries and the improvement of women's status; and (e) utilize and encourage regional cooperation by developing countries?

1. a. The Project will provide jobs for the poor, and facilitate their access to commercial financing for productive activities.

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b. FAA Sec. 103, 103A, 104, 105, 106. Does the project fit the criteria for the type of funds (functional account) being used?

c. FAA Sec. 107. Is emphasis on use of appropriate technology (relatively smaller, cost-saving, labor-using technologies that are generally most appropriate for the small farms, small businesses, and small incomes of the poor)?

d. FAA Sec. 110(a). Will the recipient country provide at least 25% of the costs of the program, project, or activity with respect to which the assistance is to be furnished (or is the latter cost-sharing requirement being waived for a "relatively least developed" country)?

e. FAA Sec. 110(b). Will grant capital assistance be disbursed for project over more than 3 years? If so, has justification satisfactory to Congress been made, and efforts for other financing, or is the recipient country "relatively least developed"? (M.O. 1232.1 defined capital project as "the construction, expansion, equipping or alteration of a physical facility or facilities financed by A.I.D. dollar assistance of not less than \$100,000, including related advisory, managerial and training services, and not undertaken as part of a project of a predominantly technical assistance character."

b. (Sec. 103) The Project will increase employment, productivity, and income of the poor by enabling them to gain access to technical and financial assistance and stimulating employment creation.

c. Use of appropriate technology will be promoted through contracted technical advisers financed with project funds.

d. Honduras will contribute at least 25% of the costs of the program.

e. No.

f. FAA Sec. 122(b). Does the activity give reasonable promise of contributing to the development of economic resources, or to the increase of productive capacities and self-sustaining economic growth?

f. Yes. The Project will increase the productive capacities of the small business and small industry.

g. FAA Sec. 281(b). Describe extent to which program recognizes the particular needs, desires, and capacities of the people of the country; utilizes the country's intellectual resources to encourage institutional development; and supports civil education and training in skills required for effective participation in governmental processes essential to self-government.

g. The project will stimulate the creation of two new institutions specifically designed to bring services to the poor and to businesses that employ poor workers, especially the unemployed.

Development Assistance Project
Criteria (Loans Only)

2.a. N/A

a. FAA Sec. 122(b). Information and conclusion on capacity of the country to repay the loan, at a reasonable rate of interest.

b. N/A

b. FAA Sec. 620(d). If assistance is for any productive enterprise which will compete with U.S. enterprises, is there an agreement by the recipient country to prevent export to the U.S. of more than 20% of the enterprise's annual production during the life of the loan?

c. N/A

c. ISDCA of 1981, Sec. 724(c) and (d). If for Nicaragua, does the loan agreement require that the funds be used to the maximum

extent possible for the private sector? Does the project provide for monitoring under FAA Sec. 624(g)?

3. Economic Support Fund Project Criteria

3. Not applicable

- a. FAA Sec. 531(a). Will this assistance promote economic or political stability? To the extent possible, does it reflect the policy directions of FAA Section 102?
- b. FAA Sec. 531(c). Will assistance under this chapter be used for military, or paramilitary activities?
- c. FAA Sec. 534. Will ESF funds be used to finance the construction of the operation or maintenance of, or the supplying of fuel for, a nuclear facility? If so, has the President certified that such use of funds is indispensable to nonproliferation objectives?
- d. FAA Sec. 609. If commodities are to be granted so that sale proceeds will accrue to the recipient country, have Special Account (counterpart) arrangements been made?

5C(3) - STANDARD ITEM CHECKLIST

Listed below are the statutory items which normally will be covered routinely in those provisions of an assistance agreement dealing with its implementation, or covered in the agreement by imposing limits on certain uses of funds.

These items are arranged under the general headings of (A) Procurement, (B) Construction, and (C) Other Restrictions.

A. PROCUREMENT

- | | |
|---|--|
| 1. <u>FAA Sec. 602</u> . Are there arrangements to permit U.S. small business to participate equitably in the furnishing of commodities and services financed? | 1. Yes, normal A.I.D. procedures will be followed. |
| 2. <u>FAA Sec. 604(a)</u> . Will all procurement be from the U.S. except as otherwise determined by the President or under delegation from him? | 2. Yes |
| 3. <u>FAA Sec. 604(d)</u> . If the cooperating country discriminates against marine insurance companies authorized to do business in the U.S., will commodities be insured in the United States against marine risk with such a company? | 3. Honduras does not practice such discrimination. |
| 4. <u>FAA Sec. 604(e); ISDCA of 1980 Sec. 705(a)</u> . If offshore procurement of agricultural commodity or product is to be financed, is there provision against such procurement when the domestic price of such commodity is less than parity? (Exception where commodity financed could not reasonably be procured in U.S.) | 4. No offshore procurement of agricultural commodities or products is planned. |

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5. FAA Sec. 604(g). Will construction or engineering services be procured from firms of countries otherwise eligible under Code 941, but which have attained a competitive capability in international markets in one or more of these areas?
6. FAA Sec. 603. Is the shipping excluded from compliance with requirements in section 901(b) of the Merchant Marine Act of 1936, as amended, that at least 50 per centum of the gross tonnage of commodities (computed separately for dry bulk carriers, dry cargo liners, and tankers) financed shall be transported on privately owned U.S. flag commercial vessels to the extent that such vessels are available at fair and reasonable rates?
7. FAA Sec. 621. If technical assistance is financed, will such assistance be furnished by private enterprise on a contract basis to the fullest extent practicable? If the facilities of other Federal agencies will be utilized, are they particularly suitable, not competitive with private enterprise, and made available without undue interference with domestic programs?
8. International Air Transport Fair Competitive Practices Act, 1974. If air transportation of persons or property is financed on grant basis, will U.S. carriers be used to the extent such service is available?
5. No major construction or engineering activities are contemplated.
6. No, shipping is not excluded from these requirements.
7. Yes, it is anticipated that all TA will be so provided.
8. Yes.

9. FY 1982 Appropriation Act Sec. 504. If the U.S. Government is a party to a contract for procurement, does the contract contain a provision authorizing termination of such contract for the convenience of the United States? 9. Yes

Construction

1. FAA Sec. 601(d). If capital (e.g., construction) project, will U.S. engineering and professional services be used? 1. NA
2. FAA Sec. 611(c). If contracts for construction are to be financed, will they be let on a competitive basis to maximum extent practicable? 2. NA
3. FAA Sec. 620(k). If for construction of productive enterprise, will aggregate value of assistance to be furnished by the U.S. not exceed \$100 million (except for productive enterprises in Egypt that were described in the CP)? 3. Yes

Other Restrictions

1. FAA Sec. 122(b). If development loan, is interest rate at least 2% per annum during grace period and at least 3% per annum thereafter? 1. NA
2. FAA Sec. 301(d). If fund is established solely by U.S. contributions and administered by an international organization, does Comptroller General have audit rights? 2. Not Applicable

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3. FAA Sec. 620(h). Do arrangements exist to insure that United States foreign aid is not used in a manner which, contrary to the best interests of the United States, promotes or assists the foreign aid projects or activities of the Communist-bloc countries? 3. Yes
4. Will arrangements preclude use of financing:
- a. FAA Sec. 104(f); FY 1982 Appropriation Act Sec. 525: (1) To pay for performance of abortions as a method of family planning or to motivate or coerce persons to practice abortions; (2) to pay for performance of involuntary sterilization as a method of family planning, or to coerce or provide financial incentive to any person to undergo sterilization; (3) to pay for any biomedical research which relates, in whole or part, to methods or the performance of abortions or involuntary sterilization as a means of family planning; (4) to lobby for abortion? a. Arrangements preclude the use of funds of this purpose.
- b. FAA Sec. 620(g). To compensate owners for expropriated nationalized property? b. Arrangements preclude the use of funds for this purpose.
- c. FAA Sec. 660. To provide training or advice or provide any financial support for police, prisons, or other law enforcement forces, except for narcotics programs? c. Arrangements preclude the use of funds for this purpose.
- d. FAA Sec. 662. For CIA activities? d. Arrangements preclude the use of funds for this purpose.

- e. FAA Sec. 636(1). For purchase, sale, long-term lease, exchange or guaranty of the sale of motor vehicles manufactured outside the U.S., unless a waiver is obtained?
- f. FY 1982 Appropriation Act, Sec. 503. To pay pensions, annuities, retirement pay, or adjusted service compensation for military personnel?
- g. FY 1982 Appropriation Act, Sec. 505. To pay U.N. assessments arrearage or dues?
- h. FY 1982 Appropriation Act, Sec. 506. To carry out provisions of FAA section 209(d) (Transfer of FAA funds to multilateral organizations for lending)?
- i. FY 1982 Appropriation Act, Sec. 510. To finance the export of nuclear equipment, fuel, or technology or to train foreign nationals in nuclear fields?
- j. FY 1982 Appropriation Act, Sec. 511. Will assistance be provided for the purpose of aiding the efforts of the government of such country to repress the legitimate rights of the population of such country contrary to the Universal Declaration of Human Rights?
- k. FY 1982 Appropriation Act, Sec. 515. To be used for publicity or propaganda purposes within U.S. not authorized by Congress?
- e. All motor vehicles purchased will be of US source and origin.
- f. Arrangements preclude the use of funds for this purpose.
- g. Arrangements preclude the use of funds for this purpose.
- h. Arrangements preclude the use of funds for this purpose.
- i. Arrangements preclude the use of funds for this purpose.
- j. No
- k. Arrangements preclude the use of funds for this purpose.

Technical Assistance Agencies

I. Description of Institutions Which Provide Assistance to Small Business

A. Federación Hondurena de Cooperativas Industriales, Limitada (FEHCIL)

The Honduran Federation of Industrial Cooperatives is in its fourth year of operations and has grown very rapidly in the number of people they are working with, in the range of services they provide, in their budget and in the resources they have to draw upon. 1982 budget \$212,500; 1983 Projected \$412,500.

Services to SSE include: Credit, non-formal management training, management assistance, technical information and training, cooperative accounting services, legal assistance, bulk purchasing of raw materials, marketing of finished products and cooperative development. Most of their services focus specifically on developing industrial cooperatives and their objective is to have the small businesses eventually join together into a single medium or large scale manufacturing operation. However, they do provide technical and management training to cooperatives members in accounting, planning and production in their individual enterprises.

FEHCIL has three service departments: education, projects and finance and commercialization. Their operations are run out of two offices; the main office in Tegucigalpa and one in San Pedro Sula which services the north region (Cortés, Santa Barbara, Copán, Atlantida and Ocotepeque). They have provided services in 10 departments. They have 9 professional staff and 25 support staff and at present have one US Peace Corps advisor in commercialization. Many of their professional staff have been promoted from within the FEHCIL network as they have gained practical experience in the cooperatives or in FEHCIL and have demonstrated capacity and willingness.

FEHCIL is interested in drawing on the financial and technical resources of the SME financiera project. As they reach the limits of their own credit resources they want to refinance or discount the raw materials purchase notes or machinery purchase notes of cooperatives or pre-cooperatives. FEHCIL would continue to provide accounting services, planning assistance, technical training and followup. At present these services are partially subsidized by grant funding and by other revenues. FEHCIL recognizes the need to strengthen the activities of the cooperatives member businesses and with outside assistance, would be willing to dedicate some resources to those efforts.

FEHCIL offers an efficient channel for the financiera to provide credit to smaller enterprises and is perhaps the only channel through which the financiera will be able to reach to the level of small productive workshops.

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B. Instituto de Desarrollo Hondureno (IDH)

The Honduran Development Institute is in its fifth year of operation. It has recently gone through a reassessment of its activities and is laying the groundwork for improving and expanding its operations. They recently signed a loan/grant agreement with IDB which will add \$400,000 to their loan funds and provide them with \$50,000 of technical assistance (from ASEPADE) over the next two years. 1982 budget \$63,000; 1983 budget \$75,000 (not including IDB T.A. package of \$30,000).

Services to SSE include: Credit, motivational and management training, management assistance, legal information, marketing assistance and community development awareness training. Their services focus on expanding existing enterprises and providing management capabilities. Their marketing assistance consists of finding buyers for their clients products, mostly in the Tegucigalpa market.

IDH presently has 4 promoters and 1 PCV who are providing assistance or follow-up to 150 small businesses in Francisco Morazan, Cortes, Olancho, Comayagua, Yoro, Choluteca and Atlántida. The promoters are based in Tegucigalpa and the PCV is based in Siguatepeque. They will be employing two more promoters within the next month and are considering placing one or more of them in field offices in Olancho and/or San Pedro Sula. There are presently two agronomists from ASEPADE who work full time for IDH on agriculture and agro-business credits. In addition, ASEPADE has provided a person half time to assist IDH in formalizing and documenting its financial accounting and management control systems. These ASEPADE advisors are being paid for out of IDB technical assistance funds and will be working with IDH for the next 18 months.

IDH feels that it works most effectively with businesses with total assets under L50,000 and would like to keep its average loans down to L10,000 in order to be able to reach as many businesses as possible with their limited funds (\$375,000 and \$400,000 IDB). They would like to graduate clients who have been responsible and competent in handling IDH credit and managing their business and refer them to the financiera when their credit needs exceed L30,000. They already have several clients who are ready to take this step. IDH would have to expand their staff and up grade the promoters management assistance capabilities in order to be able to provide follow-up and assistance to their graduated clients. However, it makes sense from both the financiera's and IDH's viewpoints to do that.

IDH would already have established a close working relationship the client, and would know the business well. Thus, the time and effort it takes to establish a good working relationship would be saved if IDH continued providing assistance and follow-up to the client. On the other hand, having

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the experience of working with growing businesses IDH would be able to better anticipate the problems that accompany growth, and thus better serve business further down the scale, their own clients.

To date IDH has set aside a small portion of the interest on loans (3%) to defray costs of management assistance; it is not enough. They charge a token fee (L20) for the introductory seminar which covers about half the costs. They have relied on grant funding to cover the difference. They have been hesitant to charge fees for management assistance, but recognize the need to consider a fee system.

C. Asesores para el Desarrollo (ASEPADE)

Development Advisers is completing its sixth year of operations. It has grown steadily and now counts 16 professional staff who are providing a range of services to individuals and development organizations (both private and public) and campesino and minority groups.

Services to SSE includes: credit, group formation, management training (direct and indirect), management assistance (indirect), organization development (indirect), studies, legal information and assistance, motivational and consciencizing training. The main emphasis of their services is on organizational development of institutions serving small and micro enterprises, both commercial and productive. They perform socio-economic studies to better identify the target population and the actual supply and demand of services in given areas. They train top management of development organizations to be more resourceful and systematic. They have developed management systems including policies, procedures and forms for credit, commercialization and inventory controls. Their services are oriented towards collaborative efforts of SSE, for practical reasons as well as to provoke social commitment and avoid unconstructive individualism.

ASEPADE has three operating units: Credit, which runs a small credit program and advises others; Organizational Development; and Consulting, which provides specific consulting services to small business development organizations on contract. All these units operate out of Tegucigalpa and provide services wherever in Honduras they are needed. ASEPADE has also provided training services to a PVO in Panamá (Tecnología Apropriada de Panamá).

Through their consulting and organizational development services ASEPADE has become familiar with many different small and micro business development programs and through their membership in FOPRIDEH, a consortium of local PVOs, has contact with other private organizations which might later be incorporated into the TA system. From conversations with the president of ASEPADE it appears that they have a pretty good idea of the assistance needs of SSE and are active in looking for and developing practical mechanisms for servicing

those needs. They seem to have a better understanding of the implications of the legal framework pertaining to SSE than other PVOs who were interviewed. The fact that they have three lawyers on their staff might have something to do with that. ASEPADE is an organization which could be involved in providing training, investigation and legal advisory services to organizations in the TA System who are directly providing services to SSE. It will probably be appropriate to have them work in conjunction with TA brought in from outside of Honduras in order to institutionalize that TA capability in Honduras.

D. Camara de Comercio de Tegucigalpa

The Tegucigalpa Chamber of Commerce and Industry is in its thirty seventh year of operation, has 532 members, the majority of which are medium scale businesses and commercial. However, there are small scale and industrial and service businesses who are members. The Tegucigalpa Chamber is more oriented towards representing the commercial sector rather than the private sector as a whole than is the Camara de Comercio e Industria de Cortés. The Tegucigalpa Chamber has developed a solid income base from membership quotas and prudent investments. 1982 budget \$195,982.

Services to S&ME include: legal services, technical economic and management information library, biweekly bulletins, monthly magazine, seminars on technologies, management and the economy, product certification, business reference, letters of introduction, market information, legal registration (La Constancia), facilities for meetings, activity coordination, representation of private sector to GOH and foreign investors, and management advice. Their services can be summarized in four categories: 1) information (library, bulletins, magazine, seminars, sector studies); 2) advisory (legal, management, seminars); 3) reference representation to GOH product certification, business reference, letter of introduction, lobbying; 4) Facilities/coordination (meeting room, activity coordination, space leasing). The Tegucigalpa chamber is particularly interested in expanding their management advisory services. They have one person who works part-time with members discussing management problems they are encountering and looking for possible solutions. They admit that this is not a service that small businesses come to them for. They claim that the majority of requests for this type of assistance come from medium scale enterprises.

Their membership is limited to Tegucigalpa and thus the services they provide are, on the whole, likewise restricted. However, they do have links to other chambers and associations through their participation in the National Chamber of Commerce and COHEP. They acknowledge that neither of these organizations is effectively integrating the efforts of the various private sector organizations in Honduras.

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The Tegucigalpa Chamber has recently paid off the mortgage on their office building. This should mean that they will have additional funds available to support expanded advisory services. It would seem appropriate to consider directing funds and TA to them in order to encourage the development of advisory services which better meet the needs of medium scale enterprises and which can be responsible to the needs of smaller enterprises who find their way to seeking such assistance from the chamber.

E. Camara de Comercio e Industria de Cortés

The San Pedro Sula Chamber of Commerce and Industry has existed for over 20 years, claims to have served in Cortés Yoro, Santa Barbara, and part of Atlántida, and has, as of December 1982, 527 members of whom 206 are commercial enterprises, 177 industries, 54 services, 11 banks, 45 "professionals", 7 farmers or cattlemen and 27 assorted members in Puerto Cortés. The Cortés Chamber is more oriented towards representing the private sector as a whole than the Tegucigalpa chamber, perhaps because their president is an industrialist. The Cortés Chamber has a solid income base from members quotas and charges for services. 1982 budget \$163,509.

Services to S&ME include: legal services, legal registration, management assistance, sector studies, information library, monthly magazine, seminars/courses on technologies, management, economy and Central American regional integration, business reference and letters of introduction, product certification, photocopying and mimeographing, coordination/sponsoring of activities (i.e. trade fairs), support to higher education (institutional and individual scholarships), arbitration, and representation to GOH. They have five professional staff including an economic advisor, a legal advisor, a public relations specialist, a journalist and the general manager of the Chamber. Their services are geared more towards medium scale enterprises, but are available to all members.

They feel that they could play a role in the TA system by screening clients for the financiera and by providing management assistance both before and after a business has received a loan. They would need one additional staff member for this to be done effectively. The person would need to have at least five years experience in management as well as knowing credit analysis. They also offered to have the financiera representative in San Pedro Sula located in their offices.

Given the other services (legal, information, photocopying, etc.) which the Cortés chamber offers and given the less formal, though not unprofessional, atmosphere of their offices it would seem appropriate to consider directing financial resources and TA to them in order to develop their in-house capability to provide advisory services to smaller enterprises. They could serve as an effective selection and support service to the financiera.

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F. Asociación Nacional de Mediana y Pequeños Industriales (ANMPI)

The National Association of Small and Medium Industrialists was formed in 1972. There are 80 active members (though there is mention of 810 affiliates) of whom 26% are artesans, 66% are small industrias and 8% are medium scale and of whom about a third are in Francisco Morazan, a third in Cortés and a third scattered in the other departments of Honduras. ANMPI does not have a well established funding base; the receipts of monthly quotas from members does not even cover the rent of their office and meeting space.

Services include: legal information, management assistance, credit source information and assistance, representation to the GOH and the public and business/personal reference to credit sources. ANMPI's paid staff is limited to a secretary and messenger, and most of the above services are provided by the President of ANMPI, and to a lesser extent by other Board members on a voluntary and informal basis. There is little acknowledgement on either the members' part or on the part of the people actually providing the services that ANMPI is providing services to member and non-member small businesses.

ANMPI has accepted the services of six students working through the UNAH Centro de Estudios y Trabajo (CETAE). They will spend 4-6 months working as management advisors to ANMPI members (see following CETAE description) beginning in July 1983.

It is clear that if ANMPI is to fulfill its institutional functions it will need assistance and financial support. Because it is (1) a national organization (2) the only representative body for small business and (3) has accumulated knowledge of the needs and characteristics of small business, it would seem appropriate that an attempt be made to incorporate them into the TA system over time. They obviously are not in a position to provide effective management or technical assistance services to small businesses now or in the near future. However, they represent a network which with minimal TA could provide very useful personal and business reference services to the financiera. Also, it will be appropriate for the TA system to provide support for one staff person who would be responsible for pre-selecting clients, assisting them in meeting the legal and documentation requirements of the financiera and in improving their management system, and making periodic followup visits to those ANMPI members who have received credit from the financiera, providing them with on-the-spot management assistance as it is needed.

G. Centro de Estudios y Trabajo y Asistencia a la Empresa (CETAE)

The Work and Study Center and Business Assistance units of the National Autonomous University of Honduras (UNAH) is an outgrowth of the UNAH faculties of Economics and Business Administration. The Centro de Estudios y Trabajos

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has been in existence for five years and is a program through which students in the faculties of economics, business administration and accounting could do practical investigations and use them to satisfy their Licenciatura thesis requirement and graduates could gain practical experience while serving the community. The Asistencia a la Empresa takes that idea one step further and is attempting to get students to assist directly small and medium scale enterprises as a practical internship.

A group of 6-8 students is planning to work with IDH on their methodologies for providing management assistance to their clients. IDH recognizes that there is room for improvement in their advisory services, and they do not want to deprive the students the opportunity of acquiring practical experience which IDH could at the same time benefit from. This is somewhat like the blind leading the blind. The students are on the most part employed by the government; how much experience they have in private enterprise is questionable. IDH was also not clear what preparation the students had besides their university courses for analyzing small and medium scale enterprise needs and suggesting procedures for responding to those needs. What is known is that there had been no intention of using CDI Small Business Field Agent training materials (which were paid for by A.I.D. and which have proven to be at least somewhat useful). CETAE coordinators have been made aware of the need to (1) be selective in the students allowed to participate in these activities, and (2) develop a course to prepare the students for being advisors.

Another group of six students have reached a preliminary agreement with ANMPI to serve as management advisors to ANMPI members. All of them have completed their course work in the Faculty of Business Administration, and their specializations include administration, planning, accounting, personnel administration, and office management. Their intention is to work for about four months and write a thesis based on their experience. Juan Rafael Cruz López and the ANMPI board would like them to commit to serving clients for a period of six months so that there is sufficient period in which to see some of the results of their assistance efforts, develop interest in such services in the membership of ANMPI and promote ANMPI as provider of services. Their work with ANMPI will start on May 1, 1983.

The point is that CETAE is out beating the bushes to get involved in management assistance services to small and medium scale enterprises. They are basing their services on what they have learned in their courses at UNAH, or so it seems from other projects that they have been involved in and written theses on. The effectiveness of services is questionable and this could have a negative impact on the receptivity of small and medium businesses to management assistance.

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Organizers of CETAE are interested in being included in the TA system. They recognize that they will need some assistance in selecting and preparing students to be small business advisors. Because the organizers have jobs in the private or public sector (i.e. Nery Chinchilla of Fortin, Lagos & Asoc. and Leony YuWay of CDI) they already have a broad network of contacts which could be very useful in integrating the TA system.

H. U.S. Peace Corps (P.C.)

The Peace Corps has 20 volunteers with business background who are providing management assistance planning, breakeven analysis, market studies, accounting, equipment selection, plant layout to cooperatives or small businesses through various PVOs including IDH and FEHCIL. Eighteen new volunteers will be completing their training in July 1983 and will be placed with PVOs and directly with cooperatives. There are amongst these volunteers several who have extensive backgrounds in engineering or management of in specific industries or businesses. The Program Manager for all these volunteers has offered to lend volunteers to the T.A. System on an on-call basis when there is a particular case which their experience would enable them to provide specialized assistance. The T.A. System Coordinator will want to collaborate with Peace Corps in the placement of volunteers.

II. Recommendations

The contractor recommended to USAID/H that FEHCIL and IDH are the PVOs in Honduras that could most effectively provide the kinds of technical assistance that small businesses will need in order to be able to manage credit offered by FIA. He also concluded that the Chambers of Commerce and Industry are the private sector organizations that could at present most effectively provide services to medium scale enterprises. With assistance and over time they might develop to serve smaller businesses, complementing the services of IDH and FEHCIL.

In addition, the contractor proposed that ANMPI be incorporated into the TA system as much as possible given its limited institutional capabilities. This will require organizational development assistance to ANMPI in addition to the support for service development.

These recommendations were based on an assessment of the organizations, their current activities, their interest in participating in the TA system, and their recognition of their own needs for assistance, and they were made recognizing that without exception all of these organizations will need some form of outside TA in order to bring their services up to an appropriate standard.

III. Additional Organizations Considered

The full text of the consultant's report, including his comments on the additional organizations considered but not recommended at this time, may be found in the LAC/DR bulk files. The names of additional organizations are:

- A. University of San Pedro Sula - USPS
- B. UNAH - School of Economics and Business Administration
- C. University of José Cecilio del Valle - UJCV
- D. Gerentes y Empresarios Asociados de Honduras - GEMAH
- E. Honduran-American Chamber of Commerce - HAM-CHAM
- F. Instituto de Federaciones de Cooperativas - IFC
- G. Fundación Hondureno de Desarrollo - FUNADESA
- H. Comité Evangélico de Desarrollo Nacional - CEDEN
- I. Save the Children Foundation - FEDEJCO
- J. Asociación San José Obrero - ASJO
- K. Centro de Educación Vocacional Evangélico Reformado - CEVER
- L. Federación Hondurena de Mujeres Campesinas - FEHMUC
- M. Fortín, Lagos y Asociados S. de R.L. de C.V.
- N. Mendieta y Asociados, S.A.
- O. Morales, Palao, William y Asociados
- P. M.A. Reyes y Asociados - Grupo de Ejecutivos Modernos (GEM)

IMPLEMENTATION PLAN - T.A. SYSTEM

	Phase I (9-12 months)	Phase II (10-21 months)	Phase III (22-28 mos.)	Phase IV (29-36 mos.)
FEHCIL	Receive assistance in providing TA	Expanded services to clients including commercialization and expended financing of experienced clients	New agreements for service provision and client screening	Identify & develop new services
IDH	Provide TA to clients Channel most experienced clients to financiers Develop Commercialization capabilities			
ANMPI, ANDI, and Camaras de Comercio	TA-Organizational Devel Client screening Market identification	Expand operations and develop services (legal & information & market)	Integrate coordination function and expand services	Identify & develop new services
FIA	TA credit officers development Service test cases	Expand test cases; continued development. Prepare for expanding funding base	More formal links with ANMPI, C. of C. ANDI expand funding base	Develop new services
Training Organizations	Inventory, begin to develop select courses in management	develop select course(s) in management; begin development of select technical course for S&ME managers.	Expand management training to S&ME Develop technical training for S&ME managers	Continued expansion of courses and materials. Integration of training services
Tech. Ass.	Inventory T.A. Test cases (e.g. IESC)	Use on on-call basis	Expand use on selective basis	
Admin. Services	Inventory; test case of admin. services	selectively promote/test new services	Promote useful, efficient service	
Coordinator Institution	Startup Counterpart training	Ongoing counterpart training and system planning	Shift into S&ME private sector representative organization	
Other BAS	Identify potential system participants Qualify their services Introduce them to system	field test services; select services to be expanded and organization through which to expand them	Expand services	

STEPS IN DEVELOPING T.A. SYSTEM

- Select and hire system coordinator (Advisor).
- Sign agreement with system coordinator.
- Select and hire system coordinator counterpart.
- Sign agreements with more BAS organizations (FEHCIL, IDH, ANMPI, CdeC).
- Inventory T.A. resources for S&ME,
- Select and contract T.A. for Business Advisor training.
- Orientation seminar - T.A. to small and medium business - core BAS org., Financiera staff, ANMPI.
- Develop and test needs assessment implements.
- Develop & test T.A. service assessment implements integrate into FEHCIL, IDH systems.
- Seminar/training -"Giving T.A."- field agents, promoters, credit officers.
- In formal agreements understandings with other BAS orgs. for provision of services to potential and actual financiera clients.
- Series of in-service seminars on T.A. system (who has what to offer how); T.A. needs of S&ME; feedback on services; how to consciencize entrepreneurs; institutional development of representative orgs; issues in S&ME development; issues of credit; review functions of credit officers, field agents and coordinators.
- Test administrative services for SSE to be provided by private companies.
- Look for other PSOs to provide core services.
- Look for specific technical resources and contract them as needed.
- Test variety of specialized and general services and provide T.A. support to orgs. to strengthen service provision capabilities.
- Train coordinator counterpart.

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- Review institutional placement of counterpart.
- Support/corraborate orgs. development of PSOs for provision of information services.
- Periodic meetings of T.A. providers and users to discuss activities/services and ways to make improvements.
- Update projection of T.A. system costs and income; evaluate schedule of charges vis-a-vis viability of system.

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AID Grant Budget

	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Total</u>
1. Small Business Adviser	40,000*	100,000	20,000	160,000
2. FIA Adviser	100,000	20,000	20,000	140,000
3. <u>Business Assistance System:</u>	<u>143,000</u>	<u>100,000</u>	<u>57,000</u>	<u>300,000</u>
TA for Firms	40,000	40,000	20,000	100,000
Training Courses/Seminars	30,000	20,000	10,000	60,000
Orientation Trips	30,000	10,000		40,000
Vehicles for Field Agents:	<u>43,000</u>	<u>30,000</u>	<u>27,000</u>	<u>100,000</u>
IDH: 1 Jeep	15,500			15,500
FEHCIL: 1 Jeep	15,500			15,500
ANMPI: 1 Motorcycle (M/C)	4,000			4,000
Cortes C of C: 2 MC's	8,000			8,000
Others		<u>30,000</u>	<u>27,000</u>	<u>57,000</u>
Total	283,000	220,000	97,000	600,000

*This first-year amount will be supplemented by \$60,000 in PD&S funds.

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TA System Budget (\$)

	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Total</u>
<u>Income:</u>					
GOH Contribution to ANDI	250,000	150,000			400,000
Business Assistance Fund	<u>50,000</u>	<u>250,000</u>	<u>400,000</u>	<u>400,000</u>	<u>1,100,000</u>
TOTAL	<u>300,000</u>	<u>400,000</u>	<u>400,000</u>	<u>400,000</u>	<u>1,500,000</u>
<u>Expenses:</u>					
<u>System Development:</u>					
System Coordinator:	80,000	80,000	83,000	86,000	329,000
Project Manager	31,000	33,000	34,000	35,000	133,000
Secretary	9,500	10,000	10,500	11,000	41,000
Travel & Office cost	24,700	26,400	27,400	28,500	107,000
Equipment	5,000				5,000
ANDI Overhead @ 25%	9,800	10,600	11,100	11,500	43,000
Courses/Seminars/Workshops				10,000	10,000
Short Term T.A. Ext.				20,000	20,000
Short Term T.A. Int.	<u>20,000</u>	<u>20,000</u>	<u>20,000</u>	<u>20,000</u>	<u>80,000</u>
Sub-Total	100,000	100,000	103,000	136,000	439,000
<u>Service Providing Agencies: 1/</u>					
Personnel	102,000	170,000	195,000	202,000	669,000
Travel & Per Diem	32,000	45,000	52,000	55,000	184,000
Miscellaneous	9,000	5,000	5,000	5,000	24,000
Regional Office Costs	14,000	11,000	7,000	3,000	35,000
Overhead	43,000	32,000	15,000	4,000	94,000
Other		<u>37,000</u>	<u>23,000</u>	<u>(5,000)</u>	<u>55,000</u>
Sub-Total	<u>200,000</u>	<u>300,000</u>	<u>297,000</u>	<u>264,000</u>	<u>1,061,000</u>
TOTAL	300,000	400,000	400,000	400,000	1,500,000

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Detail of Expenses - Service Providing Agencies

	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Total</u>
<u>IDH</u>					
Personnel (2 Promoters)	18,000	19,000	20,000	21,000	78,000
Travel & Per Diem	8,000	9,000	10,000	11,000	38,000
Regional Office Costs	6,000	3,000	3,000	3,000	15,000
Overhead (1/)	8,000	5,000	2,000	0	15,000
Sub-Total	<u>40,000</u>	<u>36,000</u>	<u>35,000</u>	<u>35,000</u>	<u>146,000</u>
<u>FEHCIL</u>					
Personnel (2 Promoters)	18,000	19,000	20,000	21,000	78,000
Travel & Per Diem	8,000	9,000	10,000	11,000	38,000
Miscellaneous	1,000	1,000	1,000	1,000	4,000
Overhead (1/)	8,000	5,000	2,000	0	15,000
Sub-Total	<u>35,000</u>	<u>34,000</u>	<u>33,000</u>	<u>33,000</u>	<u>135,000</u>
<u>ANMPI</u>					
Personnel (1 Promoter years 1-2; 2 starting Year 3)	16,000	17,000	33,000	34,000	100,000
Travel	3,000	3,000	6,000	6,000	18,000
Miscellaneous	1,000	1,000	1,000	1,000	4,000
Overhead (1/)	7,000	4,000	3,000	0	14,000
Sub-Total	<u>27,000</u>	<u>25,000</u>	<u>43,000</u>	<u>41,000</u>	<u>136,000</u>
<u>Cortés Chamber</u>					
Personnel (2 Promoters from year 2 on)		49,000	52,000	54,000	155,000
Travel & Per Diem		6,000	7,000	7,000	20,000
Miscellaneous		1,000	1,000	1,000	3,000
Sub-Total		<u>56,000</u>	<u>60,000</u>	<u>62,000</u>	<u>178,000</u>
<u>Additional 2/</u>					
Personnel (3 Promoters year 1; 4 year 2 on)	50,000	66,000	70,000	72,000	258,000
Travel & Per Diem	13,000	18,000	19,000	20,000	70,000
Regional Office Cost	8,000	8,000	4,000	0	20,000
Miscellaneous	7,000	2,000	2,000	2,000	13,000
Overhead (1/)	20,000	18,000	8,000	4,000	50,000
Contingency/Working Cap.		37,000	23,000	(5,000)	55,000
Sub-Total	<u>98,000</u>	<u>149,000</u>	<u>126,000</u>	<u>93,000</u>	<u>466,000</u>
TOTAL	200,000	300,000	297,000	264,000	1,061,000

1/ Overhead will be provided on a declining basis to encourage the service providing agencies to pick up more of this expense over time. First year overhead will be 40% of salaries, second year 25%, third year 10%, fourth year and on, 0%.

2/ Additional Promoters will be assigned after the workplan required to meet CP's has been accepted by A.I.D.

Differences Between FIA and Other Honduran Finance Companies

The desirability of creating a new finance company given the unspectacular history of a few previous efforts in Honduras was raised during the AID/W review of the Mission's 1984 ABS, and discussed at the PID review for this project. The following discussion is largely from the PID with minor editing to take into account changes in project design and focus that have occurred in preparing the PP:

The issues (regarding the need for a new institution) were reflected in a letter from Lazar to Cauterucci dated October 4, 1982, which states:

"The Small Business Financiera...project...brought to mind FINAVI, BANFINAN and CONADI and the generally poor track record of Honduran financieras. Is there a motivation for private banks to buy into a financiera and if so, why can't banks handle the costs directly? In other words, if it can be profitable as stated, why do we need to create a new institution? Can a stronger case be made that credit will not come from the banks without the stimulus of an A.I.D. loan? Is there an opportunity here for PCGP? Must we make available technical assistance to small businesses in order to meet their credit needs?"

The Mission believes that the key factors that led to less than satisfactory performance of the financieras mentioned have been taken into account in designing the proposed project. FINAVI's main problem is that it is a government institution trying to do a job that would better be handled by a private institution. It simply cannot get the necessary financial support from the GOH, nor attract the kind of management talent needed, nor interest private entrepreneurs to invest in it or help run it. FIA, as a private, market oriented operation, would not face the constraints being experienced by FINAVI. BANFINAN was a commercial bank at the time of its bankruptcy. It had operated satisfactorily as a financiera for about ten years before becoming a bank. More than five years after becoming a bank it developed liquidity problems similar to those being experienced by many Honduran banks over the last few years due largely to new and unforeseen factors in world money markets. While fraud played a major role in creating its financial difficulties, its problems might have been soluble directly with its creditors had it not been for precipitous and ill-advised Central Bank action in forcing it into bankruptcy. As a private commercial organization, FIA will not be subject to this kind of Central Bank action. CONADI's problems stem from a variety of factors. First, the influence of the previous government on CONADI's operations was detrimental to its development. Second, the GOH appointed managers and key staff of CONADI have not been experienced bankers. Third, and partially as a result of the first two, CONADI never developed an appropriate financial strategy - it borrowed on short terms at high interest and lent on long terms without

sufficient spread. Fourth, because CONADI was a government owned institution, some of its borrowers did not feel compelled to repay their loans. Finally, world market conditions have unexpectedly contributed to the financial difficulty of CONADI's major borrowers, especially those in sugar and hotels. FIA will be completely private, managed by an experienced banker, and invest mainly in enterprises that produce for the internal market.

In sum, FIA is significantly different from the previous efforts in that it builds on the existing private banking structure in a way that will help it do its job better and more profitably. Previous financieras operated as parallel organizations, in two cases completely or partially government owned, which competed with the banking structure for lending resources. The Mission believes that such efforts, while noble in purpose, had a high risk of failure in part because the existing banking structure had every incentive to kill off the competition instead of supporting it. By having the banking system own FIA, this risk will be significantly lessened. Moreover, financieras similar to the one proposed here have been started in other countries by private banks precisely because their own internal lending regulations or the regulations of the countries in which they operate forced them to turn away otherwise bankable customers to whom they could not profitably lend. They developed financieras in order to meet a specific market demand which they could not meet through normal banking operations. As such, the approach has already been proven commercially viable, which we believe further reduces the risk of failure.

Another of the issues in effect asks, "if it's such a good idea, why haven't the banks already done it? Why do they need A.I.D. funds as encouragement?" There is a clear rationale for A.I.D. support: to encourage bankers to expand their services to a group they would not likely serve even if there were sufficient liquidity in the banking system. Given the innate conservatism of Honduran bankers, and their current preoccupation for keeping their banks afloat, it is highly unlikely that they would start up the kind of effort envisioned here without an outside stimulus. Were they to do so, it is improbable in our view that small and medium scale entrepreneurs would be their clients. The more likely prospect is that such a financiera would be a new tool for escaping the rigidities imposed by the Central Bank, not an attempt to open up the banking system to a new set of clients as envisioned in the project design. We believe that the way to get the system opened up is precisely through the negotiating for a commitment on the part of the banks to increase their services to the large number of small and medium entrepreneurs in a way that will be profitable for them, while ensuring through the technical assistance activities that clients from the target group will be able to meet those requirements.

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The possibility that banks will over time change their attitudes and requirements and increase their lending to small enterprises on their own is in our view highly improbable. If liquidity were to increase dramatically, they would probably reduce interest rates for their already established clients. The Mission's experience in attempting to develop the credit activity of the Agricultural Credit Project illustrated some of the problems involved. In that effort, the Mission attempted to convince the Central Bank and the private bankers that it was in their own best interests and the country's best interest to move to a competitive system of interest rates. That would have helped to remove the cost barrier to lending to small entrepreneurs by allowing interest rates to reflect the real costs of such lending. In addition, it would have created the potential for effective resource mobilization which would have increased the lending resources of the banks and enabled them to address the needs of bankable clients who are now "frozen out" by the traditionally conservative bank's credit policies. The effort fell apart when the private bankers, who are mostly "empirical bankers" in the words of one highly professional local banker, objected to the Central Bank that such a scheme would ruin them financially and create a strong negative backlash from their clients. Heeding these objections, the Central Bank declined to further pursue the project, despite its urgent need for the foreign exchange that it would have received.

On the other hand, there are forces at work to reduce the rigidities in the money market system of Honduras. This project is part of a revised USAID strategy to break down resistance to higher interest rates in specific cases where opportunities permit. The Central Bank remains open to consider further liberalization of banking regulations, including interest rates, as evidenced by the negotiated rates that are being applied to private sector credit financed with local currency generations under the recently signed ESF Agreement (522-0230). In addition, the GOH has agreed with the IMF to consider further liberalization of interest rates. Finally, to the extent that world interest rate levels decline and this in turn affects the Honduran economy, it is conceivable that a Honduran "prime rate" of less than the current 19% maximum may develop. If the authorities can be convinced to keep the ceiling at the present level, a situation could develop in which a structure of interest rates could emerge underneath a ceiling which would be essentially ineffective. While complete liberalization may occur eventually, the Mission has concluded that, for the near future at least, Honduras will continue to have at least nominally controlled interest rates and liquidity will remain tight. Even if a moderate degree of liberalization should occur, the possibilities for opening up the regular banking system to new clients will be very limited. It is difficult to imagine a change in bankers' attitudes regarding small businesses without an outside impetus. The proposed project will make it possible to meet the needs of small and medium scale businesses by creating an institution dedicated exclusively to serve their needs. It will have the added benefit of increasing the possibility of a future liberalization of

the banking system by demonstrating in fact that some of the commonly held perceptions of bankers regarding small entrepreneurs and the desirability of higher interest rates may be partially or wholly erroneous.

The Lazar to Cauterucci letter raises the possibility of a Productive Credit Guarantee System being incorporated into the project design. In fact, two of the banks with whom we spoke suggested that a guarantee system might be a desirable complement to the SBF. The Mission believes that the project makes such a system unnecessary by enabling credit to be provided in a way that makes risk neutralization mechanisms such as a PCGP unnecessary. Furthermore, it is our belief that a guarantee system can only be effective when there is excess liquidity in the banking system. It is unlikely that there could be more than a temporary excess of liquidity in the Honduran banking system, which in any event could not help to solve the need of long term financing. Finally, having twice attempted unsuccessfully to implement productive guarantee systems in Honduras under the authority provided under Section 222A of the FAA, we are not inclined to try again. For all of these reasons, we do not believe that it makes sense to try to implement a PCGP in Honduras at this time. Should the Honduran banking community or the SBF shareholders raise this possibility with us again, we would propose to have the banks design their own guarantee system and commit themselves to implement it. Were they to do so, A.I.D. could then review the system and determine if it would be eligible for USG backing under Section 222A. If so, an agreement could be negotiated and signed on that basis.

The relationship between technical assistance and meeting credit needs is much too complex to be dealt with adequately here. Clearly, not every small entrepreneur who needs credit will also need technical assistance. The reverse is also true: not every entrepreneur who needs technical assistance will also need, want, and be able to qualify for credit. Our perception is that programs which have provided technical assistance in most developing countries have defined needs in terms of what they could provide. The system proposed in the project design will provide for a much more flexible system of assessing needs and would enable potential clients to look to several assistance providers to find the best fit between their needs and the available services. We are certain that there is a strong need for technical assistance among small entrepreneurs. Matching those needs to the right kind of services is the key to ensuring maximum benefit to the clients and to facilitating their entry into the formal financial intermediation system.

Illustrative FIA Projects 1/

NAME OF FIRM	INTERVIEWEE	PRESENT PRODUCTS	PROJECT	FINANCING REQUIRED (000)	US\$
SAN PEDRO SULA					
1) Artículos Nacionales de Aluminio	Fernando Naranjo	Aluminum Cookware	Pressure Cookers, Teflon Coating for cookware	Raw Materials, equipment	450.0
2) Técnica Industrial y maquinado	Fernando Naranjo	Mechanical gears, various machine parts	Expansion	equipment	150.0
3) Zippers de Honduras	Nedando Ripalo	Zippers	Expansion	Raw Materials	150.0
4) Group of Zippers de Honduras/Hermacasa/Ind. Corona	Nedando Ripalo	Various	New assembly plant for bicycles	Total investment	950.0
5) Industrias Chamer	Carlos Chahin Nicolas Chahin Mario Araujo	Cosmetic, detergents	Bathing Soap	Total Investment	1,750.0
6) Textiles Red Point	Juan Carbajal	Socks, underwear	Expansion	Total Investment	460.0
7) Apiarios de Honduras	Hector Guillen	Bee honey and related products (packaged honey)	-0-	Working Capital	35.0

Best Available Document

NAME OF FIRM	INTERVIEWEE	PRESENT PRODUCTS	PROJECT	FINANCING REQUIRED (000)	US\$
8) Supermercado FRANZEN	Henry Franzen	Pepper, Lea & Perrins sauce	Cracker Jacks, Mayonnaise, Coffee Cream, Instant Coffee, Vinegar (Natural), Corn Flour	Total Investment	250.0
9) Sole Partnership	Donaldo Suazo	Permanent Agriculture (coffee, cacao, avocados)	Coffee drying oven	Sales credit	300.0
10) Industrias Metalicas	Senor Caballero	Structural beams	Irrigation pipes	raw materials, equipment	350.0
11) FERTIAGRO	- . -	Fertilizer (bagging and mixing operation)	Expansion	Storage Facility	100.0
12) EXCAHO	José Andonie Arnulfo Gutierrez	Coffee	Aguafinca (purchase of shrimp farm)	Total Investment equity	500.0
SUB-TOTAL					5,245.0

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NAME OF FIRM	INTERVIEWEE	PRESENT PRODUCTS	PROJECT	FINANCING REQUIRED (000) US\$	
TEGUCIGALPA					
14) Industria Lechera Delta/Frigoríficos	Miguel C. Bendeck	Pasturized milk, orange juice, paper plates and cups	shovels and machetes, pine oil, orange juice concentrate	Total investment Total investment Total investment	200.0 500.0 600.0
15) Honduran/American Chamber of Commerce	Guillermo Hernández	- . -	Charcoal brickets, Rice husks bricketting	Total investment Total investment	200.0 894.0
16) NOVATEC	Edwin Mandal	PVC tubes	Expansion/Electrical conductors	Total investment	2,500.0
17) CAMACO	Francisco Maradiaga	Construction/retai	lute sacks and tannary	- 0 -	- 0 -
18) Industrias Cosméticos	Gunther Hedwig	Cosmetics	Expansion/Insecticides Household cleaners	Total investment	285.0
19) Honduras Regiplast	Dagoberto Odeh	Plastic bags	- 0 -	Refinancing of debts	2,000.0
20) La Constancia, Cia. de Ahorro y Préstamo	Carlos Orbis	- 0 -	Shirt manufacturing	Total investment	150.0
21) Aserradero Jamalteca	Augusto Vidal C.	Sawmill	- 0 -	Working Capital	50.0
22) Compañía Naviera Maya Line	Marco A. Aguero	Ocean freight carrier	- 0 -	Working Capital	360.0

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NAME OF FIRM	INTERVIEWEE	PRESENT PRODUCTS	PROJECT	FINANCING REQUIRED (000)	US\$
23) CAPRISA	Helen Cordova	Shoes	Expansion	Total investment	300.0
24) Rivera y Asociados	Miguel Rivera	House construction	- 0 -	Working Capital	
25) Distribuidora Itsmania	Raúl Torres Lazo	Wholesaler	Toilet paper	Total investment	
26) Leogarcía, Casanova, Arquitectos	Leonidas García	Construction	Wood panels	Total investment	
27) RYCO	Senor López	Department Store/drugs	- 0 -	Working Capital	150.0
28) FEHCIL	Guillermo Echeverría	Federation of Manufacturing Cooperatives	Retail stores (22)	Total investment	650.0
29) Leatherleaf Farnery	Robert Ware		Ornamental plants	Total investment	150.0
30) Asociación Nacional de Pequeños y Media- nos Empresarios (ANMPI)	Several Members of ANMPI	Various types of manufactured goods and handcrafts	- 0 -	Working Capital and fixed investment	
SUB-TOTAL					8,989.0
TOTAL					14,234.0

1/Based on interviews conducted by Project Team.

ILLUSTRATIVE FIA PROJECTS 1/

NAME OF ENTREPRENEUR/FIRM	TYPE OF BUSINESS	PLACE OF BUSINESS	FINANCING REQUIRED (Amount US\$000)
1) Javier Barahona	Print Shop	Tegucigalpa	7.0
2) Siles Hernández	Hogs feed cor	Choluteca	2.5
3) Sedalco	Animal food	Catacamas	50.0
4) Wilfredo Sevilla	Print Shop	Tegucigalpa	5.0
5) Julio C. Zepeda	Floor files & bricks	Siguatepeque	12.5
TOTAL			77.0

1/Potential FIA clients identified by the Instituto Hondureño de Desarrollo (IDH). This are small businessman who have received financial and technical assistance from IDH.

TABLE No. 1

PRO-FORMA INCOME STATEMENT
(L.000)

	<u>1</u>	<u>2</u>	<u>3</u>	<u>4</u>	<u>5</u>	<u>6</u>	<u>7</u>	<u>8</u>
INCOME								
Interests <u>1/</u>	1,680.0	2,310.0	2,730.0	2,961.0	3,607.0	4,688.0	5,423.0	5,911.0
Fees & Commissions <u>2/</u>	70.0	90.0	110.0	130.0	150.0	170.0	190.0	210.0
Total Income	1,750.0	2,400.0	2,840.0	3,091.0	3,757.0	4,858.0	5,613.0	6,121.0
EXPENSES								
Administration Expenses <u>3/</u>	208.4	270.4	351.5	457.0	594.1	746.3	1,004.0	1,305.2
Interest on AID Loan <u>4/</u>	494.0	819.0	1,040.0	1,040.0	1,040.0	1,040.0	1,040.0	1,040.0
Interest on Banks Loan <u>5/</u>	760.0	760.0	760.0	760.0	750.0	760.0	760.0	760.0
Depreciation	9.4	9.4	17.4	17.4	17.4	17.4	17.4	17.4
Sub-Total	1,471.8	1,858.8	2,168.9	2,274.4	2,410.9	2,563.7	2,821.4	3,122.6
Loan Reserves <u>6/</u>	240.0	321.0	357.0	337.5	360.7	564.7	705.0	807.0
Total Expenses	1,711.8	2,179.8	2,525.9	2,611.9	2,772.2	3,128.4	3,526.4	3,929.6
INCOME BEFORE TAXES	38.2	220.2	314.1	479.1	984.8	1,729.6	2,086.6	2,191.4
Taxes <u>7/</u>	9.5	66.1	94.2	143.7	295.4	518.9	625.9	657.4
Income after Taxes	28.6	154.1	219.9	335.4	689.4	1,210.7	1,460.6	1,533.9
Dividends <u>8/</u>	-.-	-.-	-.-	-.-	344.7	605.4	730.3	766.9
Capital Reserves	28.6	182.7	402.6	738.0	1,087.7	1,688.1	2,418.4	3,185.3

1/See Table No. 9.

2/See Table No. 6.

3/See Table No. 5.

4/Estimated at 13%

5/Estimated at 19%

6/See Table No. 9

7/Estimated at 25% for first year and 30% on income of the subsequent years.

8/Estimated at 50% of income after taxes.

OP

TABLE No. 2

CASH - FLOW
Lps. (000)

CONCEPT	YEAR	1	2	3	4	5	6	7	8
INFLOWS									
Cash at Beginning		--	515.9	1,309.8	2,681.5	5,354.2	8,174.4	7,734.2	8,029.4
AID Loan 1/		3,800.0	2,500.0	1,700.0	--	--	--	--	--
Bank Loans 2/		4,000.0	--	--	--	--	--	--	--
Equity		500.0	500.0	--	--	--	--	--	--
Interests 3/		1,680.0	2,310.0	2,730.0	2,961.0	3,607.0	4,688.0	5,423.0	5,911.0
Fees and Commissions 4/		70.0	90.0	110.0	130.0	150.0	170.0	190.0	210.0
Depreciations		9.4	9.4	17.4	17.4	17.4	17.4	17.4	17.4
TOTAL INFLOWS		10,059.4	5,923.3	5,867.2	5,789.9	9,351.6	13,054.8	13,364.5	11,150.4
OUTFLOWS									
Administrative Expenses 5/		208.4	270.4	351.5	457.0	544.1	746.3	1,004.0	1,305.2
Interests on AID Loan		494.0	819.0	1,040.0	1,040.0	1,040.0	1,040.0	1,040.0	1,040.0
Interests on Bank Loans		760.0	760.0	760.0	760.0	760.0	760.0	760.0	760.0
Equipment purchases 6/		71.5	--	40.0	--	--	--	--	--
Taxes		9.5	66.1	94.2	143.7	193.4	518.9	625.9	657.4
Dividends		--	--	--	--	344.7	605.4	730.3	766.9
TOTAL OUTFLOWS		1,543.5	1,915.5	2,285.7	2,400.7	3,034.2	3,670.6	4,160.2	4,529.5
INFLOWS/OUTFLOWS BALANCE		8,515.9	4,009.8	3,581.5	3,389.2	6,317.4	9,384.2	9,204.4	6,620.9
LOANS 9/									
Placement		8,000.0	3,000.0	2,000.0	1,100.0	3,075.0	5,150.0	3,500.0	2,325.0
Collection		--	300.0	1,100.0	3,075.0	3,150.0	3,500.0	2,325.0	1,250.0
Loans Balance (+/-)		-8,000.0	-2,700.0	-900.0	1,975.0	2,075.0	-1,650.0	-1,175.0	-1,075.0
CASH - END OF YEAR		515.9	1,309.8	2,681.5	5,354.2	8,174.4	7,734.2	8,029.4	5,545.5

1/AID loan for 18.0 million is disbursed in a 3 year period and enjoys an 8 year grace period.

2/Bank loans are offered to FINSA as a revolving credit line.

3/See Table No. 9.

4/See Table No. 6.

5/See Table No. 5.

6/See Table No. 4.

7/See Table No. 3.

4/6

TABLE No. 3
INTERNAL RATE OF RETURN
(L.000)

	0	1	2	3	4	5	6	7	8	
Cash Flow	(13,000.0)	515.9	1,309.8	2,681.5	5,364.2	8,179.4	7,734.2	2,029.4	5,545.9	
PVIF at 23%		.8130	.6500	.5374	.4369	.3552	.2888	.2348	.1909	
PV at 23%	152.7	419.4	865.8	1,441.0	2,343.6	2,905.3	2,233.6	1,885.3	1,058.7	13,152.7
PVIF at 24%		.8065	.6504	.5245	.4230	.3411	.2751	.2218	.1789	
PV at 24%	(367.5)	416.1	851.9	1,406.4	2,269.0	2,788.3	2,127.7	1,780.9	992.2	12,632.5

IRR = 23%-24%

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TABLE No. 4

FIRST YEAR EQUIPMENT PURCHASES AND INSTALLATION EXPENSES
(Lempiras)

<u>EQUIPMENT DESCRIPTION</u>	<u>No.</u>	<u>Unit Value</u>	<u>Total</u>
Desks	2	750.00	1,500.00
Secretarial Desk	1	750.00	750.00
Waiting Room Chairs	6	250.00	1,500.00
Air Conditioner	1	1,500.00	1,500.00
Calculators	2	300.00	600.00
Telephones	3	300.00	900.00
File cabinets	4	400.00	1,600.00
Safety Box	1	5,000.00	5,000.00
Desk chairs	2	500.00	1,000.00
Secretarial Chair	1	300.00	300.00
Other furniture	2	700.00	1,400.00
Sub-Total			<u>16,050.00</u>
Contingencies (15%)			<u>2,407.00</u>
Automobile ^{1/}	1	35,000.00	35,000.00
Sub-Total			<u>51,050.00</u>
 <u>INSTALLATION EXPENSES</u>			
Office Remodeling			5,500.00
Publicity			15,000.00
Total			<u>71,550.00</u>
 <u>DEPRECIATION PER YEAR</u>			
Automobile (5 years)			7,000.00
All Other (10%)			2,400.00
Total			<u>9,400.00</u>

^{1/}It is estimated that an additional authomovil will be purchased in Year 3 of the Project.

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TABLE No. 5
FIRST YEAR ADMINISTRATIVE EXPENSES 1/
(Lempiras)

<u>STAFFING</u>	<u>MONTH</u>	<u>ANNUAL</u>
General Manager	7,000.00	84,000.00
Loan Officer	3,500.00	42,000.00
Secretary	500.00	6,000.00
Bookkeeper	800.00	9,600.00
Sub-Total	<u>11,800.00</u>	<u>141,600.00</u>
Social Benefits (8%)	944.00	11,328.00
Sub-Total	<u>12,744.00</u>	<u>152,928.00</u>
 <u>OTHER EXPENSES</u>		
Office rent	2,000.00	24,000.00
Water	100.00	1,200.00
Electricity	300.00	3,600.00
Telephone	500.00	6,000.00
Office materials	1,000.00	12,000.00
Computer services	500.00	6,000.00
Sub-Total	<u>4,400.00</u>	<u>52,800.00</u>
Contingencies (5%)	220.00	2,640.00
Total	<u>17,364.00</u>	<u>208,368.00</u>

1/It is estimated that Administrative Expenses will grow at 30% per year due to hiring of additional loan officers and purchase of office equipment

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TABLE No. 6
ESTIMATED VALUE OF SERVICES
(L.000)

CONCEPT	YEAR	1	2	3	4	5	6	7	8
Letters of Credit		2,500.0	3,000.0	3,500.0	4,000.0	4,500.0	5,000.0	5,500.0	6,000.0
Guarantees		1,000.0	1,500.0	2,000.0	2,500.0	3,000.0	3,500.0	4,000.0	4,500.0
TOTAL		3,500.0	4,500.0	5,500.0	6,500.0	7,500.0	8,500.0	9,500.0	10,500.0
Service Charge (2%)		70.0	90.0	110.0	130.0	150.0	170.0	190.0	210.0

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TABLE No. 7

PLACEMENT OF LOANS FOR INITIAL PROJECT FUNDS 1/
(L.000)

CONCEPT	COLLECTION YEAR 2		3			4			5			6			7			TOTAL No. Amount					
	Maturity 1		2		3		4		5		6		7										
	No. Loan	Av. V	No. Loan	Av. V	No. Loan	Av. V	No. Loan	Av. V	No. Loan	Av. V	No. Loan	Av. V	No. Loan	Av. V									
FIRST YEAR 2/																							
Cofinancing:							10	150.0	1,500.0														
Direct Loans:																							
Working Capital	8	37.5	300	8	62.5	500.0	4	100.0	400.0								20	1,200.0					
Fixed Investment				2	50.0	100.0	4	75.0	300.0	4	100.0	400.0					10	800.0					
Total-Loans/Amount	8		300	10		600.0	18		2,200.0	19		3,400.0	5		1,500.0		60	8,000.0					
SECOND YEAR																							
CONCEPT	Maturity		1			2			3			4			5								
Direct Loans																							
Working Capital				20	12.5	250.0	10	37.5	375.0	10	62.5	625.0					50	1,500.0					
Fixed Investment				10	25.0	250.0				4	37.5	150.0	6	50.0	300.0	6	75.0	450.0	6	100.0	600	22	1,500.0
Total Loans/Amount				30		500.0	14		525.0	16		925.0	6		450.0	6		600	72	3,000.0			
THIRD YEAR 3/																							
CONCEPT	Maturity		1			2			3			4											
Direct Loans																							
Working Capital				8	25.0	200.0	6	37.5	225.0	6	62.5	375.0					20	800.0					
Fixed Investment							4	37.5	150.0	6	50.0	300.0	6	75.0	450.0	6	100.0	600	16	900.0			
Total Loans/Amount				8		200.0	10		375.0	12		675.0	6		450.0	6		600	36	1,700.0			
GRAND TOTAL	8		300.0	40		1,100.0	40		2,925.0	45		4,700.0	23		2,625.0	12		1,050.0	168	12,700.0			

1/Estimated distribution of loans from initial lending resources.

2/The largest portion of initial lending resources is placed in Year 1 due to the cofinancing for which the shareholder banks act as loan agents.

3/Does not include the lending of reflows generated by collection of loans at maturity, which in Year 3 amounted to L300.0. See Table No. 9.

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TABLE No. 8
SUMMARY OF LOANS 1/
(L.000)

	1		2		3		4		5		6		7		8	
	AMOUNT	No. LOANS	AMOUNT	No. LOANS	AMOUNT	No. LOANS	AMOUNT	No. LOANS	AMOUNT	No. LOANS	AMOUNT	No. LOANS	AMOUNT	No. LOANS	AMOUNT	No. LOANS
ed Investment	6,800.0	40	1,500.0	22	900.0	16	50.0	2	1,950.0	18	3,850.0	29	2,250.0	17	1,050.0	12
cing Capital	1,200.0	20	1,500.0	50	1,100.0	28	1,000.0	38	1,125.0	24	1,300.0	21	1,250.0	16	1,275.0	12
Sub-Total	8,000.0	60	3,000.0	72	2,000.0	44	1,100.0	40	3,075.0	42	5,150.0	50	3,500.0	33	2,325.0	24
TOTAL	8,000.0	60	11,000.0	132	13,000.0	176	14,100.0	216	17,175.0	258	22,325.0	308	25,825.0	341	28,150.0	365

1/Beginning in Year 3, the loans are based on collection of principal (excluding interests) from matured loans placed during first three years. It is assumed that loans from the reflows are extended on the same terms and conditions as loans of first three years (See Table 7).

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TABLE No. 9

Lps. (000)

! YEAR !	! ANNUAL PLACEMENTS 1/ !	! ANNUAL COLLECTIONS 2/ !	! ACCUMULATED LOANS !	! INTEREST RATE 3/ !	! OUTSTANDING LOANS !	! LOAN RESERVES 4/ !
	8,000.0	1,250.0	11,150.0	5,423.0	22,900.0	807.0
1	8,000.0		8,000.0	1,680.0	8,000.0	240.0
2	3,000.0	300.0	11,000.0	2,310.0	10,700.0	321.0
3	2,000.0	1,100.0	13,000.0	2,730.0	11,900.0	357.0
4	1,100.0	3,075.0	14,100.0	2,961.0	11,025.0	337.5
5	3,075.0	5,150.0	17,175.0	3,607.0	12,025.0	360.7
6	5,150.0	3,500.0	22,325.0	4,688.0	18,825.0	564.7
7	3,500.0	2,235.0	25,825.0	5,423.0	23,500.0	705.0
8	2,235.0	1,250.0	28,150.0	5,911.0	26,900.0	807.0

1/See Table 8.

2/Loan collections are estimated on the basis of Loan maturities.

3/The interest charge is 21%.

4/Estimated as 3% of outstanding loans.

Small Business Collateral

SUMMARY OF RESPONSES TO QUESTIONS ON LEGAL STATUS OF ASSETS

PHYSICAL ASSETS	OWN	RENT	LEGAL STATUS* OF LAND	EVIDENCE OF OWNERSHIP!				LIENS
				EP	DP	FC	OTHER	
1. Land & Buildings								
Land	7		4	5				1
Buildings	7	2		5				1
Residence	8			6				6
Farm	2			1				
Rental Property								
Other								
2. Machinery & Equip.								
Machinery	9				1	5		
Equipment	5						4	
Vehicles	7							
3. Inventories								
Raw Materials	5					2		
Finished Goods	3							
4. Financial Assets								
Receivables	4					3		
Sales Contracts								
Patents, Trademarks	1							
Licencing Agree.								
Distributorship								
Stocks/Bonds	1							
Other								

E.P. = Escritura Pública (Notorized Legal Document)

D.P. = Documento Privado (Private Legal Document)

F.C. = Factura Comercial (Invoice)

*Land held in full legal order

Sample of 10 businesses interview May 4-8, 1983 by Ramón Medina Luna and J. Hochschwender.

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SUMMARY OF RESPONSES ON LEGAL STATUS OF ENTERPRISE

NAME OF FIRM	BUSINESS ACTIVITY/ PRODUCT LINE	TYPE OF BUSINESS			LEGAL STRUCTURE			
		COMMERCE	INDUSTRY	SERVICE	S.A.	S.deR.L.	C.I.	OTHER
1) Zapateria Lolo	Shoemaker			X			X	CMDC
2) INHOLA	Pencils		X			X		CMDC
3) Creaciones Suyapa	Chalk figures/retailer	X	X				X	CMDC
4) Almacen Sn Miguel	Fabrics wholesaler	X				X		CMDC
5) Fabrica Italia	Sweater manufacturer		X			X		
6) Panaderia Suyapa	Bakery		X					CMDC
7) Panaderia El Hogar	Bakery			X				None
8) Estilmoda	Tailor			X				None
9) Sast. La Juventud	Tailor		X				X	CMDC
10) Ladrilleria Hond.	Floor tiles		X					Ncne

S.A. = Sociedad Anônima
SdeR.L. = Sociedad de Responsabilidad Limitada
C.I. = Comerciante Individual
CMDC = Consejo Metropolitano del Distrito Central

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NOTES:

1. The enterprises interviewed were of small to medium size, mostly employing 5-19 workers. Only two had each 20 and 21 employees.
2. The ownership of the assets was under the name of the entrepreneur, or a close relative by blood or marriage.
3. Only the enterprises organized under the corporate form of Sociedad de Responsabilidad Limitada (Limited Corporation), reported having assets registered under the corporate name.
4. The value figures of the assets varied a lot among the enterprises interviewed. The higher values reported were in land and buildings, usually in the range of \$10,000 to 60,000; one reporting a value as high as \$250,000. Mostly the machinery had values as low as \$500 and up to \$20,000; again, one enterprise had machinery valued at \$75,000. The other significant asset value was represented by vehicles, some of which were old enough to be completely depreciated, but had current market values.
5. Most of the entrepreneurs interviewed have had access to small personal loans from two private banks or public credit institutions. However, it became evident that the credit was not sufficient. They complained about difficulties in meeting bank loan requirements.

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SUPPORTING SMALL ENTERPRISES

**Orlando Hernández
PCR-AID
June 1983**

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SUPPORTING SMALL SCALE ENTERPRISES

1. General Description of Smaller Industries in Honduras

1.1. Role of Small Scale Enterprises in the Honduran Economy

It is generally accepted that small scale enterprises (SSE) have a vital role in the economies of developing countries. Kaghavan and Timberg (1982) have discussed the contribution of SSE to employment and production in Third World nations, and Kamaluddin (1982) has suggested that "they (can) act as an excellent vehicle for employment expansion, decentralized economic development and rational distribution of wealth and income." In opposition to larger enterprises, SSEs usually (a) require less fixed investment and working capital to operate, (b) generate more employment because they tend to use labor intensive and/or intermediate technologies, (c) generally use local inputs and raw materials thus permitting the expansion of marketing opportunities for local suppliers and the prevention the drainage of scarce foreign exchange reserves, and (d) create more value added.

Honduran small industry represents no exception to the rule. The Manufacturing Census of 1975 and projections from the Artisan Industry Census, published as part of the Housing Census of 1974, provide basic information that can be used to define the role of SSEs in Honduras. Tables 1 through 10, included as an Annex to this report, give us an indication of the general characteristics of the manufacturing sector in the country for that year. Classifying data for most of the discussed variables by industry size and type, these tables provide information with respect to (a) number of enterprises, (b) number of employees, (c) technological level expressed in terms of fixed investment per workers, (d) employment creation costs, (e) origin of inputs and raw materials, and (f) value added.

For the purposes of this discussion, and essentially as a consequence of the difficulty of grouping the data otherwise, industry size will be defined in terms of number of permanent employees. We will work with four size categories: artisanry, small, medium and large enterprises. As an average, artisan industries have 1.35 workers, small industries have 10, medium size industries have 15 and large have 239. Industry types, on the other hand, will be defined in terms of commodities produced. We will work with three types of industries: traditional, intermediate and light metal enterprises. Traditional industries produce consumer goods (e.g., manufactured foodstuffs, drinks, tobacco, textiles, clothes, shoes, hide and leather, lumber, timber and wood furniture). Intermediate industries produce essentially industrial goods and inputs (e.g., paper, carton and cardboard; rubber, chemicals, oil derivatives and non-metallic minerals as cement). Light metal industries produce metal furniture, metal structures for the construction industry and metal parts for machinery and equipment.

From the information presented in these tables we can draw the following conclusions.

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- (1) In 1975, manufacturing firms in Honduras were essentially small enterprises dedicated to the production of consumer goods. 99% of those enterprises had an average of 1.35 workers, and 92% of them produced what we have named traditional commodities. Despite their size, nevertheless, they employed 62% of the industrial labor force.
- (2) No information is available with respect to average gross investments per worker for the artisan sector. Nevertheless, for all other size categories considered, that investment is lowest in the case of small industries and it is highest in the case of larger industries. Medium size industries occupy an intermediate position. That is, gross fixed investments per worker averaged \$7,050 for smaller industries, \$14,110 in the case of medium size industries, and \$17,690 in the case of larger enterprises. This means that there is a direct relationship between industry size and the cost per job created. That is, the bigger the enterprise, the higher the fixed investment needed to create a job. It also means that the level of technology used in the larger firms was more capital intensive than that found in the smaller ones.
- (3) No information is available with respect to the origin of industrial inputs and raw materials by size of industries. Existing data on this question has been compiled only in terms of types of industries. As it could be expected, however, these data indicate that approximately 69% of the industrial inputs and 67% of the raw materials used by traditional industries are produced in Honduras. Conversely, about 73% of industrial inputs and 89% of raw materials used by intermediate and light metal industries were imported from outside the Central American region. Given that 92% of artisan and small industries produce traditional commodities we can only conclude that the smaller the industry the higher the possibility that local resources are being used in the manufacturing process. The situation would be totally the opposite in the case of the larger enterprises.
- (4) The artisan and small industries account for approximately 32% of the gross value added at the cost of factors in 1975. This could be considered disproportionate given the percentage of artisan and small industries in the country at that time. Nevertheless, this figure should be interpreted with care. Value added is related to the production capacity and output of enterprises, and it is obvious that larger and more capital intensive industries may not only have more production capacity but in reality be accounting for a larger proportion of production output. The output/capital ratio, which is the value added divided by the value of capital services, can give us a clearer idea of the importance of artisan and smaller industries in the creation of national wealth. Due to certain information lacunas with respect to the artisan sector such ratio cannot be provided for the micro-industries. Nevertheless, when the remaining size categories are considered it becomes obvious that the smaller the

enterprise the higher the value added performance. As indicated in Table No. 9 of the included annex, the output/capital ratio is respectively equal to 0.53 and 0.42 in the case of small and large enterprises.

Programs in support of smaller industries in Honduras would have important implications with respect to the use of local raw materials and labor. In addition, it would also imply fostering industries that can generate more value added.

1.2. General Socio-Economic Characteristics of the Small Entrepreneur

1.2.1. Basic Data

A survey of small urban enterprises was conducted by Merschrod in 1977. For sample selection purposes, small industries were defined as manufacturing firms having less than 30 permanent employees. A total number of 221 industries were visited. Firms were located in seven different cities throughout the country. The sample included both members and non-members of the then called National Association of Small Enterprises (ANPI). The selection of ANPI members was done randomly, and these subjects provided references for the selection of non-members. Table No. 11 of the Annex summarizes the characteristics of the sample in terms of location, type of industry and status with respect to ANPI membership.

From this table we can deduce that 15% of the firms visited were located in towns under 10,000 inhabitants; 46% were located in towns having from 10,000 to 40,000 inhabitants; and 39% were located in towns above the latter breaking point. In addition, 93% of these firms produced what we have previously called traditional commodities. In order of importance, the most commonly visited enterprises were clothes, shoe and wood furniture factories.

The Merschrod study reported to us that 95% of the small entrepreneurs interviewed were males having an average age of 41.4 years and a mean of 5.7 years of primary education. Within the sample, nevertheless, 58% had more than six years of schooling and out of that proportion 11% had gone beyond secondary school. In addition, 7% of them came from families dedicated to agricultural activities (e.g., farmers or wage earners) which were settled for their most part in municipal seats. According to Merschrod (1977), most of the entrepreneurs interviewed established their businesses either in the towns where they had grown up or in nearby cities which were larger in size. From this information we can deduce that contrary to small rural entrepreneurs studied by Kelley (1977) who were essentially women usually generating a second income to the family, small urban entrepreneurs are family heads, relatively well educated according to Honduran standards where only 1 out of 2 persons has just 2 years of schooling, and self-starters. Given the data presented by Merschrod we must rule out the possibility that they are essentially rural migrants, and that they are second generation businessmen that have inherited a patrimony and decided to follow their parents' example.

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Entrepreneurs started their businesses when they were approximately 35 years old. 75% of the interviewed subjects reported having held a job before opening up their own enterprise, and only the remaining 25% started the business with little or limited previous experience. In the case of those that worked previously to initiating their own companies, 80% held jobs in firms manufacturing the same commodities they were producing when interviews were conducted. 90% of those having held jobs in similar commodity producing companies worked as laborers, 7% worked as office clerks or foremen, and 2% worked as salesmen.

At the time the survey was conducted, interviewed firms had been in operation during a mean period of 6.7 years. Nevertheless, the distribution was skewed to the left and the mode was in fact equal to 3 years. Only 25% of subjects reported to have had an enterprise producing different commodities in the past. When new types of businesses were started, they were usually opened up in the same town. People that went into different manufacturing activities show little geographical mobility as only 15% of those that began a different enterprise moved to another town.

1.2.2. Possible Interpretations

It has been argued that in Honduras, as in other countries, what survives is the small entrepreneur but not the small enterprise. This argument is two-fold. On the one hand, it suggests that small enterprises have a limited life span given the conditions in which they operate. On the other hand, it proposes that small entrepreneurs are likely to initiate a new business, often a different one than that previously owned, once that they are financially capable of doing so. Interestingly enough, however, it is our impression that the data presented by Merschrod indicates otherwise. That is, the modal life of enterprises visited through that study (e.g., 3 years) should be interpreted with care. It may reflect not life expectancy, but rather the recent emergence of such firms. As mentioned earlier, only 25% of those interviewed by Merschrod reported having owned a different business before. Likewise, 25% of the visited entrepreneurs indicated that they went into business with little previous manufacturing experience. This should not be interpreted as a mere coincidence. Although we may not be dealing exactly with the same entrepreneur in each case, it is feasible to assume that there is a significant inverse relationship between business stability and technical background of owner at operations start-up. We do not have the raw data necessary to perform statistical analyses, but we believe that it is also precisely because of this relationship (1) that 75% of interviewed entrepreneurs had been trained as laborers usually in the field in which they operate and (2) that 75% of enterprises showed stability.

Small entrepreneurs are technical graduates of similar operations. We can hypothesize as Merschrod himself has suggested, that after a number of years that a laborer has been working in an enterprise he may become stagnant salary-wise, despite his technical expertise. Interested in social mobility, he decides to leave the company and to initiate his own. The separation pay

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which he may legally claim and obtain, together with personal loans from friends and/or relatives, would be invested in the new undertaking. It was of no surprise to us that the UNAH study mentioned in another section of the PP had reported that most entrepreneurs start up their businesses using their own funds. We do not want to refer to the economic implications that this may represent, as in doing so ex-laborers that become small entrepreneurs would be mobilizing financial resources that otherwise could be dedicated to non-productive activities. What is most important in this case is that separation payment may provide part of the seed capital for small firms to begin operating, and that the technical expertise of the new businessmen, acquired through practice, guarantees their survival. Only a socio-economic analysis of small enterprises can provide us with information regarding the performance of firms thus formed.

We must now turn to that analysis. We know that small enterprises are not necessarily productive, and we already know what keeps them from disappearing. We must now find out what keeps them from expanding.

1.3 The Economics of the Small Enterprise

1.3.1. Basic Data

The Merschrod survey was conducted previously to the study done by UNAH which raised the issue of seed capital in the case of small enterprises and to which we have already made reference. The data presented by Merschrod coincides in general terms with that reported by the UNAH study, although the tendencies are less marked. Merschrod has pointed out that 56% of the small entrepreneurs visited had only one source of funding at the time the initial investment was made. In addition, according to his findings in 78% of those cases a combination of family and personal funds were used, with 41% of the subjects in this situation reporting having used exclusively their own savings. In the case of combined funding, the most important secondary source was commercial credit. Companies that obtained external financial assistance were granted credits on 24-month terms as an average. Generally speaking, those than received complementary commercial credit invested it in fixed assets.

Contrary to what occurs in the case of small enterprises which are domestic firms usually operating within the homes of the owners, 64% of small urban firms were located in rented facilities. For the latter group, only 8% were in the process of making installment payments on their shops. 6% of those interviewed were using facilities for which they held usufruct rights.

Merschrod has pointed out that 65% of the interviewed subjects bought most of their raw materials in the same town and that 11% bought most of them within the same region where they worked. It must be pointed out, however, that not all locally or regionally obtained materials are produced in the same areas. Even as much as 20% of raw materials used may be imported from Central America or other parts of the world. This is particularly true in the case of

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shoe-makers and print shops. With respect to mechanisms used for the procurement of raw materials Merschrod has indicated that it is not uncommon among small entrepreneurs to have joined a cooperative with the purpose of insuring a permanent supply of raw materials and inputs at relatively lower prices. 29% of the visited subjects became cooperative members essentially for that reason. However, only 15% of them actually bought what they needed through these organizations. Existing cooperatives at that time tended to be deficient institutions, and 75% of the entrepreneurs were buying raw material and inputs on an individual basis from wholesalers. According to those interviewed, such middlemen sold commodities at reasonable prices, were geographically accessible and tended to be well stocked. Despite the preference to buy directly from the producer because of the prices offered, this was not always possible given distances and their lack of dependability.

Table No. 12 in the Annex summarizes the accounting practices of the entrepreneurs interviewed by Merschrod. The data is presented in terms of types of books kept and the system used for keeping different types of records. From the information presented in this table three basic conclusions can be drawn. One, 34% of those interviewed did not have any accounting system at all. Two, among those that did the most common records kept were of procurement and general expenditures. nevertheless, the registry system used was rather rudimentary inasmuch as entrepreneurs simply tended to keep loose receipts and only very rarely unbound leaves. And three, Payroll, Sales, Subsidiary and Monthly Double Entry Books were kept only by a small proportion of subjects. In these cases the registry system was more organized. Records were kept in either bound notebooks or formal books approved by municipalities. In other words, and as it could be expected, as the system becomes more complete it becomes more organized. Merschrod has argued that only about 30% of those visited kept organized and formal records.

75% of the entrepreneurs visited sold their production either in the same town or in the same municipality where they operated. Approximately 10% sold it in the same department, 9% sold it in other departments throughout the country and only the remaining 6% reported having access to international markets. The clientele of small entrepreneurs is composed essentially of peasants and employees of government and private agencies living in nearby towns. Generally speaking and for the whole sample, 60% of the production was sold directly to the consumer, 21% was sold to local retailers, 16% was sold to wholesalers and only 3% was sold directly to other factories. In addition 56% of the entrepreneurs sold commodities as they were produced, 40% worked under small orders, and only 3% sold directly to other factories under specific contracts. Interestingly enough, 50% of these businessmen sold their production on credit on two to eight week terms at no additional cost to the consumer.

With the purpose of determining the constraints faced by the small enterprise to the extent of hindering an "optimal" use of production factors, Merschrod asked small entrepreneurs what would happen to the firm if the demand for their products were to double.

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- (1) With respect to machinery, 28% said that no additional investments in fixed assets would be needed; 32% indicated that they would have to increase their installed capacity by about 50%, and 40% reported that their equipment would also have to double. In other words, only 40% were working full capacity. Of the remaining 60%, 32% were using about three quarters of their potential, and 28% were using only half.
- (2) With respect to labor, 15% said that the increased demand could be satisfied with the number of workers then employed; 14% indicated that the demand could be satisfied by asking the laborers to work overtime; and 71% indicated that they would need to hire new personnel. The latter group would have to increase their labor force by approximately 85%. According to these figures it would seem that at the time the interviews were conducted in a reduced number of cases the production capacity of the the labor force was under-utilized by 50%, but that in the in the majority of the cases it was under-utilized only by 15%. That is, in the majority of cases production increments would imply employment generation.
- (3) The supply of raw materials and inputs would represent a problem only to 18% of those interviewed. In order of importance those that would face difficulties would be carpenters, shoe-makers and metal shops. Carpenters reported problems in getting timber as most of the sawn wood was then being imported. Shoe-makers and metal shops confronted problems because some of the raw materials and inputs utilized were imported and they were not always available.
- (4) For the great majority of those visited, the greatest obstacle to satisfy the increased demand would be working capital. 71% considered financial difficulties to be crucial if production needed to be doubled. Because capitalization is not the characteristic among small enterprises, 75% of those anticipating financial constraints indicated that their only source of financing would be banks, and that they would have to apply either for a personal or a commercial loan. Only 5% of those interviewed indicated that they would turn to friends or relatives for financial assistance, and 4% indicated that they would use their own savings.

We need to point out in this discussion that the hypothetical question asked by Merschrod in his study has both advantages and disadvantages. Although it allows us to anticipate difficulties that small entrepreneurs would face with respect to inputs, credit, equipment and labor, it prevents us from understanding the commercial implications of doubling up production. The question is biased in that it assumes that there would be increased demand for products manufactured. And we believe that demand plays an important role in limiting the expansion of small enterprises. In order to understand the magnitude of the problem we must recall some of the data previously pointed out. First, 60% of the production of small enterprises is sold directly to the consumer. And second, in the majority of the cases this consumer is either a small farmer or a private or public employee living in the same town or in the nearby area where the firm is located. These data allow us to discard the

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hypothesis that small entrepreneurs, as it is the case with small farmers, confront a serious problem of intermediation to the point that the majority of the profits are obtained by either retailers or wholesalers and not the producer (Mejía, 1979). They are also useful in pointing out that one the greatest limitations to the expansion of small industries resides precisely in the elasticity of the market for which they are producing. Any policy or measure intended to support small entrepreneurs should take this into account, and allow beneficiaries to develop their commercial skills to be able to penetrate a market with limited buying capacity. Increasing demand may require going out of the municipio within which production is usually sold.

Merschrod was unable to obtain reliable information with respect to the profitability of small enterprises. This could come as no surprise particularly because a longitudinal study of small rural enterprises in Honduras demonstrated that when records were not kept entrepreneurs over-estimated profits generally by about 80%. In lack of information for their urban counterparts, we must make use of the information provided precisely by that longitudinal study for rural firms and extrapolate for other geographical areas and even for enterprises somewhat larger in size. Leidholm and Roeser (1981) analyzed the information obtained in the Orica-Olancho region over a 12-month period to determine the economic profitability of small manufacturing firms. In their calculations, the economic profit was obtained by subtracting from the return to the proprietor the opportunity cost of the proprietor's labor. This cost was measured in terms of the average skilled wage rate in that particular sub-sector of small-scale industry. The return to the proprietor was calculated by subtracting labor and capital costs from the firm's value added. The cost of capital was measured in terms of the rental cost of money at a 20% discount rate. Labor costs were calculated in terms of the rural industrial minimum wage which at that time was equivalent to L. 0.31 per hour. The most important conclusion drawn by these researchers was the following.

" . . . the rural small manufacturing sector in the Orica-Olancho region appears to be economically viable. The overall rate of economic profit, when weighted by the contribution of each firm to total production, is positive. In addition, the (. . .) return to the proprietor exceeds Lps. 1.00 per hour, a figure (above) the hourly wage rate of skilled labor in any industrial sub-sector of the region." (Leidholm and Roeser, 1981:2).

Liedholm and Roeser also claimed that small rural enterprises hiring labor are more profitable than (1) micro-family enterprises in the countryside that may (occasionally) hire labor, and (2) similar urban firms producing the same kinds of commodities but operating with more than 100 workers. Table No. 13 in Annex summarizes the main results of this study with respect to economic profitability. The figures are presented in terms of industry size and industry type. Data for the larger firms were obtained from the 1975 Industrial Census. Firms studied from that census were selected randomly. These data show that

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micro-family enterprises having as an average only one worker may obtain negative returns as high as -141.3%. It also indicates that urban enterprises having between 126 and 207 workers may equally obtain negative returns which may range from -21.2% to -67.2%. On the contrary, small rural enterprises operating with a average number of hired workers ranging from 2.0 to 2.6 obtained positive returns also ranging from +87.2 to +193.7%.

The enterprises studied in the longitudinal survey and those studied by Merschrod using a cross-sectional approach varied with respect to two important variables: (1) size of the enterprise in terms of the number of permanent workers, and (2) size of the towns where they were located. The enterprises studied longitudinally had an average of 1.14 workers and were located in towns having usually from 500 to 2,000 inhabitants. On the other hand, those studied cross-sectionally had an average of 5.1 workers and were located in towns having usually from 10,000 to 40,000 people. That is, the enterprises visited by Merschrod were not only larger in size but also located in larger towns. Liedholm and Roeser, nevertheless, have argued that within the sample not only industry size but also town size are positively related with economic profitability. Within certain limits and not necessarily in a linear fashion, the bigger the firm and the bigger the town the higher the return on investment. If those interviewed by Merschrod follow within the limits proposed by Liedholm and Roeser it is likely that they would have made as much profit as that reported for the Orica-Olancho region, if not more.

1.3.2. Possible Interpretations

The data previously presented with respect to the profitability of small enterprises must be interpreted with care. High returns on investment are not necessarily equivalent to capitalization, particularly given the scale of manufacturing activities with which we are dealing. Liedholm and Roeser (1981) do not provide us with data on the income levels of the small rural entrepreneurs studied. Nevertheless, we must assume that these are not very high for two reasons. One, because as Kelley (1978) has noted, an important proportion of small rural entrepreneurs are women dedicated either to the fabrication of clothes or to the production of bread for commercial purposes. That is, these are women who work within the home and provide a complementary income to the family. And two, because an important proportion of those that are men usually have a secondary activity. From the data provided also by Kelley (1978) on secondary occupation we can deduce that this is either an agricultural activity or even another small firm, most likely a commercial one. In other words, a single economic activity does not generate sufficient income so as to allow small rural entrepreneurs to provide for their families which are usually composed of 6 members. Taking into account the relatively larger size of small enterprises in the more urban areas as compared to those in the countryside, it is feasible to argue that small urban entrepreneurs are likely to have only one economic activity. Nevertheless, despite occupational specialization of the owner, they are not undertakings producing substantial net incomes in absolute terms. That is, the income level of the small urban entrepreneur is likely to be higher than that of his rural counterpart,

without this implying that the former is considerably richer than the latter. The mere fact that most of Merschrod's subjects would require working capital loans if production were to double is an indication of the low capital accumulation performance characterizing the firms under analysis.

Despite their expected profitability, small enterprises are not highly productive. From the data presented in Table No. 10 of the Annex, which excludes the artisanry sector, we can deduce that in 1975 manufacturing firms having 5-19 employees represented 56% of the total number of firms in the industrial sector, but accounted only for 6.97% of the value of industrial production output for that year.

This should not be understood in terms of absence of growth since start-up, particularly because Merschrod's subjects reported having practically doubled their personnel in a period of about six years of operations. If personnel increments reflect output growth, although not necessarily in a linear fashion, we may assume that during that same period and in the best of cases production would have been substantially increased. Nevertheless, growth is not permanent, and it is likely that after a certain threshold point small enterprises become stagnant. In addition, even after doubling their personnel over a six-year period enterprises visited retained their status as small firms. This of course means that they started as very small enterprises and grew to become small undertakings. Roeser (1982) in a somewhat different analysis of the data collected through the longitudinal study in the Orica-Olancho area reported that in those small rural enterprises visited, one of every five hours of labor was lost. This would represent 20% sub-utilization of that factor. Interestingly enough, commenting on the same matter Merschrod concluded that there was also labor sub-utilization in small urban enterprises. In the latter group of subjects, this loss was equivalent to 15%. Roeser (1982) has argued that lack of complete utilization of the labor factor in the case of small rural enterprises is a consequence of insufficient demand. Given the type of clientele to which Merschrod's subjects sell their production, we must assume that Roeser's argument is also applicable to small firms in the more urbanized areas. It is important to recall that Merschrod's subjects sold their production essentially to small farmers and low-ranking employees from either public or private institutions. These customers have a limited buying capacity, and it is precisely for that reason that 50% of the entrepreneurs visited gave credit for essentially consumer goods on 15 to 60-day terms. The elasticity of the market has been an important constraint to the expansion of small industries.

Putting two and two together in light of the data and arguments presented, it would seem that small entrepreneurs have been confronted with a vicious cycle. First, because they do not have the technical and financial resources necessary to increase their markets within or outside their traditional areas of distribution, independently of the limited resources of potential clients. And second, because even if the demand increased spontaneously, they do not have the necessary working capital to increase their outputs. Furthermore, their management skills and practices have important medium and long term

implications because even when their marketing and financial problems were immediately resolved, they are not likely to capitalize and be able to become even partially self-sufficient. Despite the fact that they are no longer domestic enterprises, they do not seem to have yet separated family and enterprise expenditures. Consequently, they are not aware of their real production costs, they do not know how much money they need to operate, and they do not know how much they are really earning. Furthermore, no money seems to be put aside for continue operation, let alone expansion.

Supporting small enterprises would require teaching small proprietors to optimize the use of available resources, to know and enlarge their markets, and to know and fight competition. It would require providing them with the necessary financial inputs so that they can either operate efficiently or increase production were demand to increase.

The time seems ripe to support small enterprises. Given the scarcity of foreign exchange, imported products have become either too expensive or are no longer on the shelves of retail shops. The import substitution model proved to be invalid during the era of the Central American Common Market because industries established in the area reduced the importation of manufactured goods, but increased that of raw materials. The present juncture could allow the model to be tested under more advantageous circumstances.

This project, by integrating technical and financial assistance, could help consolidate an entrepreneurial class in the country, a social class that started developing but which, for the reasons expressed above, has become stagnant.

2. Implication of General Characteristics of Small Enterprises for the Project

2.1. Criteria to Define the Target Group

Any attempt to help the small industry in the country should be based on the establishment of adequate criteria that can help define the target group of the project. This definition cannot be nominal or abstract. To the contrary, it should be real and operational. Some of the most commonly used criteria for this purpose are: amount of investments, number of workers and type of technology utilized. Puerta and Ospina (1981) have suggested that this list can be expanded to include type of product, source of funding, and certain structural characteristics of the firm such as decision-making levels and degree of labor division.

From the social standpoint, the project intends to finance small and medium industries so that jobs are created. Job-creating enterprises are, by definition, those that require less fixed investment per worker. That is, enterprises which utilize a less expensive and less sophisticated technology and are thus labor intensive. Such enterprises create both direct and indirect employment. Direct employment is obviously that generated for workers

involved in the manufacturing process. Indirect employment, on the other hand, is that generated in related industries that produce the raw materials and industrial inputs required for the fabrication of a given product. From the data presented in Section 1.1. of this report, it is feasible to assume that the smaller the fixed investment per worker, the greater the possibility that involved industries would produce consumer goods, and consequently the greater the consumption of local raw materials and inputs. By using fixed investment/worker ratio to determine industry size, we can easily detect the technological level of industries. This in turn would allow us to establish which industries would be more labor intensive and which are likely to use local raw materials and inputs thus creating/expanding market opportunities for local suppliers.

As a word of caution it must be kept in mind that entrepreneurs may be apprehensive about disclosing the real value of fixed investments. With the intention of becoming credit-worthy according to FIA's requirements, the value of such investments may be either under or over-estimated. Credit evaluators at FIA should have the necessary technical expertise to assess the value of machinery, equipment and installations.

2.2. The Creation of Jobs

In Honduras, the unemployed are usually defined as those individuals belonging to the economically active population between 15 and 64 years old who do not have a job and wish to work for a salary. Brohel (1982) has suggested that this definition is inadequate because it does not consider as unemployed those who are not working and are not looking for jobs, but who given the opportunity to work would do so. He has suggested that because official documents tend to use this definition for unemployment, any figures on this problem are likely to be underestimates of the real situation.

Mejía (1982) has summarized the results of different unemployment studies and estimates done by different agencies for the 1970-82 period. These results are presented in Table No. 14 of the Annex. These data clearly indicate that unemployment has increased through time, even though observed increments have not occurred in a linear fashion. From these data we can see that while in the 1970-75 period unemployment increased from 8.4 to 8.9%, in the 1975-1980 period it increased from 8.9 to 14.6%. The problem became even more acute in the 1980-82 lapse where it jumped from 14.4 to 20.6%. This represents approximately 200,000 unemployed individuals within the labor force. If we were to believe Brohel's argument, we would have to conclude that unemployment is a very serious social problem in the country at this time, if not the most important one.

Brohel has also argued that when the unemployment definition commonly used is applied, the rate of unemployment is higher in the city than in the countryside. For this author, the application of that definition would necessarily make us conclude that those that have access to land would always have work, independently of the fact that in order to be able to provide for

their families farmers, and particularly small farmers, must look for seasonal off-farm employment. For Brohel, urban employment is likely affecting more the 15-19 age bracket than any other category because those that are parents and breadwinners must and do get involved in transitory occupations while they wait for permanent positions. Interestingly enough, Brohel has also indicated that the proportion of economically active women in the 15-19 age category is higher than that of men. If we follow this argument any further, we can say that one of the most important reasons why this alarming unemployment problem has not yet created any social unrest is because a considerable percentage of those unemployed are young, and particularly young women. These are likely to be unemployed persons that can still be supported by their families.

Employment generation activities must be a priority for the USAID Mission in Honduras. Through this project, and by supporting the small and medium-size enterprises in the country, the Mission is in fact beginning to address the problem. The Economic Analysis has indicated that this project would be creating 1,000 direct and about 2,000 indirect jobs over an eight-year period. This is equivalent to about 6 % of industrial jobs existing in the country as of 1981 according to the records of the Ministry of Labor. If through this project technical and financial assistance allows small firms, particularly the new ones that may be created, to grow at a constant and permanent rate, these figures would be under-estimates of the project's real employment impact. We must recall that Merchrod's subjects doubled their personnel in about a six-year period of operations. And this occurred under the constraints that we have mentioned earlier. By supporting small enterprises, furthermore, we are likely to create permanent rather than temporary positions. Merschrod has also indicated that when small enterprises grew, they created essentially permanent jobs, with temporary jobs being created in addition to permanent ones particularly in high demand periods like Christmas time or the initiation of the school year.

3. Magnifying Social Impact?

3.1. Techn. cal Assistance

Merschrod asked his subjects which factors, according to their background, had contributed most to the development and success of their enterprise. 49% responded by pointing out the importance of training and experience. This was the most common answer. In our opinion it reflects the openness that small entrepreneurs are likely to have to further training and to assistance from those that might be "experts" in the business. Resistance to either training or technical assistance programs is not anticipated.

The project may take advantage of such openness by making sure that the TA and training provided is adequate and realistic. Solutions proposed by "experts" to improve the operations of small enterprises must be adapted to present local conditions. The development plans for small firms confronting rapid inflation, periodic shortages of commodities, unstable political environments and limited buying capacity on the part of consumers would be

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radically different from those conceived for similar enterprises in much more stable environments. Just as pre-conceived solutions to present constraints faced by small entrepreneurs must be ruled out and substituted whenever possible by individualized attention to problems, course content of any training program to be implemented should be rather practical than theoretical. This should be the main objective of such training programs despite the absorptive capacity of potential beneficiaries given their level of instruction.

We must be aware that the institutions that are likely to be involved in the technical assistance component of this project must, in the majority of the cases, either up-date skills or tune up their current programs to be able to satisfy the needs of their new clientele. This will require time and effort which in the long run may affect the project implementation schedule. If delays do occur we should be more concerned about institutional development and impact that may outlive the project than about disbursement levels.

3.2. Employment

Given the present unemployment rate in the country, it is important that the project includes mechanisms that favor those enterprises which can generate more employment. One of the most obvious means to attain such an objective consists in providing technical and financial assistance preferably to labor intensive enterprises.

As we have previously mentioned, in Honduras there is an inverse relationship between enterprise size and type of technology utilized. This is true when enterprise size is defined in terms of number of employees. Because of this relationship, it could be argued that the establishment of preferences for the purpose of providing technical assistance and credit under this project is not necessary. We must point out, however, that there are exceptions to the rule. According to the data presented in Table No. 3 of the Annex, some enterprises which we have been defined in this paper as medium-size firms and which in fact could be eligible for FIA credit, are those which in the past have required the greater fixed investment per worker. These are enterprises which produce intermediate commodities.

Given the magnitude of the unemployment problem in Honduras, FIA must be very rational with respect to the type of credits that it approves. If credit demand is in fact large and FIA must face the problem of selecting between a labor and a capital intensive enterprise, both being equally economically feasible, our suggestion would be that financial assistance be granted to the former firm rather than to the latter.

Harper and Soon (1979) have argued that some manufacturing processes require labor intensive technologies, while others do not. It is impossible for all manufacturing enterprises to use either simple or even intermediate technologies. In fact, it may even be necessary and convenient for the

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industrial development of a given country to support industries that may generate little employment. Nevertheless, given the acuteness of the unemployment problem in Honduras we believe that employment generation should be included as one of the criteria for credit approval.

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ANNEX

Table No.1 - Number of Enterprises by Size and Type of Industry (1975 Census and other Sources)

	Traditional	Intermediate	Metallic	Total
Artisanry (Up to 4 Employees)	34,052	2,526	395	36,973
Small (From 5 to 19 Employees)	389	55	32	476
Medium (From 20 to 99 Employees)	217	50	25	292
Large (100 Employees and Up)	61	12	8	81
	34,719	2,643	460	37,822

Table No.2 - Number of Employees by Size and Type of Industry

	Traditional	Intermediate	Metallic	Total
Artisanry (Up to 4 Employees)	46,044	3,492	601	50,137
Small (From 5 to 19 Employees)	3,685	599	322	4,606
Medium (From 20 to 99 Employees)	9,638	2,310	1,064	13,012
Large (100 Employees and Up)	15,547	2,533	1,277	19,357
	74,914	8,934	3,264	87,112

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TABLE No.3 - Gross Fixed Investment per Worker by Type and Size of Industry - (Current 1975 L 000's)

	Traditional	Intermediate	Metallic	Average
Artisanry (Up to 4 Employees)	(NOT AVAILABLE)			
Small (From 5 to 19 Employees)	6.71	10.25	5.02	7.05
Medium (From 20 to 99 Employees)	9.91	32.07	13.10	14.11
Large (100 Employees and Up)	16.46	28.19	11.84	17.69
AVERAGE	13.03	27.86	11.52	15.10

Source: Zuniga and Viana, The Role of Small Industry and the Artisan Sector in the Honduran Economy, 1979.

TABLE No.4 - Used Capacity of Manufacturing Industry by Industry Type

	Traditional	Intermediate	Metallic
Artisanry (Up to 4 Employees)	(NOT INCLUDED)		
Small (From 5 to 19 Employees)			
Medium (From 20 to 99 Employees)			
Large (100 Employees and Up)			
	55.5%	70.3%	58.1%

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TABLE No.5 - Origin of Raw Materials Used by Industries
(Excluding Artisanry) According To Type of Industry
(Percentages)

	National	Central America	Rest of the World
Traditional	67.2	6.5	26.3
Intermediate	9.0	1.9	89.1
Metal	6.9	3.5	89.6
AVERAGE	43.0	4.7	52.3

TABLE No.6 - Origin of Overall Industrial Inputs used
by the Manufacturing Sector by Type of Industry
(Percentages)

	National	Central America	Rest of the World
Traditional	68.8	6.1	25.1
Intermediate	24.7	2.3	73.0
Metal	24.6	2.8	72.6
AVERAGE	51.7	4.6	43.7

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Table No.7 - Gross Added Value at Costs of Factors
(Current 1975 L.000's)

	Traditional	Intermediate	Metallic	Total
Artisanry (Up to 4 Employees)	(Not available by the typr of industry)			56,801.6
Small (From 5 to 19 Employees)	12,638.3	29,926.3	1,601.4	17,166.0
Medium (From 20 to 99 Employees)	44,720.6	27,963.2	7,085.2	79,769.0
Large (100 Employees and Up)	118,076.7	18,473.2	6,934.9	143,484.8
	175,435.6	49,362.7	15,621.5	240,410.8

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Table No.8 - Gross Fixed Investment
(Current 1975 L 000's)

	Traditional	Intermediate	Metallic	Total
Artisanry (Up to 4 Employees)	(N O T	A V A I L A B L E)		
Small (From 5 to 19 Employees)	24,734.3	6,141.2	1,616.8	32,492.3
Medium (From 20 to 99 Employees)	95,592.2	74,082.3	13,942.3	183,553.8
Large (100 Employees and Up)	255,873.8	71,417.6	15,122.5	342,413.9
	376,137.3	151,641.1	30,681.6	558,460.0

TABLE No.9 - Output Capital Ratio (Gross Value Added
Over Gross Fixed Investments) 1975

	Traditional	Intermediate	Metallic	Total
Artisanry (Up to 4 Employees)	(N O T	A V A I L A B L E)		
Small (From 5 to 19 Employees)	0.51	0.48	0.99	0.53
Medium (From 20 to 99 Employees)	0.47	0.38	0.51	0.43
Large (100 Employees and Up)	0.46	0.26	0.46	0.42
AVERAGE	0.47	0.32	0.51	0.43

TABLE No.10 - Value of Industrial Output
(Current 1975 L.000's)

	Traditional	Intermediate	Metallic	Total
Artisanry (Up to 4 Employees)	(N O T	A V A I L A B L E)		
Small (From 5 to 19 Employees)	44,768.4	2,203.7	4,168.0	51,140.1
Medium (From 20 to 99 Employees)	198,100.2	11,113.6	19,467.5	278,681.3
Large (100 Employees and Up)	402,684.2	33,950.7	22,950.0	459,584.9
	645,552.8	47,268.0	46,585.5	739,406.3

TABLE No.11 - Number of Enterprises Interviewed in the Merschrod Study According to Location, Type of Industry And Status with Respect to ANDI Membership

Region	I N D U S T R Y							Total
	Lumber	Clothes	Shoes	Metal	Food	Print	Miscellaneous	
ANDI MEMBERS								
Tegucigalpa	7	5	11	1	2	2	7	35
San Pedro Sula	5	5	4	1	2	2	3	22
La Ceiba	4	10	6	1	3	-	3	27
Santa Bárbara	2	-	-	-	-	-	3	5
Choluteca	4	3	3	2	1	1	4	18
Juticalpa	4	4	3	1	1	-	1	13
El Progreso	4	5	2	1	-	-	1	13
								n = 13
NON-MEMBERS OF ANDI								
Tegucigalpa	3	4	5	-	-	-	1	13
San Pedro Sula	1	2	3	4	2	1	3	16
La Ceiba	5	10	9	1	1	-	-	26
Santa Bárbara	-	1	-	-	2	-	-	3
Choluteca	2	3	2	1	-	-	-	8
Juticalpa	3	3	3	-	1	-	1	11
El Progreso	3	3	2	2	-	-	1	11
								n = 88
TOTAL	46	58	53	15	15	6	28	
PERCENTAGE	21	26	24	7	7	3	13	

TABLE No. 12

Bookkeeping Practices of Small Enterprises visited through Merschord's Study
Type of Books kept by Types of System Used
(Percentages)

	BOOKKEEPING AS A PRACTICE	LOOSE RECEIPTS	UNBOUND LEAVES	BOUND LEAVES	OFFICIAL BOOKS
Procurement	66	31	3	11	21
Expenditures	67	32	3	11	21
Payroll	45	4	1	14	26
Inventory	37	2	0	10	25
Sales	48	11	2	15	20
Subsidiary Double Entry	45	10	1	13	20
Monthly Double Entry	32	2	0	8	22

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Table No. 13 - Annual Economic Profitability Expressed as a Percentage of Total Assets by Type of Industry and Size of the Enterprise (Average Number of Workers in Parenthesis) (1)

	Small Rural Industry		Larger Urban
	Domestic	With Hired Labor	Enterprises
Clothes	- 33.1% (1.0)	+ 107.1% (2.6)	- 21.2% (207)
Wood	-141.3% (1.0)	+ 87.2% (4.1)	- 67.2% (115)
Metal	+ 42.1% (1.2)	+ 193.7% (2.0)	- 26.4% (126)

(1) Sources: Small

Industries: CDI/PTR. Longitudinal Study of Small Rural Enterprises in Honduras, 1980. (Only for the Orica-Olancho Region)

Larger

Industries: Industrial Census, 1975. (Enterprises selected at random).

Table No. 14 - HONDURAS: Open Unemployment, 1970-1982(1)

(Percentages)

	Estimates Based on National Surveys	CONSUPLANE ESTIMATES	OTHER SOURCES
1970		8.4	
1971			
1972	8.0		
1973	11.7		
1974	9.3		
1975	8.9		
1976	9.3		
1977	8.6		
1978	7.5	9.1	
1979			
1980	14.4		
1981			
1982	20.6		

(1) Source: C. Mejía, Estado Actual de la Información Sobre el

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TABLE No. 1

HONDURAS: OPEN UNEMPLOYEMENT, 1970-1982
(Percentages)

	<u>ESTIMATES BASED ON</u> <u>NATIONAL SURVEY</u>	<u>CONSUPLANE</u> <u>ESTIMATES</u>	<u>OTHER</u> <u>SOURCES</u>
1970			8.4
1971			
1972	8.0		
1973	11.7		
1974	9.3		
1975	8.9		
1976	9.3		
1977	8.6		
1978	7.5		9.1
1979			
1980	14.4		
1981			
1982	20.6		

Source: C. Mejía, Estado Actual de la Información Sobre el Empleo en Honduras, pg. 4.