

PD-ARB-183

66932

UNCLASSIFIED

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

HONDURAS

PROJECT PAPER

SMALL BUSINESS II

AID/LAC/P-504

Project Number: 522-0241

UNCLASSIFIED

AGENCY FOR INTERNATIONAL DEVELOPMENT
PROJECT DATA SHEET

1. TRANSACTION CODE
 A = Add
 C = Change
 D = Delete
 Amendment Number _____
 DOCUMENT CODE **3**

COUNTRY/ENTITY
HONDURAS

3. PROJECT NUMBER
522-0241

4. BUREAU/OFFICE
LAC 05

5. PROJECT TITLE (maximum 40 characters)
Small Business II

6. PROJECT ASSISTANCE COMPLETION DATE (PACD)
 MM DD YY
07 31 93

7. ESTIMATED DATE OF OBLIGATION
 (Under "B" below, enter 1, 2, 3, or 4)
 A. Initial FY **88** B. Quarter **4** C. Final FY **90**

8. COSTS (\$000 OR EQUIVALENT \$1 =)

A. FUNDING SOURCE	FIRST FY 88			LIFE OF PROJECT		
	B. FX	C. L/C	D. Total	E. FX	F. L/C	G. Total
AD Appropriated Total	1,000	2,000	3,000	5,359	9,641	15,000
(Grant)	(1,000)	(2,000)	(3,000)	(5,359)	(9,641)	(15,000)
(Loan)	()	()	()	()	()	()
Other						
U.S.						
Host Country		3,205	3,205		16,025	16,025
Other Donors) Private Sector		1,795	1,795		8,975	8,975
TOTALS	1,000	7,000	8,000	5,359	34,641	40,000

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) SDA	714	840				2,900		10,000	
(2) ARDN	274	110				3,600		5,000	
(3)									
(4)									
TOTALS						6,500		15,000	

10. SECONDARY TECHNICAL CODES (maximum 8 codes of 3 positions each)
819 **740**

11. SECONDARY PURPOSE CODE
760

12. SPECIAL CONCERNS CODES (maximum 7 codes of 6 positions each)

A. Code	BR	PVON
B. Amount	5,000	8,600

13. PROJECT PURPOSE (maximum 480 characters)

To (1) strengthen and expand an institutional system that will increase and improve the supply of credit, training, technical assistance and services to the small-scale enterprise sector (SSEs); and (2) improve the policy and regulatory environment in which SSEs operate.

14. SCHEDULED EVALUATIONS

Interim	MM YY	MM YY	Final	MM YY
	06 90	06 92		06 93

15. SOURCE/ORIGIN OF GOODS AND SERVICES
 000 941 Local Other (Specify) _____

16. AMENDMENTS/NATURE OF CHANGE PROPOSED (This is page 1 of a _____ page PP. Amendment)

17. APPROVED BY
 Signature: *John Sanbrailo*
 Title: **John A. Sanbrailo**
 Mission Director

Date Signed: MM DD YY
08 1 88

18. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION
 MM DD YY
 | | | | | |

PROJECT AUTHORIZATION

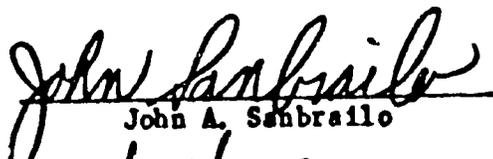
Name of Country: Honduras
Name of Project: Small Business II
Number of Project: 522-0241

1. Pursuant to Sections 103 and 106 of the Foreign Assistance Act of 1961, as amended, I hereby authorize the Small Business II Project for Honduras, involving planned obligations of not to exceed FIFTEEN MILLION UNITED STATES DOLLARS (\$15,000,000) in grant funds over a four-year period from the date of authorization of funds for the Project, 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 five years from the date of initial obligation.

2. The Project consists of two components: (a) a Small-Scale Enterprise Support System to strengthen and expand the programs of Honduran institutions which provide credit, technical assistance and training for small-scale enterprises (defined as including micro-, small-, and medium-scale enterprises), and (b) a Small-Scale Enterprise Research and Policy Analysis component to assist Honduran institutions with research and policy dialogue efforts to encourage the development of micro-, small-, and medium-scale enterprise in Honduras.

3. The Project shall be implemented primarily through a direct contract with a competitively selected technical assistance contractor and operational program grants to the Honduran Development Foundation (FUNADEH), Advisors for Development (ASEPADE), and the National Association of Industrialists (ANDI). These agreements may be negotiated and executed by the A.I.D. officer to whom such authority is obligated in accordance with A.I.D. regulations and delegations of authority.

4. Commodities and services financed by A.I.D. under the Project Agreement shall have their source and origin in the United States, the Host Country, or the Central American Common Market, except as A.I.D. may otherwise agree in writing. Except for ocean shipping, the suppliers of commodities or services shall have the United States or the Central American Common market as their place of nationality, except as A.I.D. may otherwise agree in writing. Except for motor vehicles, where the total procurement element (i.e., including all purchase orders and contracts for goods and services) of an operational program grant is \$250,000 or less, the recipient of an operational program grant shall procure all goods and services necessary for the activity in the following order of preference: (a) United States (b) Honduras (c) Code 941 countries, and (d) Code 935 countries. Procurement shall not take place from sources other than code 935 countries. Ocean shipping financed by A.I.D. under the Project shall, except as A.I.D. may otherwise agree in writing, be financed only on flag vessels of the United States.


John A. Sanbrailo
8/26/86
Date

Draft:GC/LAC:KWilliams:

Clearance:

DF:EKvitashvili in draft

DF:DCruz-DePaula in draft

PSP:MLikar in draft

CONT:RZelaya draft

DP:ESzepesy in draft

A/DMD:DRobbins draft

SMALL BUSINESS II

Table of Contents

	Page
Part I. SUMMARY AND RECOMMENDATIONS	
A. Background and Rationale	1
B. Project Description	2
C. Estimated Project Budget	3
D. Project Issues	3
E. Recommendation	7
Part II. BACKGROUND AND RATIONALE	
A. Definition of the Problem: Macroeconomic Setting	7
B. Response to the Problem: Promotion of Small-Scale Enterprises (SSEs)	9
C. Constraints to the Growth of SSEs in Honduras	12
1. Policy Constraints	12
2. Institutional Constraints	14
3. Financial Market Constraints	15
4. Technical Constraints	16
5. Attitudinal Constraints	17
D. Overview of Recent USAID-Supported SSE Activities and Lessons Learned	17
1. Overview of USAID-Supported SSE Activities	17
2. Analytical Base and Lessons Learned	19
E. Project Strategy	21
Part III. PROGRAM FACTORS	
A. Relationship to A.I.D. and Mission Strategy and Action Plan	22
B. Relationship to GOH and Other Donor Programs	24
Part IV. PROJECT DESCRIPTION	
A. Project Goal and Purpose	25
B. Beneficiaries and Expected Accomplishments	26
1. Small-Scale Enterprises	26
2. Intermediary Institutions	27
C. Project Components	28
1. SSE Support System	29
a. NGO Strengthening and Service Expansion	30
b. Expanded Financial System Lending	35
2. SSE Research and Policy Analysis	44
D. Summary Inputs	47
1. Inputs	47
2. Summary Budget	47

Part V. PROJECT ANALYSES	
A. Financial Plan	48
1. Project Budget	49
2. Disbursement Procedures	49
3. Disbursements by Year	49
4. Methods of Financing	50
5. Financial Analyses	53
a. NGO Credit Reflows	53
b. Loan Fund and Guarantee Fund Analysis	54
B. Administrative Feasibility and Institutional Analysis	55
1. Administrative Feasibility	55
2. Financial System, Participating Banks, and the Fiduciary Agent	59
3. Participating NGOs	62
a. ANDI/YIME	62
b. FUNADEH	64
c. ASEPLADE	65
C. Social Analysis	67
D. Economic Analysis	70
1. SSE Demand for Credit	70
2. Economic Analysis	72
 Part VI. PROJECT MANAGEMENT AND IMPLEMENTATION	
A. Administrative Arrangements	72
1. Grants to Participating NGOs	73
2. PFI Credit and Guarantee Program	74
3. PTU Linkage to Participating Institutions	75
B. Procurement Procedures	75
C. Evaluation and Audit	75
D. Implementation Plan	78
E. Gray Amendment	78
F. Environmental Concerns	78
 Part VII. NEGOTIATION STATUS	
A. Conditions Precedent to Disbursement	78
B. Negotiation Status	79

ACRONYMS*

AHIBA	National Association of Bankers
ANDI	National Association of Industrialists
ANMPIH	National Association of Small and Medium Industrialists
ASEPADE	Advisors for Development
BAS	Business Assistance System
BCH	Central Bank of Honduras
CDI	Industrial Development Center
COHEP	Honduran Council for Private Enterprise
ESF	Economic Support Funds
FLA	Industrial and Agricultural Finance Company
FIDE	Foundation for Investment and Export Development
FONDEI	Industrial Development Fund
POPRIDEN	Federation of Honduran Development PVOs
FOPEME	Small- and Medium-scale Enterprise Fund
FUNADEH	National Development Foundation
GEMAH	Association of Honduran Managers and Entrepreneurs
GOH	Government of Honduras
IESC	International Executive Service Corps
INCAE	Central American Business Administration Institute
INPOP	National Training Institute
MOU	Memorandum of Understanding
NGOs	Non-governmental Organizations
OPG	Operational Program Grant
PACD	Project Assistance Completion Date
PFI	Private Financial Institution
PISCES	Program for Investment in the Small Capital Enterprise Sector
PTR	Rural Technologies Program
PTU	Project Technical Unit
PVO	Private Voluntary Organization
PYME	Small and Microenterprise Program
SB I	Small Business Development Project (522-0205)
SB II	Small Business II Project (522-0241)
TA	Technical Assistance
SSEs	Small-scale Enterprises

* For Honduran organizations, Spanish acronyms are used.

ANNEXES

Annex I Legal Exhibits

- Exhibit A. Director's 611 (a) Certification
- Exhibit B. Statutory Check List
- Exhibit C. Grantee Requests
- Exhibit D. Environmental Threshold Decision

Annex II Technical Exhibits

- Exhibit A. Logical Framework
- Exhibit B. PP Approval Action Memorandum
- Exhibit C. Steps for Firm Registration and
Flowchart of Classification Steps
- Exhibit D. Summary of Policy Constraints
- Exhibit E. List of Documents Reviewed for PP Design
- Exhibit F. Social Analysis
- Exhibit G. Criteria for Participation
- Exhibit H. Description of NGO Programs
- Exhibit I. Other Possible Participants

Annex III Unattached Annexes
(Available in USAID/H Bulk Files)

- Exhibit A. USAID/Honduras Employment Strategy Paper
- Exhibit B. The Effect of Policy on Small Industry Development
in Honduras, Development Alternatives, Inc., 1987.
- Exhibit C. Institutional Analyses
- Exhibit D. Honduras—A Small and Micro Enterprise Development
Strategy, ARIES Project, Robert Nathan and
Assoc., 1987
- Exhibit E. ASEPADE Proposal
- Exhibit F. FUNADEH Proposal
- Exhibit G. ANDI/PYME Proposal
- Exhibit H. Expressions of Interest from Private Financial Institutions
- Exhibit I. Economic Analysis
- Exhibit J. Project Completion Report on Honduras - First and Second
Industrial Credit Project, World Bank, Dec. 1987

TABLES AND FIGURES

- 1 Size Distribution of Industrial Firms
- 2 Summary Project Budget
- 3 Project Budget
- 4 Disbursements by Year
- 5 Loan Fund Analysis
- 6 Projections of the Guarantee Fund

Figure 1 Institutional Configuration

1

PART I. SUMMARY AND RECOMMENDATIONS

A. Background and Rationale

High levels of unemployment -- the result of low labor productivity and a lackluster economy -- are viewed by most Hondurans as the critical problem confronting the economy and the well-being of the country. Nearly 12% of the economically active population is currently unemployed, and underemployment accounts for perhaps a similar if not higher figure. An equally critical problem is that of low income levels which have fallen significantly over the past several years.

The importance of small-scale enterprises -- SSEs -- (which we define to include micro-, small-, and medium-scale enterprises) in creating productive jobs and increasing the incomes of the poor in developing countries is widely recognized in the development literature and by the Mission. In many developing countries, including Honduras, SSEs are by far the most important component of the industrial sector, in terms of total number of firms and contribution to employment.¹ Moreover, most of the employment is concentrated at the smallest end of the size spectrum (i.e., micro and small-scale enterprises). Virtually all studies reveal that SSEs generate more employment per unit of scarce capital than their larger scale counterparts. Yet despite the recognized attributes of SSEs, numerous constraints inhibit their development and growth. These include policy, institutional, financial, technical, and attitudinal constraints.

Accordingly, in order to create employment and increase incomes in Honduras, the proposed Small Business II Project (SB II) will implement an expanded SSE development program as Honduras enters the 1990s. The Project will build on the valuable experience and lessons learned from previous USAID-supported SSE programs. It will also address those constraints either not previously addressed, or for which our ongoing efforts are only partially complete.

The Project strategy is to direct efforts at two levels. First, Project resources will reinforce and complete the long-term institution-building process that has already begun by strengthening a select group of key Honduran Non-Governmental Organizations (NGOs) that support SSEs. Institutional strengthening will be accomplished by improving the NGOs managerial and technical capacities, as well as by supporting their efforts to move toward financial self-sufficiency. At the same time, the Project will incorporate private financial institutions (PFIs) into the Mission's SSE outreach program, significantly expanding the number of beneficiaries assisted.

Second, the Project will place much greater emphasis on policy analysis and reform than has previously been the case. The establishment of a better policy framework will assist all SSEs and significantly increase the impact of A.I.D. and other donor assistance.

¹ 1979 figures for Honduras indicate that SSEs provided over 70% of employment in the manufacturing sector. Liedholm, Carl and Mead, Donald. Small Scale Industries in Developing Countries: Empirical Evidence and Policy Implications, 1987.

The SB II Project supports Mission Action Plan, National Bipartisan Commission on Central America, and Central American Initiative objectives of increasing employment opportunities and spreading the benefits of economic growth. It also responds to increased interest by the U.S. Congress in microenterprise development. Finally, the Project supports the Government of Honduras (GOH) objective of expanding employment opportunities through SSEs.

B. Project Description

The Project goal is to increase employment and expand production. The Project purpose is to: (1) strengthen and expand an institutional system that will increase and improve the supply of credit, training, technical assistance, and services to SSEs; and (2) improve the policy and regulatory environment in which SSEs operate. Project beneficiaries include institutions which assist SSEs and the SSEs themselves. It is expected that no less than 30,000 individuals will be directly assisted by Project activities. A much greater number will be assisted indirectly through policy reform and other activities.

The Project is composed of two interrelated components: (1) an SSE Support System component to strengthen and expand the programs of Honduran institutions, both Non-Governmental Organizations (NGOs) and Private Financial Institutions (PFIs), which direct credit, technical assistance, and training resources to the SSEs; and (2) an SSE Research and Policy Analysis component to focus primarily on research, data collection, and analysis efforts to assist policy-making institutions in the formulation of recommendations for policy changes which will lead to an improved policy environment for SSE development.

1. SSE Support System - The first component will be implemented through dollar-financed Operational Program Grants (OPGs) to three leading Honduran NGOs which assist SSEs. These grants will ensure that their programs are sustainable over the long term. It will also include a ESF-generated local currency Loan and Guarantee Fund Program (Spanish acronym POPEME) that will be channeled through Private Financial Institutions (PFIs), including commercial banks and finance companies and managed by the Industrial Development Fund (FONDEI) of the Central Bank of Honduras.

2. SSE Research and Policy Analysis - The second component will assist the GOH and the Honduran private sector to establish an effective policy environment for SSE development in Honduras. This component will: (1) undertake discrete research activities which will give the GOH, the private sector, and the Mission a more detailed analytic base on SSEs to permit continued program development and modification, and (2) support specific policy and regulatory analyses and reforms which facilitate policy dialogue between the public and private sectors and which lead to policy changes that assist the development of SSEs in Honduras. Activities under this component will be closely coordinated with other GOH-USAID programs, including the Economic Support Fund (ESF) Program and the Policy Analysis and Implementation Project (522-0325).

The Project will establish a Project Technical Unit (PTU) consisting of a U.S. institutional contractor to guide overall Project implementation. The PTU will have four specific functions: (1) to provide technical assistance to

the NGOs and financial institutions participating in the Project; (2) to work with these entities and other leading private and public sector institutions on the broader arena of research and policy analysis; (3) to advise the Mission on a continuing basis on implementation of our SSE strategy; and (4) to assist Project implementing agencies in day-to-day Project management, including monitoring and processing of Project-related documents.

C. Estimated Project Budget

The total estimated cost of the Project is \$40 million, comprised of a \$15 million A.I.D. contribution (Development Assistance Grant funds) and a Government of Honduras/private sector contribution of the U.S. dollar equivalent of \$25 million. The A.I.D. appropriated funds will cover primarily the costs of three Operational Program Grants (OPGs) to three participating Non-Governmental Organizations (NGOs) and a technical assistance contract.
(US \$ 000)

	S O U R C E S			TOTAL COST
	<u>U S E S</u>	<u>A. I. D.</u>	<u>GOH</u>	
I. <u>SSE Support System</u>				
a. Grants to NGOs		8,600	-	4,540*
b. PFI Credit and Guarantee Program		500	15,000	4,435
II. <u>Research and Policy Analysis</u>		200	1,000	-
III. <u>Project Technical Unit</u>		4,800	-	-
IV. <u>Technical Assistance Support Fund</u>		250	-	-
V. <u>Evaluations/Audits</u>		150	25	-
VI. <u>Project Liaison Officer</u>		500	-	-
<u>TOTAL PROJECT COSTS</u>		<u>15,000</u>	<u>16,025</u>	<u>8,975</u>

* A waiver of the 25% minimum counterpart contribution was approved by the Mission Director for ANDI/PYME.

D. Project Issues

The following issues arose in the course of intensive Project review, and were analyzed and discussed at length by the Project Design Committee and Mission management. Summary responses to these issues are provided below.

1. Issue: The Project will be implemented by a broad group of NGOs and private financial institutions. Is the Project dealing with too many institutions? Is the institutional configuration too complex for effective implementation and management? Why were the three participating NGOs chosen over other eligible entities?

Response: As previously noted, the Project will direct efforts at two levels: it will strengthen and expand the programs of Honduran institutions assisting SSEs (including NGOs and the private financial system) and it will improve the policy environment under which SSEs operate. These activities are essential to expanding employment and increasing incomes through SSEs over the long run. Eliminating any one of them would leave us short of developing a comprehensive SSE program, which is the objective of this Project. This dual focus requires by necessity, however, that resources be channeled to multiple institutions serving different segments of the SSE spectrum.

During intensive review, the Mission determined that, with respect to NGOs, Project impact would be increased by further strengthening those key private sector institutions with the capacity to reach the greatest number of beneficiaries, rather than by concentrating resources solely on one institution. The Mission explored at length the possibility of providing assistance to these institutions through one "umbrella" entity. Yet our discussions with the GOH and the private sector indicated that creating a new entity for this purpose was not a viable option and that no existing institution had the capacity to carry out this role effectively. Hence, the Mission will sign three separate OPGs with the participating NGOs. While in theory having one agreement with one institution to channel resources might be more attractive, the Mission determined that no single institution is yet capable of assuming such a significant role.

With regard to the Expanded Financial System Lending, this component has been designed to be operationally simple and will require minimal oversight once functional. Moreover, the design permits significant expansion of the number of participating PFIs with minimal additional management costs.

In sum, it is the conclusion of the Project Design Committee that the Project's institutional configuration is effective and that it adequately combines achievement of Project objectives with management efficiency and existing institutional capabilities. A Project involving numerous implementing institutions tends, of course, to be more complex. But the Team feels that responsibilities are sufficiently clear, and that the incorporation of some Project elements, e.g., a Project Technical Unit (PTU), will result in expeditious implementation.

In choosing existing organizations as agents of implementation, the Mission carefully looked at a number of organizations, both private and public sector, that met the general qualification requirements outlined in Annex II, Exhibit G. The Mission determined that limited Project resources should be initially focused on strengthening private organizations assisting the SSE sector since, for the most part, these private organizations are more cost effective than their public counterparts and are protected from the politicization that often affects governmental agencies. Within the private sector, we selected the three entities which, based on our analysis during intensive review and our own experience, provide the greatest possible coverage to SSEs and which have the most effective programs consisting of various forms of assistance.

2. Issue: The primary Project focus is to assist SSEs. The private financial system credit and guarantee component authorizes loans up to \$125,000 which is a large loan by any criteria. Is there a danger that most credit resources will go to larger enterprises? Shouldn't the loan and guarantee funds focus exclusively on smaller firms?

Response: The Project places great emphasis on assisting the smaller of the SSEs, particularly microenterprises, as reflected in the NGO programs. It must be kept in mind, however, that the Action Plan objective to which this Project responds is employment creation. The promotion of SSEs is a means to accomplish this end. To the extent that support for medium-scale enterprises also contributes to the cost-effective creation of jobs—as A.I.D. and Mission experience indicates—they should be included as eligible beneficiaries under the PFI program.¹ In this regard, the aim of the Project is to let the market allocate funds, rather than to target selected firms through burdensome eligibility criteria, which complicate the operation of credit programs and distorts the allocation of resources.

Moreover, numerous studies worldwide have highlighted the important role that medium-scale enterprises can play, not only in creating jobs and increasing production but in creating demand for the goods produced by SSEs through forward and backward linkages. Our own experience indicates that the linkages between small- and medium-scale enterprises are important and can be significantly increased. In fact, the relative absence of medium-scale enterprises in Honduras has been identified as a problem afflicting the Honduran industrial sector.

Medium-sized enterprises often suffer from many of the same constraints that are encountered by smaller firms. This is particularly true with respect to credit. While they generally have access to the financial sector, large collateral requirements posed by banks often result in undercapitalized firms with insufficient working capital, operating far below their capacity, which limits their potential impact on employment and value added. Experience in previous USAID credit programs indicates that the proposed lending limit of \$125,000 is not unreasonable for plant expansion and working capital requirements of medium-sized firms. While a number of loans of this size will finance plant expansion and/or important working capital requirements of some firms, lending practices suggest that the average loan size, for both the NGOs and the PFIs, will be far below this limit, in the \$25-30,000 range. For example, PIA's loan limit is \$125,000 and yet its average loan size has been consistently going down and is now approximately \$35,000; with its current emphasis on smaller enterprises, this average is expected to decrease further. Ongoing Project monitoring will indicate whether or not the average loan size is reasonable for a comprehensive small business program such as the one proposed in this Project. Based on Mission monitoring, as well as formal evaluation, adjustments in the lending limits may be made during Project implementation.

3. Issue: Is the inclusion of both a credit and a guarantee fund necessary? Why should USAID and the GOH guarantee their own funds?

Response: The Loan and Guarantee Funds have two different purposes. The first is to provide liquidity. Although in the recent past many (but not all) banks have been highly liquid, this situation appears to be

¹ Periodic evaluations will provide information on the cost per job created for all enterprises. These evaluations will serve to make any necessary adjustments in eligibility or other criteria.

changing quickly and the banking system now faces a lack of liquidity. The Loan Fund will permit relatively illiquid institutions to have a source of funding for SSEs. Second, and more importantly, the Loan Fund makes it possible for SSEs to receive longer-term loans which many banks are now unable to provide because savers, concerned about economic and political uncertainty in the country, are cautious about making long-term deposits. Third, during the expansion phase of the project, new PFIs which very often are relatively illiquid, such as Savings and Loan Cooperatives and Savings and Loan Associations will be invited to participate in the project in order to expand the financial network.

The Guarantee Fund, on the other hand, will permit SSEs with viable projects, but without sufficient or adequate collateral, to have access to commercial credit. Thus, we would reduce the banks' exposure but leave them with enough risk to ensure that they would perform adequate financial analysis. Ongoing discussions with banks suggest that the Guarantee Fund will be in great demand. Since banks can guarantee loans using their own funds (and not just loans made available through the Project's credit program), Project resources will leverage considerable private sector resources and increase lending to SSEs, even if the lack of liquidity turns out to be a short-term problem and the Credit Fund does not move as quickly as anticipated.

In sum, the two components are highly complementary but serve distinct needs. The PFIs have the option of using the Loan Fund or the Guarantee Fund or both. To the extent that PFIs use the Guarantee Fund in conjunction with the Loan Fund, it will help ensure that POPEME resources are channeled to riskier enterprises which would not normally receive bank credit.

The Guarantee Fund will generate sufficient income through capital investments and fees to cover anticipated defaults from the Loan Fund program. Hence, USAID-GOB principal will not be used when the program is underway to cover defaults. Moreover, in case of default, banks must repay principal and interest from the Loan Fund, whether or not they use the Guarantee Fund.

4. Issue: The Project will initially work with three NGOs who at present are not financially self-sufficient. To what extent should the Project seek to ensure their sufficiency by Project end?

Response: The Mission determined that for those NGOs with credit programs, total self-sufficiency is highly desirable and should be pursued. This objective has been carefully incorporated in Project design. All credit programs are designed to be self-sufficient. However, Mission and A.I.D. experience also recognizes that training and technical assistance efforts may never be fully recoverable or self-sufficient if we are to support microenterprises and work with the smallest of the small-scale enterprises. Given the very high cost of reaching this target group (often with loans of \$100-\$500), it is difficult, if not impossible, to pass along all administrative costs plus technical assistance and training costs to borrowers. Therefore, complete self-sufficiency, i.e., including technical assistance and training programs, may be outside the reach of some of these NGOs, and, if insisted upon, would push the NGOs to eliminate technical assistance and training programs from their SSE assistance packages.

In order to assist the NGOs to maximize efforts to attain self-sufficiency for their entire program or, at a minimum, independence from A.I.D. financing, the Project will work with the NGOs to identify additional sources of revenue -- specifically through the implementation of revenue-generating activities and the commitment of other donor and/or private and public sector funding. While the Mission may not provide additional funding to the initial three NGOs beyond the life of the Project, it will retain the flexibility to finance future efforts associated with training and technical assistance. As noted above, all credit programs are expected to be self-sufficient.

B. Recommendation

The proposed Project fully supports the USAID commitment to establish sustained economic growth and development by creating employment and increasing incomes. Moreover, providing employment opportunities to Hondurans is a key priority in the GOH National Development Plan. It is the Project Design Committee's opinion that the Project is technically, financially, socially, and economically sound. Therefore, the Committee recommends that the USAID/Honduras Mission Director authorize the Project.

II. BACKGROUND AND RATIONALE

A. Definition of the Problem: Macroeconomic Setting

With a per capita GDP in 1985 of approximately \$769 (in 1988 values), Honduras is one of the poorest countries in the Western Hemisphere. At the end of 1987, approximately two thirds of the population had earnings below the estimated poverty line income of \$230 per annum.

Honduras' poverty is reflected in key social indicators associated with underdevelopment. The human resource base is extremely weak and social services are woefully inadequate. This is evidenced by the literacy rate which, for the adult population, is a low 60%. Moreover, only 20% of the rural population over 14 years of age is literate. The situation is similar in the health sector where, despite considerable progress over the last decade, generally poor health conditions continue to limit productivity, earning power, and improvements in the quality of life for most Hondurans. Malnutrition affects nearly 40% of the population. Sanitation and housing are inadequate for the majority of the population. These and other factors contribute to a high infant mortality rate (79/1000--third worst in Latin America) and a life expectancy of only 62 years, lowest in Central America.

High levels of unemployment -- the result of low labor productivity and a lackluster economy -- are viewed by most Hondurans, including the GOH, as the critical issue confronting the economy and the well being of the country. At the same time, labor market conditions (i.e., wage levels and unemployment rate) generally are a reliable indicator of the health of a society. In Honduras, labor market conditions have gone from bad to worse during the 1980s and threaten to deteriorate even further as the decade ends. An estimated

12% of the population is unemployed and underemployment accounts for perhaps a similar figure.¹ Moreover, the aggregate figures hide the especially hard impact that adverse labor market conditions are having on specific population subgroups. For instance, GOH employment figures in September 1986 cited unemployment rates of 21% and 18% for men and women, respectively, between the ages of 15 and 24 years living in urban areas. March 1985 figures show that over 51% of the unemployed in Tegucigalpa and San Pedro Sula (Honduras' two largest cities) had been unemployed for over three months, and over 18% for two years or more. Such statistics suggest the existence of a substantial core of long-term unemployed who are in danger of becoming unemployable.

The wage situation in the labor market is equally bleak. September 1986 figures indicate that 22% of the employed urban workers labored more than 36 hours per week yet earned less than \$100 per month—a level of income which places these workers at just barely above subsistence. Moreover, if one takes into account that GDP per capita has fallen from 1980 to 1986, and that labor force growth has been substantial (estimated at 3.5%), it is very likely that real wage rates have fallen significantly.²

Current labor market conditions are troublesome, but even more so is the possibility that these conditions will worsen in the coming years unless corrective actions are taken. Economic growth is expected to be modest in the near future. Yet Honduras is likely to continue to experience high labor force growth rates for over a decade. As a consequence, the demand for labor will not be sufficient to absorb the ever-increasing numbers of workers entering the labor force. The GOH estimates that by 1986, about 30,000 additional workers were being added to the labor market each year—but that only 10,000 new productive jobs were being created annually. As a result, unemployment rates might rise in the near term, or, more likely, real wages could fall even further.

To the extent that Honduras has a predominantly agricultural-based economy, opportunities to create jobs and increase incomes must be sought in the agricultural sector, including off-farm employment in agroindustry and support services, supplies, and equipment for agriculture. But demographic trends (urbanization exceeds 6% per annum) and low productivity indicate that jobs must also be created and incomes increased in the non-agricultural sector to meet the employment challenge facing Honduras as it approaches the 21st century. Yet, although the manufacturing sector's contribution to GDP and employment has increased during the past 15 years—accounting for 12% of GDP in 1986—performance has been poor.

¹ The GOH's General Directorate of Statistics and USAID's Office of Economic Policy Analysis estimate unemployment at 12%. Using an incomes based approach, the IBRD estimates open and underemployment at 25%.

² See the USAID/Honduras Employment Strategy Paper. The above section summarizes its findings. The paper provides a comprehensive picture of the labor situation in Honduras. Copies are available in USAID/H and LAC/CA.

Manufacturing output grew at a reasonable average rate of 5.6% per year in real terms during the 1970s but declined by 2.5% per year during 1981-85. The large import-substitution industrialization (ISI) firms that were initiated or expanded in the sixties and seventies still account for a considerable portion of the industrial value added and total output. However, they are in many cases inefficient and are financially viable only due to protective tariffs and special incentives associated with the ISI model. Investment costs per job created through these firms appear to have exceeded \$15,000 in all cases and approached \$30,000 in many.¹ Under these conditions, investment in the range of \$150-300 million per year would be required for the industrial sector to absorb even one-third of new entrants into the labor force (\$15,000 or \$30,000 X 10,000).

In sum, the critical problem facing the Honduran economy and its policymakers is to generate additional productive employment and increase incomes to improve the well being of the Honduran people. Yet the agricultural sector can meet only part of this demand while the manufacturing sector as a whole has been stagnant and has failed to produce the jobs needed to absorb the growing labor force at anything approaching a reasonable investment cost.

B. Response to the Problem: Promotion of Small-Scale Enterprises (SSEs)²

The importance of SSEs in creating productive jobs and enhancing incomes of the poor in developing countries is widely recognized in the development literature. Over the years, ISI firms in Honduras have been unable to create increasing numbers of jobs. While precise data are not available, it is estimated that in Honduras, large-scale ISI-type enterprises actually provide fewer jobs today than they did a decade ago. Moreover, as in many developing

¹ Development Alternatives, Inc., The Effect of Policy on Small Industry Development in Honduras, USAID/H contracted study, 1987 and, ARIES Project, Honduras--A Small and Micro Enterprise Development Strategy, March 1987. These documents will be referred to as the DAI Policy Study and the ARIES Honduras Strategy respectively.

² The term SSE is used in a broad sense in this section to cover microenterprises (which employ less than 5 persons and have fixed assets of less than \$10,000) and small enterprises (which employ from 5 to 19 workers and have fixed assets of less than \$25,000). The term Medium-Scale enterprises, also used throughout this paper as part of the SSE definition, encompasses firms which employ from 20 to 99 workers and have a capital base between \$25,000 and \$250,000. This definition conforms to that used in the 1974 Industrial Census. Note, however, that Section IV establishes an alternative definition of SSEs based on AID/W guidance and the Mission's experience in its Small Business Development Project SB I). This latter definition will be used in this Project.

countries, SSEs, particularly microenterprises, are by far the most important component of the industrial sector -- in terms of total number of firms and contribution to employment. SSEs include both "formal" enterprises (i.e., those registered with GOH authorities, which pay taxes, licenses, and other government charges) and those "informal" enterprises which operate outside of government control and registration systems.

Table 1 below summarizes findings from the 1974 Industrial Census and illustrates that Honduras' industrial structure is dominated by microenterprises with relatively few small, medium, or large enterprises. Of the approximately 38,000 Honduran industrial enterprises identified by the census, approximately 98% of these firms fell into the microenterprise category (under five workers).

The 1974 survey demonstrated that microenterprises make the greatest contribution to industrial employment, providing jobs to approximately 57% of the industrial workforce of approximately 90,000 laborers (see Table I). Recent updates of employment data indicate that microenterprises now play an even greater role in the provision of industrial jobs. Central Bank data estimate that currently there exists a universe of approximately 300,000 individuals, employed by about 78,000 SSEs in various subsectors. ¹ In fact, microenterprises (sometimes called the informal sector) are the only segment of the industrial sector that grew significantly throughout the last decade. An additional 40,000 micro businesses are engaged in commerce and services (including market vendors and street merchants) and employ approximately 120,000 people. ²

These figures illustrate the importance and magnitude of SSEs in Honduras. Based on 1985 Central Bank estimates of an economically active population of 1.11 million, SSEs in industry, service, and commerce employed more than a third of the total workforce. This estimate coincides with a World Bank figure of approximately 300,000 persons who are employed by SSEs. ³ In Tegucigalpa alone, microenterprises are estimated to employ nearly half of the workforce. ⁴ Numerous studies indicate that these figures significantly underestimate employment by SSEs in rural areas of the country.

Finally, studies commissioned by the Mission indicated that SSEs in Honduras outperformed larger ISI firms in net return to capital, net return to

¹ ARIES Honduras Strategy. pg. 16. The PP document uses the 300,000 figure to denominate the universe of potential beneficiaries.

² DAI Policy Study

³ World Bank, Country Memorandum, 1986.

⁴ ARIES Honduras Strategy

labor, and social cost/benefit measurements (see following paragraphs).¹

In sum, SSEs form the most important component of the industrial sector not only from the point of view of number of firms and people employed, but also with respect to the overall efficiency of resources allocated to industry. The advantages of SSE promotion — as a means both to overcome the employment and low income problems facing Honduras and to attain other important developmental objectives — are summarized below.

* Potential to Increase Employment Levels: Based on comparative data on investment cost per job created, SSEs tend to employ more direct labor per unit of capital than larger enterprises. Studies also show that SSEs generate more indirect employment as well, due to the stimulation of complimentary businesses (forward and backward linkages). Data in Honduras demonstrate that jobs created by SSEs (fixed capital per worker) cost considerably less than those created by larger enterprises (approximately \$500-4,500 per job for micro-, small and medium-sized firms, versus \$17,000 to \$30,000 for larger enterprises).²

* Dynamism of SSEs: In many developing countries, SSEs represent the fastest growing segment of the economy and the most important provider of new jobs. As noted above, figures in Honduras have confirmed this fact.

* Impact on the Poor: SSEs generally undertake activities having appreciably higher employment demand for unskilled workers which translates into greater employment opportunities for the poor and their ability to increase their incomes. Moreover, due to the nature of SSEs, the unskilled also often gain experience in other facets of business, including management and other tasks requiring greater skill levels.

* Higher Productivity of Capital: SSEs, with a lower level of investment per worker, tend to achieve a higher productivity of capital than do larger, more capital-intensive enterprises. Available data measuring value added in relation to financing for enterprises in Honduras suggests that small manufacturing firms outperform other enterprises in the same manufacturing sector. Output per capital ratios for small and large enterprises in Honduras range from 2.13-3.57 for SSEs to 0.28-1.41 for larger firms, indicating much higher productivity for smaller enterprises.³

¹ DAI Policy Study and ARIES Honduras Strategy

² DAI Policy Study and ARIES Honduras Strategy

³ DAI Policy Study and ARIES Honduras Strategy

TABLE I
SIZE DISTRIBUTION OF INDUSTRIAL FIRMS

	No. of Firms	Percent of Total	Employ- ment	Percent of Total	Gross Value Added (Lps. 000)	Percent of Total	Output	Percent of Total
Artisan (1-4)	36,973	97.8%	50,137	57.1%	NA	NA	NA	NA
Small (5-19)	476	1.3%	4,606	5.3%	17,166	7.1%	60,473	6.1%
Medium (20-99)	292	0.8%	13,012	14.8%	79,769	33.2%	397,396	40.3%
Large (over 100 employees)	81	0.2%	19,975	22.8%	143,485	59.7%	528,219	53.6%
TOTAL	37,822	100.0%	87,730	100.0%	240,420	100.0%	986,088	100.0%

SOURCE: Stallman, Judith and Pease, James "Rural Industrialization Policy and Programs in Honduras: A Preliminary Assessment" International Labor Office, Geneva.

* Encouragement of Private Sector-Led Growth: Fostering SSEs supports the development of market-led growth and of a dynamic, indigenous private sector. Forward linkages to larger scale enterprises, such as subcontracting arrangements, for example, provide a means for established firms to play important roles in technical assistance, marketing, and other functions. Moreover, emphasis on the importance of SSEs to the overall economy, particularly those firms towards the micro and small end of the spectrum, will increase awareness among the general population about the pluralistic nature of the private sector and will reinforce democratic values.

* Other Arguments for Promoting SSEs include: The creation of complementary businesses; SSEs' effectiveness as mechanisms to support economic decentralization; the stability and coherence they lend to communities; their generally minimal adverse environmental impact; their importance as generators of savings; and their role as a major source of employment for women.

For these reasons and others listed in the development literature, the promotion of SSEs is considered a viable and effective mechanism to increase employment and incomes in both rural and urban areas in Honduras. SSE promotion addresses the employment problem facing Honduras and encourages the country to rethink national policies and procedures which discriminate against the use of labor absorptive production techniques in favor of an excessive use of capital. Furthermore, assistance to SSEs addresses a major A. I. D. developmental priority, which is to support and strengthen the private sector as a catalyst for economic growth and development, and responds to the U.S. Congressional mandate to channel increasing levels of resources to microenterprises.

C. Constraints to the Growth of SSEs in Honduras

Despite the recognized attributes of SSEs, numerous constraints inhibit their development and growth. These include policy, institutional, financial, technical, and attitudinal constraints, which are discussed below.

1. Policy Constraints

One of the important characteristics of the Honduran industrial sector is the overwhelming number of microenterprises compared to small, medium, and large firms. Indeed, microenterprises account for the great majority of firms in the industrial sector, as noted earlier in Table 1. This relative absence of small- and medium-scale firms is disturbing because studies have demonstrated that, while microenterprises are very important generators of employment (particularly compared with large firms), the small enterprise and the lower range of medium-sized enterprises are more efficient and have greater economic potential, in terms of employment, value added and other economic measurements. An increase in the number of small firms and medium-sized firms would, therefore, be expected to have a greater impact on the development of the Honduran economy.

The relative absence of small- and medium-scale enterprises in Honduras raises an important question: Given their dynamic nature, why don't microenterprises grow (i.e., "graduate" to the formal sector and to formal financial institutions)? The answer is complicated and differs by subsector and even according to firm. There are numerous reasons and constraints that affect their growth, as noted below. Perhaps most important is the hidden, yet pervasive influence of inappropriate macroeconomic policies and regulations. The potential for economic growth is limited by the distortions and inefficiencies generated by these policies, which effectively prevent microenterprises from "graduating" to the formal sector.

For example, financial market policies cap the maximum lending rate, thereby providing a disincentive for banks to lend to smaller, riskier clients. At the same time, most microenterprises and some small firms only have access to informal credit at ruinous interest rates. Exchange rate policy supports an overvalued Lempira (currently L2 = \$1) which primarily benefits larger enterprises that have access to foreign exchange at the official rate. Smaller firms must purchase imported inputs through other channels and add the customary markups. Similarly, trade policies favor firms that can readily obtain tax exemptions on imported inputs. In effect, financial market and exchange rate policies as well as trade policies lower the cost of capital for larger firms but hurt the competitive position of small firms. In addition, the tight monetary policy required to maintain the official exchange rate reduces the liquidity of the system and the limited financial resources are channeled to the larger well collateralized big firms.

Another result of Honduran trade and exchange rate policy, albeit unintended, which hurts smaller firms is the large quantity of smuggled goods entering the country. Contraband is destroying firms in the shoe production, textiles, and clothing industries—subsectors dominated by large numbers of microenterprises. At the same time, these firms' export potential is severely hampered. The cost of Honduras' progressive labor legislation -- provisions such as the seventh day and 13th month of pay -- also affects the smaller, more labor-intensive firms disproportionately to their financial means, because the wage bill for those firms, i.e., SSEs, is proportionately greater than for larger, more capital-intensive firms.

The implementation of policies is plagued by bureaucratic inefficiency. The existing system of tramités or red tape saps the resources of all firms but particularly inhibits the progress of small firms. The process is sufficiently complicated and costly that it discourages smaller firms from attempting to receive benefits under the Industrial Incentives Laws, to import products directly or, to a lesser degree, to export. Although it is illegal to be unregistered, the cost of legalizing a firm includes paying all back taxes due since the firm began operations. Thus, unregistered SSEs comprising the "informal" sector must leap over a high barrier of costs to join their formal sector counterparts and grow. Annex II, Exhibit C presents an overview of steps required to register firms formally as well as a flowchart of steps required to classify firms.

If the employment and economic potential of SSEs is to be realized and needed dynamism injected into the Honduran economy, inappropriate policy and regulatory conditions such as those outlined above should be corrected.¹ While this Project alone cannot redress the existing imbalance, it will initiate policy research and analysis and will support other Mission efforts directed at policy reform.

2. Institutional Constraints

There are numerous constraints associated with institutions that provide various services to SSEs. An important one concerns limited service coverage to SSEs. Commercial banks have not traditionally provided loans to SSEs because of the high transactions costs and high risk (lack of collateral) that SSE lending represents. Those banks that have expressed interest in providing assistance to SSEs have also requested technical assistance in the areas of management information systems, asset and liability management and small business project analysis.

In the absence of commercial bank lending to SSEs, public and non-governmental organizations (NGOs) have attempted to fill the gap. There are approximately 25 such organizations in Honduras that provide some type of service to SSEs through approximately four SSE promotion "models."² Yet coverage of SSEs by these institutions is extremely low. A recent survey indicates that only 6,700, or less than 10% of small- and medium-scale industrial enterprises in Honduras received some type of services in 1986.³

Overall individual coverage by existing NGO institutions is low, ranging from approximately 150 to 2,600 clients assisted yearly. Only five (non-banking) organizations reach over 100 clients per year.⁴ Yet expansion

¹ The previously cited DAI Policy Study presents a thorough description of policy constraints which this section very briefly summarizes. A more complete summary is presented as Annex II, Exhibit D. The complete study is listed as unattached Annex III, Exhibit B, and is available in USAID Honduras and LAC/DR.

² These models are described in the ARIES Honduras Strategy Paper, unattached Annex III, Exhibit D, pages 40-46.

³ Ibid. This survey assumed no overlap; services include credit, TA, training, attendance at workshops or seminars, and promotional talks.

⁴ They include the National Association of Industrialists' Program for Small and Micro Enterprise (ANDI/PYME), Advisors for Development (ASEPADE), Honduran Development Foundation (FUNADEH), Center for Industrial Development Rural Technologies Program (CDI/PTR), and the Honduran National Association of Small and Medium-sized Industries (ANMPIH).

of coverage is a difficult task. Many of these organizations are relatively new. Others can be categorized as "mom and pop" operations whose capacity to grow is limited. Others, particularly—though not exclusively—public sector institutions, are burdened with high management costs and operational ineffectiveness. Moreover, the experience of A. I. D. and other donors has demonstrated that transforming organizations with small programs to organizations with significant outreach capacity is extremely difficult and must be undertaken with caution in order to avoid overextending the institutional capacity of the entities.

Another problem faced by many of these institutions is their limited ability to raise resources through fund-raising and/or charges for services. Contributing to the problem is the fact that donor programs have not emphasized self-sufficiency nor have they in most cases been concerned with this issue. No Honduran NGO serving SSEs is presently financially independent and all must depend on some form of donor assistance. However, some credit programs, notably those of ASEPARE and FUNADEH, have attained a high level of self-sufficiency. While it may be difficult, if not impossible, to attain self-sufficiency for overall programs, NGOs supporting SSE development can give greater attention to financial viability, including generating income from services and attracting contributions from additional resources, especially those in the private sector.

Inadequately trained staff, particularly in the areas of accounting and financial controls, data processing, and overall credit delivery, is another institutional constraint that affects many NGOs.

Finally, there is a notable absence of effective coordination between NGOs and donors supporting SSE development, as well as between these institutions and the government. Efforts to improve coordination have been undertaken over the last year with some success. For example, in November 1987, the Friedrich Ebert Foundation sponsored a conference that brought together numerous local NGOs to discuss problems faced by the SSEs. Another example is the recently established Committee on the Informal Sector which includes representatives from Honduran small business assistance entities, the formal financial sector, and the GOB. Its purpose is to discuss problems of SSEs, and to define and implement a course of action. While some efforts have been initiated, there is considerable room for improving coordination of efforts—particularly those geared to analyzing policy constraints and making recommendations to solve these constraints.

3. Financial Market Constraints

A major impediment to SSE growth is very limited access to formal credit resources by SSEs, particularly microenterprises and the smaller range of small enterprises. A credit demand analysis of SSEs confirmed that their potential annual needs (\$115 million) far outstrip the availability of credit from the existing NGO programs and the formal banking sector. (See Part VI.D.1) Until recently, the linkage between the financial sector and the small business assistance community was practically nonexistent. As in most

countries, the formal banking system is apprehensive about lending to small enterprises. To a large extent, this resistance is understandable given the higher costs associated with a large portfolio of small loans, higher risks of lending to the sector, and the low levels of collateral that SSEs can offer. Yet while banking is (and should be) a conservative business, the Honduran financial community relies almost exclusively on asset-based lending, i.e., collateral, for its lending decisions. This precludes the financing of many projects which could be justified on a cash-flow basis. Reliance on collateral as a basis for financing has a particularly negative impact on SSEs, particularly the smallest of these enterprises.

There are also structural constraints which inhibit lending to SSEs. For example, preferences accorded to the public sector in the financial sector (e.g., tax free bonds earning 10% annual interest with no risk for banks holding these instruments) leave little incentive for banks to increase their lending portfolio to SSEs or in many cases for larger SSEs or medium-scale businesses to make additional investments. Thus, the lack of access to financial resources by many SSEs must be viewed not only in the context of limited availability of funds, but also as part of a series of policy and structural constraints which plague the financial sector.

Finally, lack of liquidity is a constraint to SSE lending. NCO organizations chronically face a liquidity problem, but more recently in Honduras, lack of liquidity is an issue for PFIs as well. While banks were liquid through most of 1987, at the end of the year, excess liquidity began to diminish as a result of a seasonal peak for coffee pre-export and export financing and Christmas inventory purchases. In early 1988, the Central Bank announced a 3% legal reserve increase effected in monthly increments of 1% from February through April. This measure has hastened the reduction of liquidity in the system.

4. Technical Constraints

The owners, managers and workers in the majority of informal sector businesses and other SSEs lack sufficient knowledge of basic business, management and technical operations to permit them to expand. Knowledge and application of basic management tools such as accounting systems and inventory controls are not common among SSEs.

These shortcomings are compounded by a limited knowledge of marketing and a lack of information on available markets for their products. At the micro- and small-enterprise level, marketing of products appears to be haphazard and few learning opportunities exist that directly meet the needs of the entrepreneurs. For larger SSEs and medium-scale enterprises, attempts to enter the international market are hampered by export regulations, lack of information on the international marketplace, and the difficulty of meeting quantity and quality standards and delivery targets.

5. Attitudinal Constraints

One of the most important characteristics of an entrepreneur is his/her willingness to take risks to mobilize the enterprise. Yet the Honduran business community tends to be risk averse and is often reluctant to take the steps necessary to expand production, or to undertake new ventures and investments due to the high risks involved at the micro level. The microentrepreneur often has no choice since there are few other income-earning opportunities. For the microentrepreneur to survive, he must accept adverse conditions. Expanding production beyond the micro level and particularly from the small- to the medium-scale enterprise level, however, requires risking hard-earned capital that may be lost in the undertaking. This category of Honduran businessman is characteristically conservative by nature and frequently does not demonstrate resourcefulness, flexibility or willingness to take risks. In essence, then, a problem affecting the growth of many enterprises in Honduras is the lack of entrepreneurship among many business persons at all levels.

D. Overview of Recent USAID-Supported SSE Activities and Lessons Learned

In recognition of the importance of small-scale enterprises and of the problems and constraints affecting their growth and development, the Mission has undertaken various activities that support them through the implementation of several projects and operational program grants (OPGs). These activities are briefly presented here.

1. Overview of USAID-Supported SSE Activities

USAID/Honduras' development strategy has been based on the premise that private sector-led growth resulting in the generation of foreign exchange and employment is the most appropriate way to address the weak economic conditions prevalent in Honduras. In recognition of the extent of rural poverty and the importance of rural enterprises in Honduras, the Mission approved the Rural Technologies Project (522-0157) in 1979. A main focus of the project has been to increase small-scale rural industrial production and employment through the introduction of improved production and management systems and the establishment of new enterprises. The project has provided financial support to the Centro de Desarrollo Industrial's (CDI) Rural Technologies Program (PTR) component. PTR, previously an autonomous division of CDI and now a semiautonomous unit within the Ministry of Economy, has offices in rural areas throughout the country and provides vital services to the small-scale industrial and agro-industrial sector, including technology adaptation and dissemination and limited amounts of credit. A 1986 project evaluation indicated that the dissemination of technologies has had a highly positive economic impact on the rural participants. It found that, on average, rural participants increased their annual income by approximately 27%. Assistance has been provided to small-scale rural industries with significant potential for generating income and employment, as well as foreign exchange through exports.

In the early 1980s, various studies identified the major problems of the small- and medium-scale enterprises as low availability of and access to credit sources and a limited understanding of administration, marketing, technical knowhow and the legal environment. In 1984, the Mission approved the Small Business Development Project (SB I, 522-0205), its flagship project in support of SSE development. The project was designed to expand financial and technical assistance to a segment of the private sector that had virtually no access to the banking system. It provided support for the establishment of a development-oriented but for-profit finance company, the Financiera Industrial y Agropecuaria (FIA), and a complementary technical assistance system (known as the Business Assistance System - BAS) which is coordinated by the National Association of Industrialists (ANDI).

FIA provides loans to small- and medium-scale businesses; as of March 1988, it has made 80 loans for \$3.2 million. FIA's activities are complemented by technical and managerial support provided by organizations participating in the EAS, or through its own newly created technical assistance capability. ANDI, through its PYME program (Programa para la Pequeña y Microempresa), coordinates existing small business service organizations, strengthening them through budgetary support, personnel training, financing of dollar costs of technical assistance, and the establishment of monitoring and evaluation systems. As of March 1988, the ANDI/PYME program has made 59 grants to 21 PVOs and has conducted 38 training courses.

The Small Business Development project has in fact developed a source of accessible financial and technical assistance for Honduras' small- and medium-scale businesses, thereby increasing production and employment in these businesses as recently confirmed by an independent evaluation of the project. The evaluation indicated that both organizations are positively affecting employment and income generation through the strengthening of small and medium-sized enterprises. FIA's program has directly created 650 jobs and maintained 700, while the ANDI/PYME network has resulted in the creation/maintenance of more than 5,000 jobs and the provision of technical assistance to over 3,000 small and microenterprises.

To complement the FIA/ANDI programs, the Mission also approved a series of small Operational Program Grants to NGOs which provide credit, technical assistance, and training services to small-scale enterprises so that they can expand their businesses and strengthen their technical and managerial skills.

For example, under the Microenterprise Development Project, Asesores para el Desarrollo (ASEPADE), a local NGO, is helping entrepreneurs in the informal sector to obtain access to credit to develop or expand as microenterprises. In 1984, a U.S. PVO, Acción Internacional/AITEC, initiated a pilot program with ASEPADE to serve the credit needs of the smallest urban businesses in Tegucigalpa and two other cities (now expanded to eight cities throughout the country). In August 1986, the Mission provided a local currency grant to AITEC to support an expansion of this program of credit and managerial assistance for microenterprises in the areas of services, manufacturing, small vendors and to businesses which are members of, or are forming, solidarity groups. Loans range between \$200 and \$1,000 per

beneficiary. The project goal is to improve the socioeconomic conditions of the lowest stratum of the economically active urban population, create new jobs and increase family incomes. In eighteen months, ASEPADE has made 3,160 loans totalling \$1,200,000; their efforts have resulted in the creation of 490 jobs (35% women) and maintenance of 3,700 jobs (59% women).

The National Foundation for the Development of Honduras (FUNADEH), a Honduran PVO, received a grant from the Mission in 1985 to focus on the provision of loans, technical assistance and training to micro- and small enterprises. FUNADEH is providing credit and technical assistance to small-scale and microenterprises with limited resources in and around San Pedro Sula, Honduras' second largest city and the country's business and commercial center. By increasing the profitability of selected SSEs, the project is helping these SSEs to establish and maintain a stable income base to create new employment opportunities. In three years, FUNADEH has made 650 loans totalling \$2.2 million; their efforts have created more than 1,000 jobs.

Beginning in mid-1985, USAID/Honduras also provided a grant of \$5 million in local currency equivalent to the Honduran Federation of PVOs (FOPRIDEH) which provides financing and technical assistance to the Honduran PVO community at large. To date, FOPRIDEH has approved grants totalling approximately \$1.5 million in local currency equivalent to 25 local organizations. A substantial number of projects approved by FOPRIDEH (10) in turn provide credit and production assistance to the SSE sector. The Mission also supported a local PVO working with small women's cooperatives in rural areas; this assistance has continued under the FOPRIDEH project.

Finally, in 1985, the Partners of the Americas initiated a program to train Honduran small business owners in the partner state, Vermont. To date, fifteen groups (each comprising 20 individuals) have received training in Vermont in areas such as basic accounting and management as well as technical areas (e.g., restaurant management, pork production, horticulture and dairy herd management).

2. Analytical Base and Lessons Learned

Through the implementation of these projects, including evaluations, contracted studies, and our review of current development literature on the design and implementation of SSE-type projects, USAID/Honduras has gained a valuable analytical base on SSEs.¹ This analytical base has assisted us to conceptualize and refine the strategy for the proposed Project. This section summarizes briefly key lessons learned that are relevant to the Project.

- * While discrete project-specific interventions are required in the promotion of SSEs, more important is the establishment of an adequate economic policy and regulatory environment that will benefit all SSEs and remove structural biases against them.

¹ A complete listing of the studies, evaluations, and other documents analyzed during Project design appears in Annex II, Exhibit E.

- * The formal financial system could reach the greatest number of SSEs and a strategy to accomplish this should be incorporated in a comprehensive SSE promotion strategy. The best way to do this is to ensure that the strategy promotes commercially viable activities and that it programs SSEs to "graduate" to borrowing from commercial financial institutions.
- * A strong base of institutions serving SSEs must be developed. But this institution-building process is a long-term proposition. In particular, these organizations must develop the managerial base to implement these programs efficiently. The long-term nature of the institution-building process also suggests that the establishment of new institutions should be undertaken only when no alternatives exist.
- * The long-term sustainability of these institutions depends upon their ability to achieve an adequate level of self-sufficiency. Credit programs in particular should become completely self-sufficient. While costs for training, technical assistance, and similar programs may not be completely recoverable, every effort should be made to recover at least a portion of these costs through fees and efficient, market-oriented credit programs.
- * Coordination of efforts among institutions serving SSEs is necessary and must be promoted. In particular, institutions serving SSEs must avoid duplication of efforts and concentrate in their areas of comparative advantage. For example, training is one area in which several organizations should avoid duplication and benefit from greater coordination. With regard to cooperation, however, programs must avoid a "forced marriage of interest between organizations."¹ Collaborative efforts must be beneficial to all participating entities.
- * There is an important "missing middle" of small- and medium-scale enterprises in Honduras that should be assisted as part of SSE programs if forward and backward linkages in the sector are to be maximized.
- * The literature on SSEs and our own experience verify the importance of involving implementing institutions in Project design.
- * The literature on SSEs and our own experience confirm that it is extremely difficult for the NGO training and technical assistance programs to become self-financing due to the relative inability of the beneficiaries to pay for the costs associated with these types of programs.
- * While Project design must be based on a clear and defined strategy, projects serving the SSE sector must be flexible in their design, allowing for operational modifications and the incorporation of

lessons learned. The Mission's ongoing small business activities have all undergone some modifications and improvements which have been instrumental to their success.

In addition to these general observations, numerous operational or technical "lessons learned" have been drawn upon in the course of implementing the current SSE portfolio and analyses of the sector. An important lesson learned is that credit delivery systems must be as simple as possible, with reduced information and administrative requirements. A serious mistake made in many SSE programs is that—to ensure proper "targeting"—the credit criteria which are developed result in a burdensome approval system. It has also been found that repayment schedules need to conform to the time profile of cash flow—but a "flexible" policy on loan repayments often results in inefficient and bankrupt programs. Experience in other programs in other countries indicates that the shorter the repayment period, the better the loan recovery rate. In any case, loan repayments must be strictly enforced.

Another key lesson learned is the importance of a well-designed, well-managed information and computerized data base system to track the loan portfolio and to provide vital information on job creation and increases in production value added.

B. Project Strategy

As measured in recent evaluations, Mission efforts to date in support of SSEs have been highly successful in accomplishing planned outputs. Our programs have helped establish a preliminary institutional base of support for SSEs. Through resources made available for credit, technical assistance, and training, these programs have reached thousands of businesspersons, helping to increase their production and incomes. However, despite their success, our programs are reaching only a small percentage (no more than perhaps 5%) of the target group. Moreover, serious constraints continue to affect the ability of SSEs to develop and expand.

In evaluating present and past efforts, and in further analyzing the problems and constraints facing SSEs, the Mission determined that a more comprehensive and far-reaching approach to SSE development was required. Accordingly, the proposed Project will implement an expanded SSE program as Honduras enters the 1990s. The Project will build on the valuable experience and lessons learned from our recent efforts. It will also address those constraints either not previously addressed, or for which our ongoing efforts are only partly complete.

The Project strategy is to direct efforts at two levels. First, Project resources will significantly but prudently expand the ongoing credit, technical assistance, and training efforts of initially six core institutions. The Project will reinforce and complete the long-term institution building process that has already begun with selected Honduran Non-Government Organizations (NGOs) serving SSEs, enabling those organizations to expand their service capacity and numbers of beneficiaries reached. These institution building efforts will constitute the second and final phase effort aimed at increasing the efficiency of ongoing NGO programs (the first phase

having been implemented under the SBI Project and the two OFGs). Institutional strengthening will be accomplished by improving the NOOs' managerial and technical capacities as well as by enhancing their chances of achieving financial self-sufficiency for, at a minimum, their credit programs.

At the same time, the Project will incorporate private financial institutions (PFIs) into the Mission's SSE outreach program, which will also significantly expand the number of beneficiaries assisted. The incorporation of private banks into the Project is perceived as the first phase of a long-term Mission strategy to address financial sector constraints and enhance the capability of the Honduran private financial system to serve as a catalyst for private sector led growth.

Second, the Project will place much greater emphasis on policy analysis and reform than has previously been the case. Under this Project, research and policy analysis activities will identify key policy constraints and elaborate recommendations for policy dialogue and change. The Project implementing team will work closely with policy-making bodies in both the public and private sectors to ensure coordination. Specifically, the Project will supply the analysis on policy constraints to SSE development to those entities -- such as the Honduran Council for Private Enterprise (COHEP), ANDI, and the chambers of commerce -- that lobby for and have the clout of achieve policy change with the Government of Honduras (GOH). The Project will provide close coordination with efforts under the Mission's Policy Analysis and Implementation Project (522-0325) and with the structural reform component of the Economic Support Fund (ESF) program. Through this emphasis on policy analysis and reform, the Project has the potential to benefit the entire universe of Honduran SSEs.

Maximum flexibility in implementation will be key to Project success. The Project will permit flexibility for innovation during implementation, including the possible expansion of core group institutions through Project amendments. Any such expansion will be subject to written USAID approval. The Project incorporates the design of a flexible and effective mechanism -- a contracted Project Technical Unit (PTU) -- to provide technical assistance to core group institutions, research and policy analysis support, and Project implementation support. In addition, during the course of Project implementation, the PTU will be encouraged to recommend to the Mission possible refinements or new approaches for reaching SSEs more effectively. (See Part IV for more discussion of the Project Technical Unit.)

III. PROGRAM FACTORS

A. Relationship to A.I.D. Policy, Mission Strategy and Action Plan, and Ongoing Projects

The promotion of SSEs through increased growth and development is a priority area for A.I.D. and one in which the Agency has had much experience. Through centrally funded programs like the Program for Investment in the Small Capital Enterprise Sector (PISCES), individual projects in most A.I.D. Missions, other donor programs, and considerable research in this area, the Agency has come to appreciate the economic and social dimensions of SSE

programs and their potential to contribute to economic development. SSEs have been a valuable instrument for the Agency to promote several of its mandates. For example, SSE promotion is an effective means of targeting the poor. Moreover, in terms of numbers of beneficiaries reached, support for SSEs is the most important component of the private sector in the majority of developing countries, and thus has been an effective mechanism for using private initiatives to catalyze economic growth and development.

More recently, the U.S. Congress has shown a greater awareness of the importance of SSE development and has mandated, through the earmarking of funds in the FY88 Continuing Resolution, that A.I.D. target microenterprises in its development programs. The SB II Project will contribute to meeting that objective. The Project's goal of providing increased employment opportunities also support the recommendations of the National Bipartisan Commission on Central America (NBCCA) and the Central American Initiative (CAI).

For the Mission, SSE promotion is a means to meet our Action Plan objective of generating productive employment under the broader goal of wider sharing of the benefits of growth. While the Project will certainly be instrumental in assisting the Mission to meet this goal, it will also support USAID efforts under another broad goal: Basic Structural Reforms Leading to Rapid and Sustained Economic Growth. The Project's policy analysis and reform efforts, in coordination with the ESP program and other USAID-supported projects such as the Policy Analysis and Implementation Project (522-0325), will help establish a more appropriate policy framework for the growth of small- and medium-scale businesses in Honduras.

The Project will be complementary to and will support the efforts of other USAID projects. For example, small-scale industrialists under the Land Use Productivity Enhancement Project (522-0292) will have access to credit funds under SB II, as will lumber operators under the Forestry Development Project (522-0246). In addition, local currency disbursements will continue to be provided to the Rural Technologies Program (PTR) to cover basic operating expenses of this program; furthermore, it is expected that the participating NGOs will contract with PTR to provide specialized technical assistance in the area of technology development and dissemination. Coordination with the CADERH OPG (522-0257) will be important since financing for industry specific training needs analysis and contracted training is available. The POPRIDEH OPG, fully funded and recently amended to extend its grant expiration date to March of 1989, will continue to provide limited grants to private, non-profit organizations, oriented towards the development of self-sustaining programs in Honduran communities nationwide. Support will continue to the Partners of the Americas/Vermont and Honduran branches which are implementing various small business training activities.

Similarly, the Project will complement the work being undertaken by Peace Corps Volunteers (PCVs) throughout Honduras. In fact, PCVs have been previously assigned to several of the Honduran organizations that will be supported through the Project (e.g., ASEPADE has had the services of a PCV whose field of expertise is data information and computer systems). It is expected that cooperation with the Peace Corps will continue and be expanded through SBII.

B. Relationship to GOH and Other Donor Programs

As noted in the GOH's four-year 1987-1990 National Development Plan, and in deliberations of the National Tripartite Commission—which includes representatives of the public, private, and labor sectors—providing employment opportunities is the number one priority for Honduras. The GOH has actively supported SSE development through numerous programs, some of which will receive limited assistance under this effort. In particular, the Mission supported Rural Technologies Project has been acclaimed by the GOH as a successful instrument in promoting employment.¹ The GOH will continue to support this and other SSE development programs. More recently, the GOH has expressed an interest in assessing the policy framework under which SSEs operate and in studying policy reforms required to increase their growth and development. Separately from the Project, the Mission will program local currency funds with the GOH to support these programs. In addition, the Project's technical assistance unit may also provide assistance to these programs.

Both bilateral and multilateral donors have also been active in SSE support in Honduras. Their support has for the most part targeted small and medium industry in order to increase both production (industrial/manufacturing, agricultural) and create new employment opportunities. In particular, the Inter-American Development Bank (IDB) has utilized its small program loan window to provide funds for several Honduran NGOs. The IDB program focuses primarily on institutional strengthening efforts to organizations that, in turn, provide credit to micro and small businesses. In the case of IDB programs, ensuring uniformity of interest rates and that these rates reflect market conditions has been a problem in the past. Through intensive dialogue with the IDB, however, these problems have been largely overcome. We will continue the dialogue with the IDB under this Project and will bring any policy discrepancies to the attention of AID/Washington.

The World Bank (IBRD) supports SSEs and medium-scale enterprises through the Fondo de Desarrollo Industrial (FONDEI), a Central Bank rediscount program implemented with a technical staff supported by the IBRD and the GOH. The UNDP has supported the Center for Industrial Development's (CDI) program of assistance for the development of small and medium industries, and plans to sign another agreement with CDI in the near future. The European Economic Community has promoted small rural enterprises through a simultaneous package of credit, technical assistance and training that leads to the diversification of income sources. The Canadians, Swiss and West Germans also have provided assistance to this sector mostly in the form of technical assistance and training and on a much smaller level than that of the multilaterals.

As part of the Project design effort, it became apparent through discussions with other donors, that there exists a lack of knowledge among donors of what others are doing in support of SSEs. The Project will seek

¹ The Mission anticipates that local currency funds will be provided to cover operating costs for PTR's program beginning in FY89. These funds will be programmed with the GOH.

active cooperation and dialogue with these donors, particularly in the area of policy coordination, including a concerted effort to highlight the policy constraints facing the SSE sector.¹

IV. PROJECT DESCRIPTION

A. Project Goal and Purpose

The Project goal is to increase employment and expand production. Indicators of achievement of the goal will be approximately 20,000 jobs created by 1993 and increased value added to production by SSEs.² This figure will increase the number of productive jobs currently being created on an annual basis by approximately 30%.

The Project purpose is to: (1) strengthen and expand an institutional system that will increase and improve the supply of credit, training, technical assistance, and services to SSEs; and (2) improve the policy and regulatory environment in which the SSEs operate. End-of-Project Status indicators will be an increase in direct coverage (i.e., individuals receiving assistance) of small-scale enterprises from 5,000 individuals to approximately 20,000; a 20% increase in formal bank lending to SSEs; the adoption of policy and regulatory reforms by the GOH; and two self-sufficient NGO credit programs.

¹ In an effort to begin donor coordination, a workshop/seminar will be held in 1989. This workshop will bring together numerous donors and NGOs to discuss how best to work together to strengthen individual institutions and increase services to the SSEs.

² This figure is based on estimates reviewed by the Mission of approximately 7,100 jobs to be created through the FUNADEH and ASEPADE programs; 6,900 jobs to be created through the PFI lending program; and approximately 6,000 indirect jobs to be created through forward and backward linkages, particularly through the PFI program. The experience in SSE development worldwide has indicated that approximately 1-3 indirect jobs are created for every direct job created. Our figures use a very conservative estimate of 0.5 indirect job created for every direct job created. The total direct employment number is also very conservative and is likely to be significantly higher. Because of the difficulty of quantifying jobs created by a second story organization, the total figure excludes ANDI/PYME estimates of 9,000 jobs created through their program. Moreover, the PFI lending program will in all likelihood, create jobs at less than \$5,000/job. Lowering this figure will significantly increase the number of jobs created. Most important, this figure does not take into consideration that number of additional jobs that may be created through an improved policy environment for SSEs. These measures alone could easily double or triple the number of jobs created.

Key assumptions linking the purpose and goal statements are: (1) a policy climate favorable to SSE development, particularly SSE lending; (2) continuing political and economic stability; and (3) continued support by Honduras for entities that assist SSEs.

B. Beneficiaries and Expected Accomplishments

In line with the Project strategy and purpose, resources will be targeted to existing SSEs throughout Honduras in industry, commerce and other nonagricultural sectors. Project activities will also strengthen local institutions that support the SSE sector.

1. Small-scale entrepreneurs

The main emphasis of the Project will be micro and small businesses which in Honduras are owned and run primarily by people who can be broadly categorized as the working poor. Data developed from the previous Small Business Development Project indicate that this target group has the following characteristics: low incomes, little education, and limited access to credit and the factors of production, except for labor. In the commercial sector, women entrepreneurs predominate and tend to have lower average incomes and the smallest businesses. Manufacturing enterprises are owned and operated by both sexes, with gender lines often drawn by product. While the focus of the Project will be micro and small enterprises, based on their potential importance to employment and economic development, the Project also will support medium enterprise development, through the participating for-profit financial sector institutions. (See Summary Social Analysis, Section V C and Annex II, Exhibit F for a more detailed description of project beneficiaries.)

Following new guidelines from the A.I.D. Advisory Committee on Microenterprise Development, we define microenterprises as firms which employ less than 10 persons and have fixed assets of less than \$10,000 and small enterprises as firms which employ from 11 to 25 workers and have fixed assets of \$10,001 to \$50,000. For the purposes of this Project, we define the term SSE to include micros and small businesses as well as medium-scale enterprises encompassing firms employing from 26 to 99 workers and having a capital base between \$50,001 and \$250,000.¹

The geographic emphasis of the Project will be on the Honduran growth corridor, an open "S" curve extending from the North Coast to Choluteca in the south, including both urban and rural areas. This area contains the greatest percentage and concentration of the population and the greatest number of

¹ The definition of small and microenterprises has been debated at length in the development literature. One major study suggests that there are over 50 definitions currently in use—all with some validity and some liabilities. The definition here has been chosen to incorporate the legal definition in Honduras and A.I.D.'s most recent definition as indicated in STATE 129707.

businesses. While the geographic focus is not exclusive, it is expected that the vast majority of SSEs assisted will be in these areas. SSE programs in other areas will be supported only to the extent that they are administratively and economically viable.

It is anticipated that the Project will provide direct assistance to approximately 30,000 individuals employed at the micro-, small- and medium-scale business level. This figure represents approximately 10% of the SSE universe. Including families, approximately 150,000 will directly benefit from the Project. Through forward and backward linkages, an additional 150,000 to 300,000 people will benefit from the Project. Moreover, the entire universe of SSEs will benefit from an improved policy environment which the Project will promote.

2. Intermediary Institutions

Initially, a core group of six intermediary institutions--three nongovernmental institutions (NGOs) and three private sector financial institutions (PFIs)--will implement this Project. The NGOs will receive grants to maintain and expand their ongoing small business assistance and small-scale lending programs. The PFIs will receive local-currency generated loans through a rediscount Loan Fund and will have access to a Guarantee Fund in order to encourage them to enter into or expand their SSE lending programs. Four of the entities (the three NGOs and one of the PFIs) were selected based on demonstrated strengths and potential observed over the past several years in carrying out A. I. D.-funded small business activities. The other two PFIs were selected based on their expressed interest in SSE lending.

After careful review of the broad spectrum of public and private institutions that support the SSEs in Honduras, the Mission has concluded the SSE support system currently established in Honduras can be most efficiently strengthened by expanding the programs of this selected core group.

The Project includes the initial participation of two additional private sector financial institutions in order to increase and improve the efficiency of commercial lending to SSEs. The Project will focus on building the capacity of the six institutions to support SSE growth in order to provide a continuous source of credit, technical assistance and training to small entrepreneurs in Honduras.

Assistance provided to the intermediary institutions will accomplish the following:

- * Minimum of two financially viable non-bank institutions with expanded programs providing credit, technical assistance and/or training to the SSEs;¹

¹ By the end of this Project, the NGOs should have reached a level of self-sufficiency and/or have generated sufficient non-AID funding so that they will not require additional financial support from A. I. D.

- * A strengthened second-story NGO providing greater support to NGOs and PVOs assisting SSEs;
- * Costs of NGOs providing services per SSE beneficiary reduced;
- * Substantially increased private financial sector participation in SSE lending;
- * A self-sustaining credit guarantee program.

C. Project Components

The SB II Project is composed of two interrelated components: (1) an SSE Support System component to strengthen and expand the programs of Honduran institutions, both NGOs and PFIs, which direct credit, technical assistance and training resources to the SSEs; and (2) an SSE Policy Analysis and Research component to focus primarily on research, data collection, and analysis efforts to assist policy-making institutions in the formulation of recommendations for policy changes which will lead to an improved policy environment for SSE development.

The first component will be implemented through dollar-funded Operational Program Grants (OPGs) to three leading Honduran NGOs assisting SSEs. These grants will ensure that their programs are sustainable over the long term. It will also include a Loan and Guarantee Fund that will channel through Honduran Private Financial Institutions (PFIs), including commercial banks and finance companies. This combination of activities will expand the number of SSEs that currently have access to services necessary to increase their production. These services include credit, technical assistance, and training.

The second component will assist the GOH and the Honduran private sector to establish an effective policy environment for SSE development in Honduras. A major constraint to this objective is the lack of accurate, reliable, and current data on SSEs, particularly data on microenterprises. This component will: (1) undertake discrete research activities which will give the GOH, the private sector, and the Mission a more detailed, analytic base on SSEs for continued program development and modification, and (2) support specific policy and regulatory analyses to facilitate policy dialogue between the public and private sectors. Honduran SSEs in general will benefit from this research, policy analysis, and dialogue.

The Project will establish a Project Technical Unit (PTU) consisting of a U.S. institutional contractor which will assist the private sector institutions in overall Project implementation. The PTU will have four specific functions: (1) to provide technical assistance to the NGOs and financial institutions participating in the Project with primary responsibility to the initial three NGOs; (2) to work with these entities and other leading private and public sector institutions in the broader arena of policy analysis and research; (3) to advise the Mission on a continuing basis on the implementation of our SSE strategy; and (4) to assist Project implementing agencies in day-to-day Project management, including monitoring and processing of Project-related documents, e.g., vouchers, reports, action memos. Although the PTU will prepare all documentation in draft, final approval of all documentation will rest with the Mission.

- 29 -

Contracted directly by the Mission, the PTU will be responsible to the Office of Private Sector Programs (PSP). Project funds will finance a Project Liaison Officer assigned to PSP to work directly with the PTU in the oversight and management of all Project activities.

The Project will address the constraints previously cited. Improving the policy framework under which SSEs operate through research and policy analyses is a specific Project objective. Institutional constraints are also specifically addressed. In particular, the Project aims to establish sustainable programs which will continue to assist SSEs long after the Project terminates. The Project addresses the important constraint of inadequate access to financial resources. More important than simply providing credit resources, the Project's objective is to make NGO credit programs financially viable and ensure their long-term sustainability. Through an innovative guarantee program to reduce collateral requirements and through training and technical assistance for participating financial institutions, the Project also will have an important impact in expanding SSE access to the formal financial sector.¹ The SSEs' lack of marketing and technical knowledge also is addressed by the Project's NGO programs.

Finally, a Project of this type cannot in and of itself change risk aversion and other attitudinal constraints. But a more attractive policy environment and increased access to financial and technical resources will have an impact on the Honduran small-scale investor's perception that his hard earned capital can earn a profitable return.

1. SSE Support System (A.I.D. Contribution of \$9.1 million; COH Contribution of \$15 million Local Currency Equivalent; Private Sector Contribution of \$8.9 million Local Currency Equivalent)

The SSE support system component is divided into two subcomponents: (a) NGO strengthening and service expansion and (b) expanded financial system lending.

Initially, the NGOs included in the core group will be ANDI/PYME, ASEP/DE and FUNADEH. These three organizations were selected based on their past track records, their ability to expand their services, and their desire to participate in the program evidenced by their presentation of in-depth proposals. In-depth institutional analyses of the three organizations (see Part V and Annex III Exhibit C) corroborated their ability to participate successfully in the Project. Given the private sector nature of the Project, it was felt that initial focus should be on private sector institutions rather than those in the public sector (e.g., CDI, PTR).

¹ This guarantee program is described in the section on Expanded Financial System Lending.

Assistance to these organizations will be channeled through Operational Program Grants (OPGs) using appropriated funds. The private financial institutions (PFIs) which will participate initially are FIA, Banco de Occidente and BANCAHSA. Credit resources from ESP-generated local currencies will be provided to the PFIs on a loan basis through a Participation Agreement that will be signed between private financial institutions and the Central Bank of Honduras (BCH).¹ Through the PTU, each institution will also benefit from technical assistance and training to enhance the effectiveness of their ongoing or emerging SSE programs.

Although the Project will support six entities in the first year, the Project retains the flexibility to expand the core group as Project implementation progresses and management capabilities permit. This expansion will be financed through Project Amendments. In particular, it is expected that an expansion of participating PFIs, which will not require any Project amendments (since funding is available from ESP local currencies), will occur over the short term. Participation of NGOs will be based on a review of each institution's ongoing programs, level of coverage and potential impact, the market orientation of the organization, complementarity with ongoing programs, and technical and financial management capability. It is not expected that this Project will help create any new NGOs.

Pending the availability of additional funds (e.g., additional to those to be authorized initially under this Project), for expansion in years two and three, the Project Technical Unit, in coordination with the Mission, will initiate discussions with selected organizations to determine the most suitable candidates for participation. Expansion will be determined by the availability of funds and selection will be based upon the criteria outlined in Annex II, Exhibit G. The PTU will not initiate any discussions with new NGOs without prior written approval from USAID.

- a. NGO Strengthening and Service Expansion (A. I. D. Contribution of \$8.6 million; Private Sector Contribution of \$4.5 million Local Currency Equivalent)

The objective of this subcomponent is to provide technical assistance to the three participating NGOs to strengthen them as institutions and enable them to expand their actual output of services delivered to targeted SSEs. Through the Project, OPGs will be awarded to three leading Honduran institutions serving SSEs: FUNADEH (\$2 million), ASEPADE (\$2 million), and ANDI/PYME (\$4.6 million) to expand and improve their current programs. A summary description of the programs of each NGO is provided in Annex II, Exhibit H. Unattached Annex III, Exhibits E-G, available in USAID/Honduras Project bulk files, include the proposals presented by each NGO and a detailed description of each institution's program.

The PTU staff of long- and short-term advisors will provide institutional strengthening assistance to the three NGOs to improve their operational efficiency, increase their technical expertise in specific areas that are identified in their respective proposals (e.g., internal accounting systems, information systems, marketing assistance, etc.), and develop their monitoring and evaluation capacities.

31

The TA will be based both on the needs outlined in the individual grant/loan agreements with the participating entities and on the PTU's own assessment of needs within the core group in conjunction with these institutions and A.I.D. The NGOs and the PTU will sign annual technical assistance plans which will lay out the responsibilities of both parties with regard to TA and training efforts, and the level of TA and tasks expected. The PTU will be responsible for assuring the provision of TA either directly with its own staff and through a sub-contract for services, and/or identify and coordinate TA and training efforts with Honduran, U.S. or other private and public sector TA and training institutions.

Initially, the PTU will provide guidance and technical assistance in the areas of marketing, credit systems, overall program management and administration, management information systems and training systems. Through the assistance provided by the PTU, the three primary NGOs will further improve their capacity to provide credit, technical assistance, and training to their beneficiaries. A brief overview of the Project-supported activities of the NGOs in these areas follows.

(1) NGO Credit for SSEs

Approximately \$2.0 million in credit will be channeled through the NGOs, permitting them to increase their ongoing lending portfolios. The NGO credit programs will complement those of the PFIs (see below). The NGOs will reach a broad segment of the target group which have good business prospects but which are for the most part "unbankable" due to limited assets available for collateral, limited or no experience in obtaining resources from the formal banking system, and other concerns. Hence, the NGO credit programs aim to reach a target group which would not be covered by the private financial system.

ASEPADE in particular will reach the poorest segment of the target group which is currently perceived as not creditworthy -- microenterprises including the micro commerce sector. FUNADEH will reach the larger of the microenterprise and small-scale business target group; it is expected that many of FUNADEH's clients can become bankable over the medium term.¹ Indeed, a key Project objective is to graduate clients from informal sources of credit to private commercial banks, initially under the Project to the three participating PFIs. Special emphasis will be placed on establishing good working relations between the NGOs and the PFIs to enhance this graduation process.

The credit program will adhere to market principles, both in the determination of costs to borrowers and costs to the implementing institution. The principal thrust of the Project-supported credit programs is

¹ ANDI/PYME does not have a credit program and, therefore, is not discussed in this section.

not only to make resources available to SSEs, but to ensure that these programs are economically and financially sustainable. Interest rates to NGO borrowers currently range between 17% to 24%; during Project implementation, rates will be increased as necessary to ensure that credit programs are financially viable and cover all credit-related operating expenses.

The NGOs will receive credit funds on a grant basis from the Mission. Nonetheless, FUNADEH and ASEPADE have agreed to impute an initial interest rate of 12% which will be increased by approximately 2% per year to either the ceiling on lending rates for commercial banks, or an equivalent market rate in the absence of such a ceiling.¹

Interest generated from this imputation process will recapitalize the NGO's credit funds. It will also establish administrative discipline in the operation of these credit programs in that resources from this 12% rate will not be used to cover operating expenses or bad debts. Rather, operating expenses and loan loss reserves will have to be covered by the remaining spread charged by the institution. Through this mechanism, the Project aims to make the FUNADEH and ASEPADE credit programs self-sufficient and put them in a position to gain access to commercial loans, rather than rely on grant resources for the future expansion of their credit programs. Over the course of Project implementation, these institutions will essentially impute an amount equivalent to what banks would charge them to onlend resources and make it possible for them to borrow profitably from the formal financial sector in the future to enhance their credit programs. This mechanism will also increase the incentive that FUNADEH and ASEPADE have to charge interest rates that reflect the higher transactions costs and risk inherent in lending to SSEs. Section V.A.5 describes the imputation process in detail. This concept will be outlined in each of the OPG agreements with these NGOs.

(2) NGO Technical Assistance/Training Services for SSEs

ANDI/PYME, ASEPADE, and FUNADEH all provide training services to their clientele. (In the case of FUNADEH, they usually contract out their training, but would like to be able to provide limited training services themselves.) The PTU will review the existing training programs to determine their quality (course content, appropriateness of topic, methodology used) and value compared to cost. The PTU will suggest necessary changes to improve the overall quality of the training programs and their usefulness to the SSE sector.

As required, the PTU will assist the intermediaries in the design and development of new courses and/or identify existing Honduran or Central American training institutions whose courses are practicable for use by

¹ Imputation is defined in Part V. A.5.

project beneficiaries. For example, a local NGO, Gerentes y Empresarios Asociados de Honduras (GEMAH), has initiated a pilot training program for small businesses based on a model developed by the Carvajal Foundation in Cali, Colombia. If the pilot program is successful, the PTU could contract GEMAH to carry out more extensive small business training under SB II.

The NGOs will also require specific technical assistance as they develop and expand their programs. For example, in the case of ASEPADE, despite the great strides that the organization has made in the management and operation of its microenterprise support programs, the Mission and ASEPADE both feel that the presence of a full-time advisor will be of continuing benefit to the organization. We recognize that SSE programs require close monitoring and overall management to ensure an efficient and cost-effective program. Moreover, alone among the core group entities, ASEPADE is faced with the inherent difficulties of dealing with a much larger target group of microenterprises which results in an extremely high volume of loans and rapid rotation of funds. Therefore, in order to continue to assist ASEPADE with the day-to-day management of its programs, an individual will be contracted to work full-time with ASEPADE and its Executive Director. This individual will either be contracted through the PTU (and be a member of the long-term TA team) or will be contracted directly by ASEPADE itself. In addition, short-term assistance for specific requirements will be provided as needed, particularly in the area of accounting and financial management. We anticipate that other NGOs will require ongoing support from the PTU as well as selected short-term assistance, as described in their proposals.

Based on our analyses, SSEs are likely to require technical assistance in a number of key areas: basic accounting, financial analysis, management principles, and marketing. Project-supported NGOs will play a key role in providing these services to a greater number of SSEs. A brief illustrative description of two key areas -- accounting and marketing -- where TA and training are expected to be provided to the SSEs follows.

Our past experience confirms that most small enterprises have no formal accounting system. Business accounts and funds are commingled with family accounts and funds; few records of purchases or sales are kept. As a result, SSE owners have difficulty estimating their annual or monthly sales volume or their profit margin. Many lack any systematic way of establishing costs of production and oftentimes pricing for the products sold is unrelated to the cost of production. The need for training in basic accounting practices is fundamental for all SSEs; Project technical assistance and training efforts will focus priority attention on this area.

Another area requiring attention is marketing. A majority of small businesspersons lack sufficient marketing knowledge necessary to develop their businesses. Market research at this level is nonexistent; small entrepreneurs produce what they think they can sell or simply what they know how to produce. For most of the target group, marketing is haphazard and inefficient, even though it is one of the keys to the survival of an enterprise in a limited national market such as the one in Honduras.

Through implementing institutions supported in most cases by the Project Technical Unit, the Project will address marketing constraints through several means. First, credit resources and technical assistance will be targeted to micro- and small-scale commercial enterprises that market goods produced by SSEs. Second, implementing entities, as well as the PTU, will aggressively establish production/marketing links between micro- and small-scale enterprises and between these enterprises and medium- and large-scale businesses. Third, through research efforts undertaken by the PTU, specific marketing constraints and means of overcoming them will be identified. Fourth and finally, training will be provided to the intermediaries to assist them to develop marketing strategies to be disseminated to the SSEs.

In the first instance, FUNADEH and ASEPARE will continue to target resources directly to commercial enterprises since most of their client entrepreneurs market their goods through small commercial outlets or stalls in the marketplaces. These commercial intermediaries generally lack financing for inventory and so cannot pay the producer for the goods to be sold until they are actually sold. These two intermediaries have acknowledged the linkage between producer and commercial outlet and are now providing financing to commercial enterprises. Under the new Project, these activities will be closely monitored and ways of strengthening these linkages devised.

Secondly, production/marketing links between micro- and small-scale enterprises and between these enterprises and medium- and large-scale businesses will be strengthened. One highly successful effort has already begun in the shoe industry. Honduras has literally hundreds of shoemakers, most of whom operate independently as family businesses with perhaps one or two nonfamily employees. Many of these shoemakers have a difficult time making a living, because they lack quality raw materials, have inadequate equipment, and must compete with cheaper contraband goods in the limited domestic market. These problems were identified by an International Executive Service Corps (IESC) volunteer brought in by FUNADEH to help a group of shoemakers that had received FUNADEH financing. The volunteer also identified one very important comparative advantage that these shoemakers had — superb hand stitching. This volunteer began working with FUNADEH and FIDE, a local export and investment promotion agency which implements an A.I.D. assisted export promotion project, to develop a project to hand-sew leather uppers for shoes as part of a U.S. assembly operation.¹ Under contract with a U.S. shoe company, three medium-sized shoe companies (20-25 employees) as well as two larger shoe companies, have been organized to assemble leather shoes from U.S. raw materials.

Thirdly, the PTU, in conjunction with ANDI, FIDE and others, will continue to identify major marketing constraints that small-scale businesses face in Honduras. This will be done primarily through contracted industrial

¹ This is an assembly operation which is governed by Section 807 of the Tariff Schedule of the United States and therefore is exempt from Lautenberg Amendment restrictions.

profiles of up to five industries where SSEs predominate. Fourth they will then assist the participating entities, primarily the NGOs, to develop and initiate basic marketing training programs and product-specific strategies for the SSEs, e.g., programs that link micro and small-scale enterprises to larger-scale enterprises through contracting-out or other means. Individual or group training seminars may then be scheduled by the intermediaries (especially by ANDI/PYME) and their effectiveness monitored by the PTU. In addition, in coordination with the intermediaries, the PTU will undertake an assessment of available markets and product market strategies and the results will then be applied in appropriate SSE training courses.

Training resources for small and microenterprises will be available under the CADERH OPG (522-0241). CADERH's component II (Industry Specific Training Needs Analyses and Contracted Training) has financing available for the undertaking of training needs analyses as well as funds to contract specific industry-related training (predominately vocational training for workers in such areas as tailoring, shoemaking, metallurgy, woodworking, etc.). Financing is provided on the basis of low interest loans (NGOs may wish to contract CADERH's services). NGOs and SSEs can submit proposals for training analyses and/or training to CADERH. For example, ANDI/PYME would like to undertake analyses of five industries where SSEs predominate in order to get a better understanding of the industrial environment. It is likely CADERH will be contracted to undertake these studies for ANDI.

Training will be contracted on the basis of training performance objectives defined by CADERH and the SSE. Trainees will receive training and be evaluated on the basis of CADERH's certification system with payment for training contracts made on the basis of the number of people who master the previously defined training objectives. Whenever possible, local trainer counterparts will participate in training programs so that a multiplier effect can be achieved after the initial training is completed.

The SBII Project will provide an opportunity for the Peace Corps to expand their services to Honduran NGOs assisting the SSE sector. As previously noted, some PCVs are already working with these institutions. Furthermore, discussions are underway with the Peace Corps to determine how their contribution in this area can be strengthened.

- b. Expanded Financial System Lending (A. I. D. Contribution of \$550,000; GOH Contribution of \$15 million Local Currency Equivalent; Private Sector Contribution of \$4.4 million Local Currency Equivalent)

- (1) Overview

The commercial banking system and numerous NGOs in Honduras have made loans to SSEs in varying degrees. Lending to SSEs by commercial banks has been mostly directed to larger, better collateralized firms on the upper end of the small business spectrum. The few micro and small firms which can provide sufficient collateral are, according to USAID research, of only marginal interest to the banks because of the relatively high transactions

36

costs and high risk associated with smaller loans. Given the legal lending rate limit of 17% currently placed on commercial bank loans, banks cannot raise their rates sufficiently to compensate for these costs. NGOs have also provided financial assistance to SSEs, but these institutions are relatively illiquid and have difficulty achieving financial self-sufficiency due to their small portfolios. In short, available loan sources have the following characteristics: banks, with available resources, show only marginal interest in small business loans; NGOs, which show interest are illiquid; informal sources of credit (local money lenders) offer very high rates; and traditional government programs are unresponsive.

A.I.D. experience in Honduras indicates that, given the importance of the private financial system to overall business development, three conditions must be met before the SSEs' potential can be fully realized: (1) a broad spectrum of SSEs must have access to commercial credit; (2) the institutional capabilities of the private financial institutions to develop large SSE lending programs must be strengthened; and (3) policy constraints to the commercial viability of SSEs, such as the legal lending rate limit, and a cumbersome regulatory environment must be rectified.

A banking analysis undertaken by USAID revealed that, given the high risk and relatively high transactions costs of small business lending, a significant increase in lending to SSEs by private financial institutions (PFIs) would require the following conditions:

- * Interest spreads would have to be sufficiently ample to cover costs and produce a profit. This implies that interest rates charged must be at least the same or higher than the prevailing market rates charged by banks to their preferred, larger customers;
- * Risk would have to be reduced or minimized to get financial institutions to reduce excessive collateral requirements;
- * Banks would have to be free to use their established procedures in loan analysis and approval system, in order to maintain financial discipline.

With these principles in mind, and building upon the credit experience of local PFIs, the Project will establish a Small- and Medium-Scale Fund (Spanish Acronym: FOPEME) to expand lending to SSEs by Honduran private financial institutions (PFIs) including commercial banks, finance companies, cooperatives and credit unions, and other private entities.¹ FOPEME will consist of two inter-related but independent sub-components. One will be a rediscount credit facility to finance SSE lending by participating PFIs. The other consists of a self-sustaining Guarantee Fund which will partially secure the loans made by PFIs through FOPEME credit resources or their own resources. The Guarantee Fund will thus reduce the PFIs' exposure but will leave enough risk for the banks to ensure that they would treat each loan with due care.

¹ PFIs are defined as private financial institutions that will sign the Participation Agreement with the BCH.

The participating PFIs will use their existing systems and procedures to channel increasing volumes of credit to SSEs at marginal cost to a new client group with reasonable expectations of profit. Additionally, formal financial institutions will continue to tap domestic savings, channeling a percentage to their SSE lending program and leveraging the Project financial resources. With the participation of private financial system institutions, the Project will channel more resources to a greater number of entrepreneurs, resulting in significant increases in productive employment and value added.

The Small Business Loan and Guarantee Funds, initially funded at consisting of \$14.0 million and \$1.0 million in local currency equivalents, respectively, will be financed by a COH ESF-generated local currency contribution. The objectives of FOPEME is to:

1. Create new jobs: It is estimated that among SSEs a credit of about \$5,000 will result in the creation of new job. PIA's experience todate indicates that they have created an additional direct job for every \$4,923 of credit. Disregarding the multiplier effect and assuming that investment by SSEs will be financed 30% by the PFIs and 70% by the Loan Fund, the \$14.0 million participation of the loan fund and the \$13.1 million accumulated profit would represent a total outstanding portfolio of about \$35.1 million after ten years of operation. Assuming average maturity of three years for the loans it would mean that, in year five, the Project has generated approximately 6,921 new jobs.
2. Leverage PFI resources for SSE lending: Under the Project, PFIs are entitled to a maximum rediscount of 70% of the amount of the loan disbursed to a PFI, therefore leveraging private sector resources. For every seventy cents disbursed from the loan fund the PFIs would contribute 30 cents from their own resources. Moreover, the Guarantee Fund will leverage PFI lending from their own resources.
3. Encourage medium-term credits to SSEs: At present there are few financial institutions engaged in term lending to SSEs. Through the rediscount and guarantee mechanism, the Project will encourage medium-term lending, since the PFIs credit rediscount operation will be based on the term that the PFIs give to the SSEs.

The Loan and Guarantee Funds are complementary. The Loan Fund will permit relatively illiquid institutions to have a source of funding for SSEs. Although in the recent past banks have been highly liquid, the banking system now faces a lack of liquidity. The Loan Fund also makes it possible for banks to make term loans, by providing access to resources for longer terms than are currently available to banks. The Guarantee Fund will permit SSEs with a viable project, but without sufficient or adequate collateral, to have access to commercial credit.

Discussions with banks suggest that the Guarantee Fund will be in great demand. Since banks can guarantee loans using their own funds (and not just loans made available through the Project's credit program), Project resources will leverage considerable private resources and increase lending to SSEs.

FOPEME, both Loan and Guarantee funds, will be managed by the Industrial Development Fund (FONDEI) representing the Central Bank of Honduras (BCH) and acting as a Fiduciary Agent for the funds. The bilateral project agreement will detail operating guidelines and responsibilities.

(2) Loan Fund

(a) Operating Procedures

As previously noted, the FOPEME loan fund will be initially capitalized at \$14.0 million in local currency equivalent, to support lending to small-scale enterprises.¹ The Loan Fund will have minimal eligibility requirements and straightforward operating procedures so as to facilitate its usage. To establish and manage the loan fund and channel financial resources to the PFIs, the Central Bank will assign FONDEI to serve as a Fiduciary Agent.

FOPEME will work as a rediscount mechanism, financing 70% of the loans disbursed by the PFI. The banks will, therefore, be required to provide 30% of the loan from their own resources. Since they are likely in turn to require a minimum equity of 20% from borrowers, the fund will leverage a higher volume of private sector funds.

The Fiduciary Agent will make funds available to the PFIs under the terms and conditions of the Participation Agreements that it will sign with each participating financial institution. The Participation Agreement will, among other things, specify eligible SSE borrowers, maximum amount of the loan, method of disbursement and payment to the Loan Fund, cost of money to PFIs from the Loan Fund, the percentage of loans eligible for guarantee and the premium to be charged (these conditions are outlined below).

The Fiduciary Agent will not have the authority to reject a loan requested by a PFI. The approval or rejection of the loan is solely at the discretion of the PFI. The BCH will continue to have the authority to spot check the loans approved to see if they adhere to the terms and conditions of the Participation Agreement. The PFIs will, as needed, fill out a form and request from the Fiduciary Agent disbursements from FOPEME under the loan fund. The Fiduciary Agent will honor the requests within two business days. The funds will be credited in the account that the PFIs will open or already maintain with the BCH.

The direct costs of the Fiduciary Agent for its management services will be financed through local currency resources. All net earnings of the Loan Fund will be used to increase the capital base of the Fund. (Additional roles and functions of the Fiduciary Agent are described in Part V.A.2.)

¹ Although this amount will be reserved for the Loan Fund through established local currency procedures between the Mission and the GOH smaller tranches may be made to FONDEI, the Fiduciary Agent, in the initial stages of implementation as Loan Fund activities are initiated.

The Fiduciary Agent will act on behalf of the COH in managing the day-to-day operations of POPEME. The income from the Loan Fund will pay for the Agent's services. The Fiduciary Agent will not be liable for the losses incurred by the Loan Fund except when, according to an independent authority, its mismanagement has been the cause of the loss.

(b) Eligible PFIs

The three institutions which will participate initially are the Financiera Industrial y Agropecuaria (PIA), Banco La Capitalizadora Hondurena, S.A. (BANCAHSA) and Banco de Occidente. These institutions have been selected based on their interest in the SSE sector and their potential to expand their SSE credit portfolios significantly. The Fund will be open to any private financial institution that qualifies and signs the Participation Agreement. Additional participants will include commercial banks and finance companies, and could include cooperatives, credit unions, and similar institutions. In addition, POPEME may after a careful assesment, permit lending to NGO intermediary institutions that lend to SSEs under the same terms and conditions as those that apply to the banks.

The PFIs will be also encouraged to enter into arrangements with NGOs and producer associations whereby these organizations borrow Project funds from financial institutions to support their productive microenterprise lending activities after the Project Agreement Completion Date (PACD). Alternatively, NGOs and producer associations may also enter into cooperative arrangements with the financial institutions to support the latter's lending activities through any combination of screening, monitoring, training, and guarantee services. Thus, disbursements from POPEME by the Fiduciary Agent to the participating institutions may go through a second-level lending institution to reach the borrower. This procedure reduces bank administrative costs of dealing with smaller enterprises.

(c) Terms to PFIs

A. I. D. wishes to encourage the mobilization of domestic savings. Accordingly, the cost of funds to participating institutions will be set at the cost of capital, i.e., the cost of mobilizing savings to the banks, which is currently estimated to be approximately 12% per annum. This costs of POPEME funds fully supports recommendations made by the Mission's recent "credit dilemma" study, which highlighted the fact that below mobilization costs of rediscount lines was impeding savings mobilization and was a constraint to an efficient financial system.

Within guidelines established within the Participation Agreement, the loan length given to the PFI will be exactly the same length that the PFI gives to the SSE. For example, if the PFI gives the SSE a term of five years with a one-year grace period, the Fiduciary Agent will give that same term to the PFI. Participating PFIs will be able to tap the Loan Fund on a demand basis -- no amount will be reserved for any particular institution. In this fashion, fund resources will be available to those that move the Loan Fund aggressively. The advantage of the Loan Fund to the banks is easy access to long-term resources, particularly if liquidity is reduced in the short or medium term.

(d) Eligible Enterprises

The direct beneficiaries of the Project include micro, small and medium enterprises. The target group by classification and anticipated need are as follow:

Micro Enterprises

1 to 10 employees.

Total assets of less than \$10,000 (excluding land and buildings)

Small Enterprises

11 to 25 employees.

Total assets of more than \$10,001 and less than \$50,000 (excluding land and buildings)

Medium Enterprises

26 to 99 employees

Total assets of more than \$50,001 and less than \$250,000 (excluding land and building).

In order to minimize conditions on the lending program and to maximize the attractiveness of the Loan Fund to the banks, PFIs will not be required to allocate a fixed percentage of funds to any of these categories. Thus, the market will determine the efficient use of loan resources. It is the objective of the program that POPEME resources will increase PFI interest in lending to SSEs, including smaller firms. But A.I.D.'s experience in Honduras and elsewhere has shown that forcing a particular clientele on private banks can be difficult and, most often, unproductive. The Mission will monitor the program closely to ensure that the average loan size is reasonable and that Project objectives are met.

(e) Terms to SSEs

The Project will provide working capital and medium-term financing (the terms for which are to be defined by the participating PFI) for the acquisition of fixed assets and working capital requirements of SSEs engaged in all productive, distributive, service, and agribusiness activities. Only agricultural activities will be excluded, since USAID is providing financial assistance to this sector through other projects.

The maximum loan amount will initially be \$125,000, subject to review at the end of the first year of implementation of the Fund. Based on the Mission's experience, this limit will be sufficiently high to cover the investment and working capital needs of dynamic medium-scale firms. It is anticipated, however, that most loans will be significantly smaller, averaging in the \$10,000 to \$20,000 range. Minimum amounts will be established by the PFIs according to their individual credit policy.

To avoid disruption in their programs, the PFIs will establish both the terms and the interest rates for the SSEs. Interest rates to each client will

41-

be freely determined by each participating institution. A.I.D. will encourage all participants to institute competitive pricing policies, sufficient to cover cost of funds, risk, profit, and the greater administrative expenses associated with SSE lending. Given the costs of resources to the banks (approximately 12%), and based on a minimum spread of 5% that is likely to be required by banks to recover all costs, it is fully anticipated that all loans will be made at the current maximum ceiling of 17%. Whenever possible, the participating financial institutions will be encouraged to develop fees and commissions separate from the interest rate so that SSE lending becomes an attractive line of business to the institution despite the overall interest rate lending ceiling presently imposed by the BCH. Approval and/or rejection of each loan is solely at the discretion of the PFI.

The Loan Fund is consistent with USAID policy to encourage financial institutions to extend credit to SSEs with terms suited to each enterprise. Additionally, the Project terms and conditions need to be few and simple, though fundamental, to allow each lending officer maximum flexibility to structure the loan package most appropriate to each client, within the general lending restrictions of the Project. Therefore, the conditions outlined here are judged to be appropriate to reach the intended target group with maximum flexibility.

3. Guarantee Fund

(1) Operating Procedures

A Guarantee Fund, initially set at \$1.0 million equivalent from local currency resources, will be also be managed by the Fiduciary Agent. As with the Loan Fund, the terms and conditions which govern the use of the guarantee mechanism will be set out in a Participation Agreement executed between the Fiduciary Agent and the PFI. Once a PFI signs the Participation Agreement they will automatically have access to both the Loan and the Guarantee Funds. The two Funds will be treated as a separate cost centers. The Guarantee Fund will secure up to 70% of the loan made by PFIs to the SSEs. The 30% exposure of the bank is small enough to reduce the risk, yet large enough to insure careful lending practices. The Guarantee Fund will increase its capitalization by investment of its capital base and by a one-time, up-front premium of 6% collected from the SSEs for use of the guarantee. The initial capital base will serve as a safeguard or buffer in the case that the actual default rate is higher than the projected rate. If this were the case, the one time premium would be adjusted immediately to compensate for this loss. Utilizing resources from the initial capital base for purposes other than short term emergencies would be equivalent to failure.

The Mission recognizes that previous A.I.D. experience with guarantee funds has been mixed, at best. To date, Honduras has no experience with guarantee programs of this type. Other guarantee programs have been designed in Honduras but have not worked since the rules of the game were unclear and there was too much margin for interpretation. However, the operational design of this fund was based on the success of a guarantee fund designed by the A.I.D. Mission in Panama for a similar small business project. The Panama fund was so successful that the private insurance companies were interested in purchasing the fund from the government.

42

Default rates have been projected on the basis of the experience of the local private commercial banks and the careful lending practices of the financial intermediaries who will provide credit under this Project. These rates, however, will be affected in part by the inherently riskier nature of small business lending. It is reasonable, then, to expect that default rates under this Project will be greater than the PFI's historical rates. To insure prudent sub-loan approvals and disbursement and hence containment of the default rate, the PFIs will take 30% of the risk on the uncollateralized portion of each loan guarantee.

Taking into account experience elsewhere, as well as the unique element of this Project which will bring lending practices in line with normal bank standards, it was the consensus of the banks and A.I.D. that the default rate would be about 4.5-5.5%. Project projections are based on this estimate. Theoretically, we could leverage the guarantee reserves at least 20 times. Thus with \$1.0 million we could guarantee up to \$20.0 million. However, until a track record is established, Project estimates remain conservative and the Guarantee Fund will leverage the reserves no more than 1:10.

The Guarantee Fund will be self-sufficient since the earnings from the invested capital and from the 6% one time charge on amounts guaranteed will be sufficient to meet all claims against the fund and to accumulate surpluses. If successful, the Guarantee Fund may be reinsured by a group of private insurance company or sold to them, so that they, in turn, would offer the 70% guarantee for small business lending. At this stage, the initial capital base plus its generated revenues would be returned to the GOR.

In managing the day-to-day operations of the Guarantee Fund, the Fiduciary Agent will act on behalf of the GOR. Fund income will pay for the Agent's services. The Fiduciary Agent is not liable for the losses incurred by the Guarantee Fund except, when according to an independent authority, its mismanagement has been the cause of the loss.

(b) Eligible PFIs

As with the Loan Fund, the three institutions which will participate initially are the Financiera Industrial Agropecuaria (FIA), Banco La Capitalizadora Hondurena, S.A. (BANCAHSA) and Banco de Occidente. However, the Fund will be open to any private financial institution that qualifies under the general terms of the Participation Agreement.

(c) Terms to PFIs

The Participation Agreement between the PFIs and the Fiduciary Agent and will specify SSE borrowers eligible for guarantees, method of payment from the Guarantee Fund in case of bad debts, administrative and legal steps to be taken by PFIs in cases of default by SSEs, the percentage of loans eligible for guarantee and the premium to be charged (these conditions are outlined below). Similar to the Credit Fund, the Fiduciary Agent will not have the authority to reject a guarantee requested by a PFI. The approval or rejection of the guarantee will be solely at the discretion of the PFI. The BCH will continue to have the authority to spot check the guarantees approved to see if

47

they adhere to the terms and conditions of the Participation Agreement. The PFIs will request guarantee certificates from the Fiduciary Agent under the Guarantee Fund. The Fiduciary Agent will provide the certificates within two business days.

The Fund will provide a collateral base upon which private financial institutions could make loans to borrowers that lack sufficient collateral. PFIs may use the Guarantee Fund to cover POPME loans or loans using their own resources. The PFIs would, at their option, secure the 70% guarantee by submitting a simple form and forwarding it along with a check to cover the premium to the BCH. As demonstrated in Section V.A.5.b., the earnings from the invested capital base and from the one-time 6% premium charged will be sufficient to meet all claims against the fund and accumulate surpluses. The BCH may, at its discretion, suspend new loans and/or guarantees to any PFI if, in its judgement, the PFI does not comply with the Participating Agreement or if its financial performance is considered unsatisfactory. The Fiduciary Agent may also increase the premium to a PFI if its default rate increases.

The Fiduciary Agent will honor claims against the Guarantee Fund within 48 hours after receiving the request from a PFI. To apply for the reimbursement request, the PFI must meet the following conditions:

- The loan has to be in arrears, as defined in the loan agreement between the bank and the borrower, for a period of 120 or more days.
- The bank has to indicate that it has used its normal operating procedures for collection, e.g. telephone calls, letters, visits, etc.
- The bank has to present the balance of the loan to determine the outstanding principal due and calculate the Guarantee Fund's exposure.
- The PFI has to present evidence that legal court procedures have been initiated against the SSE.

After determining the Guarantee Funds liability, the Fiduciary Agent will proceed to credit the account of the PFI with 70% of the outstanding principal. The disbursement will be considered to be an interest-free loan to the PFI until all legal procedures have been completed and the SSE assets are liquidated. The funds that are recovered after the court settlement will be distributed proportionately between the PFI (30%) and the Guarantee Fund (70%) after all fees, interest, and legal expenses have been deducted. The PFI will then proceed to repay the interest-free loan.

(d) Eligible Enterprises

Eligibility criteria will be the same as for the Loan Fund.

(4) Technical Assistance and Training to Borrowers

The PFIs will not provide training and technical assistance to their borrowers directly. Rather, they will channel their borrowers to the institution that they consider most appropriate to provide these services (INPOP, GEMAH, FIDE, ANDI/PYME and other public or private sector

institutions). They will charge for this TA based on their own policy. Through the PTU, the Project will make a concerted effort to establish effective linkages between these institutions and the participating PFIs.

(5) Technical Assistance and Training to PFIs

Through the PTU, technical assistance and training efforts will be targeted to improve the capabilities of Honduras' financial system. In addition, as noted in the following section, policy research efforts will also analyze financial system constraints and identify possible solutions.

During the initial stages of Project implementation, the PTU will conduct an updated assessment of financial system training and technical assistance needs. Under the ANDI/PYME OPG, Project funds have been budgeted and reserved to the Mission for training seminars at institutions such as INCAE and GEMAH, as well as for technical assistance specifically targeted at the financial sector. For example, the project will provide expert consultants in bank operations through consulting firms and the International Executive Service Corps (IESC). FIA has requested assistance in strategic planning and funding mechanisms; BANCAHSA has requested support in account profitability and MIS; and Banco de Occidente needs assistance in designing the implementation framework for their SSE lending program, asset/liability management, MIS and savings mobilization.

The total cost of the bank training component is approximately \$550,000 of which A.I.D. will finance \$500,000 and the PFIs \$50,000 in staff salaries and local expenses.

2. SSE Research and Policy Analysis (\$200,000 in DA Grant Funds and GOB contribution \$1 million local currency equivalent)

The objective of this component is to assist the GOB and the Honduran private sector to establish an effective policy environment for SSE development in Honduras. Although the estimated costs of the proposed activities are not a large percentage of total Project costs, they are nonetheless important first steps in establishing a more appropriate policy environment.

A major constraint to this objective is the lack of reliable and current data on SSEs, particularly data on microenterprises. As noted in one recent study, "most (microenterprises) elude the standard statistical nets and exist frequently unobserved in the underground economy."¹ This component will: (1) undertake discrete research activities which will give the GOB, the private sector, and the Mission a more detailed, analytic base on SSEs to permit continued program development and modification, and (2) support specific policy and regulatory analyses and reforms which facilitate policy

¹ Liedholm and Meade, Small Scale Industries in Developing Countries: Empirical Evidence and Policy Implications, 1987.

- 45 -

dialogue between the public and private sectors and which lead to policy changes that assist the development of SSEs in Honduras. These research, policy analysis and dialogue activities and the implementation of recommendations from those activities will have an impact on all SSEs.

The PTU, in close coordination with leading Honduran public and private sector institutions, will lead efforts to conduct research on SSEs in Honduras, and will analyze, on a continuing basis, the policy framework affecting them. To provide greater assurance of acceptance, dissemination of findings will be led by institutions such as the Honduran Council for Private Enterprise (COHEP), Cortes Chamber of Commerce (CCIC), ANDI, and the Ministry of Economy. This component will closely coordinate with and complement efforts under the Mission's Policy Analysis and Implementation Project. For example, the PTU will play a lead role in SSE-related analyses undertaken by COHEP through the Policy Project.

a. Research

Although some work has been done in Honduras in recent years to gain a clearer picture of the role of SSEs in the economy, there still exists a paucity of hard, accurate data. The Project will strengthen knowledge about SSEs in Honduras in two ways. First, the PTU will assist implementing institutions, particular the NGOs, to strengthen their current data base of existing clients. The organizations already disaggregate data according to sex, capital base, sales, and other variables. There is room for improvement in this undertaking, however, without adding to the management burden of the NGOs or the SSEs. Based on the improved data collection capabilities of the NGOs, the PTU will prepare quarterly reports on the characteristics of enterprises being assisted under the Project. The aim of these reports will be to better quantify the number and type of SSEs assisted under the Project.

In addition, these reports will strengthen the country's knowledge and understanding of SSEs. As necessary, the PTU, in coordination with the core group intermediaries and other organizations that may be identified, will gather additional detailed information to determine how specific policies affect the functioning of SSEs, the best channels for improving policy, and appropriate arrangements to change those policies. The data gathered will supplement that already existing. To the extent possible, PTU technicians will work with other institutions assisting the SSEs (e.g., the Center for Industrial Development, POPRIDEH) to strengthen their own data gathering capabilities and to develop a comprehensive, updated data base of SSE activities.

Second, the Project will support through the PTU and/or direct financing, specific SSE-related studies that will be conducted through private and public sector Honduran institutions. For example, the Project will support the efforts of a committee of NGOs led by ASEPADE, financial sector institutions, and the Ministry of Economy to analyze the problems of small business development, including those enterprises in the Honduran "informal sector" (broadly defined as those micro and small enterprises that are not formally constituted under the Honduran Commercial Code).

46

As a separate but complementary activity, ANDI/PYME will establish a data bank for its client PVOs and financial institutions who wish to gain access to this mechanism. ANDI/PYME recognizes that much data collected and analysed over the years has been lost for lack of an institutional memory or capacity to retain the data. As a result, this data bank will be created to serve as the repository for much of the data that will be collected during the life of the Project.

In sum, at the end of the Project, Honduras will benefit from a much greater understanding of who the small-scale entrepreneurs are, what their role in the economy is, and the problems and issues they face in trying to develop and grow.

b. Policy Analysis

As noted in Section II. C. 1. and reflected in the 1987 study on The Effect of Policy Upon Small Industry Development in Honduras, there are numerous policy constraints which inhibit economic growth and the development of SSEs in the country. A number of these constraints are macro in nature (e.g., the overvalued exchange rate; crowding out of the private sector from financial markets as a result of public sector deficits; interest rate ceilings; a cumbersome regulatory environment and trade regime). Although their resolution is beyond the scope of this Project, their importance to SSE development highlights the need for close coordination between the SB II Project, the GOH-USAID ESP program, and other related programs such as the Policy Analysis and Implementation Project.

The proposed Project will assist Honduran private and public sector institutions to analyze these constraints. It will do so by first increasing the awareness among Hondurans (both in the public and private sectors) of the critical link between a sound policy environment and SSE development. Second, through the PTU and private and public sector institutions, the Project will finance analyses of specific policy issues, and will support and coordinate fora to disseminate findings and carry out policy dialogue.

An important first step has already been taken to increase awareness of policy constraints to SSE development. The previously cited study on The Effect of Policy Upon Small Industry Development in Honduras, undertaken as part of Project design has provided a wealth of information on policy issues. The GOH and the private sector have expressed considerable interest in the study. Accordingly, a conference or workshop will be undertaken during the first six months of Project implementation to disseminate its findings, to exchange public and private sector views on its conclusions, and to begin a dialogue on SSE policy constraints. This event will be sponsored by a leading private sector institution to be identified (ANDI, COHEP, and the CCIC are likely candidates) with the collaboration of NGOs that support SSE development, by the Ministry of Economy, or co-sponsored by the latter and the private sector.

From this conference will flow follow-up analyses and other workshops and conferences on specific policy constraints and issues. Approximately four major conferences or workshops will be undertaken during the life of the

Project. The Project specifically budgets for three and it is expected that the fourth as well as others will be financed from other activities (e.g., funds from other USAID-supported initiatives such as the Policy Analysis and Implementation Project; activities supported by the GOH or other donors). While most policy analyses related to SSE development will be undertaken or coordinated by the PTU, it is important that dissemination (i.e., publications and workshops) be led by influential Honduran private sector associations (e.g., COHEP, CCIC, ANDI) as well as public sector institutions to gain greater acceptance.

In addition to this effort, the Project will formalize the group of private and public sector institutions which have been meeting regularly on SSE issues. This group will encompass an SSE Development Task Force. It will meet on a regular basis and serve as an official forum for policy analysis and dialogue.

Annex II, Exhibit D summarizes the major policy constraints identified in the previously cited policy study. Among the issues and constraints that are likely to be addressed by the PTU early on as the subjects of seminars or workshops are issues related to fiscal policy (the need to review the tax system with respect to exemptions, loss carryover provisions, and increase in the income tax structure); exchange and trade policy (analysis of protection levels, problems associated with and the roots of contraband); and regulatory procedures (need to review the direct and indirect costs of registering SSEs).

D. Summary Inputs and Project Budget

1. Inputs

The primary inputs of the Project are technical assistance and training, credit, and operational expense resources. A combination of long- and short-term technical expertise (204 person months and 122 person months respectively) will be provided under the Project through an institutional contract. In addition, short-term technical assistance will be provided by the intermediaries to the SSEs themselves. Credit funds totalling \$14.3 million will be provided to the banks and initially to two participating NGOs with credit programs to supplement existing SSE lending programs. Resources in the amount of \$2,710,000 for operational expenses will cover those costs associated with the running of the day-to-day programs of the participating intermediaries. Other inputs include a limited amount of commodities (through the OPGs); a project liaison officer; workshops, seminars, and publications for the policy analysis component; travel to SSE-related workshops and seminars; and evaluations and audits.

2. Summary Project Budget

Total Project costs are estimated to be \$40 million. Table 2 presents a summary budget consisting of an A.I.D. DA contribution of \$15 million; a GOH contribution of \$16.025 million, primarily for the credit and guarantee funds.

The private sector contribution which will include the counterpart contribution of implementing institutions and equity provided by SSEs, will total approximately \$8.9 million. Section VI.A.1. presents a more detailed budget and analysis.

Table 2
Small Business II Budget Summary
(US \$ 000)

	S O U R C E S			TOTAL COST
	<u>U S E S</u>	<u>A. I. D.</u>	<u>GOH</u>	
I. <u>SSE Support System</u>				
a. Grants to NGOs		8,600	-	4,540*
b. PFI Credit and Guarantee Program		500	15,000	4,435
II. <u>Research and Policy Analysis</u>		200	1,000	-
III. <u>Project Technical Unit</u>		4,800	-	-
IV. <u>Technical Assistance Support Fund</u>		250	-	-
V. <u>Evaluations/Audits</u>		150	25	-
VI. <u>Project Liaison Officer</u>		500	-	-
TOTAL PROJECT COSTS		15,000	16,025	8,975

* A review of the 25% minimum counterpart contribution was approved by the Mission Director for ANDI/PYME.

V. PROJECT ANALYSES

A. Financial Plan

1. Project Budget

As illustrated in Table 3 below, the total estimated cost of activities to be financed under this five-year Project is \$40.0 million. This consists of an A.I.D. contribution of \$15 million in appropriated grant funds and a host country (GOH and private sector) contribution of \$25 million. The A.I.D. contribution will consist of \$5 million in Agriculture and Rural Development funds and \$10 million in Special Development Activity funds. The GOH will provide a counterpart contribution from ESF local currency earmarked to the Private Sector equivalent to \$16 million. Other counterpart funds in the amount of \$8.9 million (including both cash and in-kind contributions) will be available from the private sector represented by the NGOs, financial

institutions participating in the Project, and SSEs themselves in the form of equity contributions. The percentage contribution to the Project is 37% for A. I. D. and 63% for the host country. As can be observed from Table 3, the OFGs for the participating NGOs comprise \$8.6 million or 57% of the total appropriated-fund costs. The amounts of the grants have been derived from NGO proposals reviewed by the Mission. The other major budget item requiring appropriated funds is the PTU contract expected to be approximately \$4.7 million or 31% of those costs. This estimate includes funding for TA based on estimates of \$10,000 and \$15,000 per person month for short- and long-term TA, respectively.

Training, workshops, and publications related to the PFI credit program and to the Policy Analysis and Research component total approximately \$700,000. In addition, the Project budgets \$250,000 for short-term technical assistance, training, and other related services to be procured directly by the Mission outside of the PTU contract which will be reserved through the bilateral agreement with the GOH.

Finally, with respect to costs requiring appropriated funds, the Project budgets financing for a Project Liaison Officer, as well as evaluations and audits.

2. Disbursement Procedures

A. I. D.-funded U. S. dollar costs for technical assistance, training, evaluations, limited commodities and some operating expenses will be paid directly to the suppliers or participants by the Mission in accordance with existing A. I. D. practices. The funds allocated to NGOs for credit, operating expenses, training, and institutional support purposes will be disbursed directly to NGOs through advances on a detailed quarterly budget basis. Funds to cover operating expenses of the Project Technical Unit will be disbursed through advances on a detailed quarterly budget basis. In both cases, the advances will be liquidated periodically following normal A. I. D. practices.

Economic Support Funds (GOH Counterpart) will be disbursed directly to the NGOs by the Central Bank of Honduras using already established procedures between the GOH and A. I. D.

3. Disbursements by Year

Table 4 provides a five-year disbursement schedule for the Project.

Table 3
Small Business II Budget
(US \$ 000)

		S O U R C E S					
		A. I. D. GRANT FUNDS					
		FX	LC	TOTAL A. I. D.	COH (ESP)	PRIVATE SECTOR	TOTAL PROJECT COST
I.	SSE Support System	750	8,400	9,150			
	A. Assistance to NGOs	400	8,200	8,600	15,000	8,975	33,125
	1. ASEPADE	100	1,900	2,000	-	4,540	13,140
	Credit	-	985	985	-	1,040	3,040
	Institutional Support	-	647	647	-	330	1,315
	TA/Training	100	223	323	-	366	1,013
	Commodities	-	45	45	-	330	653
	2. FUNADEH	100	1,900	2,000	-	14	59
	Credit	-	1,900	1,900	-	2,160	4,160
	Institutional Support	50	367	417	-	775	1,928
	TA/Training	50	380	430	-	1,295	1,712
	3. ANDI/PYME	200	4,400	4,600	-	90	520
	Institutional Support	-	850	850	-	1,340*	5,940
	Sub-Projects to NGOs	200	3,527	3,727	-	815	1,665
	Commodities	-	23	23	-	520	4,247
					-	5	28
	B. PFI Credit and Guarantee Program	300	200	500			
	1. Credit	-	-	-	15,000	4,435	19,935
	2. Guarantee Fund	-	-	-	14,000	4,385	17,750
	3. Seminars/Training	300	200	500	1,000	-	1,635
					-	50	550
II.	Research and Policy Analysis	-	200	200	1,000	-	1,200
	A. Technical Assistance **	-	-	-	-	-	-
	B. Workshops/Seminars	-	175	175	500	-	675
	C. Publications	-	25	25	500	-	525
III.	Technical Assistance Support Fund	250	-	250	-	-	250
IV.	Project Technical Unit	4,059	741	4,800	-	-	4,800
	A. Technical Assistance	4,059	176	4,235	-	-	4,235
	B. Management	-	565	565	-	-	565
V.	Evaluations/Audits	100	50	150	25	-	175
VI.	Project Liaison Officer	250	250	500	-	-	500
	TOTALS	5,359	9,641	15,000	16,025	8,975	40,000

* A waiver of the 25% minimum counterpart requirement was approved by the Mission Director for ANDI/PYME.
 ** Costs associated with this line item are included in the overall technical assistance contract - Project Technical Unit.

LE 4

PROJECT DISBURSEMENTS

PROJECT ACTIVITIES	1988	1989	CALENDAR YEAR			1993	TOTAL
	(4 Mo)		1990	1991	1992		
<u>A.I.D. Contributions</u>							
<u>SSE Support System</u>							
<u>Assistance to NGO</u>							
<u>ASEPADE</u>							
Credit	66.0	197.0	197.0	197.0	197.0	131.0	985.0
Institutional Support	43.1	129.4	129.4	129.4	129.4	86.3	647.0
TA/Training	21.5	64.6	64.6	64.6	64.6	43.1	323.0
Commodities	-	45.0	-	-	-	-	45.0
<u>FUNADEH</u>							
Credit	76.8	230.5	230.5	230.5	230.5	153.7	1,152.5
Institutional Support	27.7	83.3	83.3	83.3	83.4	55.7	416.7
TA/Training	28.5	86.2	86.2	86.2	86.0	57.7	430.8
<u>ANDI/PYME</u>							
Institutional Support	56.7	170.0	170.0	170.0	170.0	113.3	850.0
Subprojects with NGOs	248.5	745.4	745.4	745.4	745.4	496.9	3,727.0
Commodities	-	23.0	-	-	-	-	23.0
<u>PFI Credit and Guarantee Program</u>							
Seminar/Training	-	125.0	125.0	125.0	125.0	-	500.0
<u>Policy Analysis and Research</u>							
Workshops/Seminars	-	43.8	43.8	43.8	43.8	-	175.2
Publications	-	6.2	6.2	6.2	6.2	-	24.8
<u>Technical Assistance Support Fund</u>							
Project Technical Unit	-	62.5	62.5	62.5	62.5	-	250.0
<u>Technical Assistance</u>							
Management	331.5	982.7	923.4	840.1	756.6	400.5	4,234.8
Project Liaison Officer	50.5	143.9	97.9	97.9	97.9	77.1	565.2
<u>Evaluations</u>							
Evaluations	25.0	100.0	100.0	100.0	100.0	75.0	500.0
<u>TOTAL A. I. D.</u>	<u>975.8</u>	<u>3,288.5</u>	<u>3,077.7</u>	<u>3,031.9</u>	<u>2,910.8</u>	<u>1,715.3</u>	<u>15,000.0</u>
<u>GPJ (ESF) Contributions</u>							
<u>PFI Credit and Guarantee Program</u>							
Credit	1,500.0	3,000.0	3,000.0	3,000.0	3,000.0	500.0	14,000.0
Guarantee Fund	140.0	200.0	200.0	200.0	200.0	60.0	1,000.0
<u>Policy Analysis and Research</u>							
Workshop/seminars	-	125.0	125.0	125.0	125.0	-	500.0
Publications	-	125.0	125.0	125.0	125.0	-	500.0
<u>Audits</u>							
Audits	-	8.3	-	8.3	-	8.4	25.0
<u>TOTAL GOH</u>	<u>1,640.0</u>	<u>3,458.3</u>	<u>3,450.0</u>	<u>3,458.3</u>	<u>3,450.0</u>	<u>568.4</u>	<u>16,025.0</u>

-52-

4. Methods of Financing

<u>TYPE OF ASSISTANCE</u>	<u>METHODS OF IMPLEMENTATION</u>	<u>METHOD OF PAYMENT</u>	<u>APP AMOUNT OF ASSISTANCE (\$000)</u>
1. OPGs	90-Day Advances	Direct Payment	\$ 8,532
2. Commodities	Host Country Contract	Direct Payment	\$ 68
	Direct AID Contract	Direct Payment	\$ 45
3. TA Contract	Direct AID Contract	Direct Payment	\$ 4,705
	Direct Purchase	Direct Payment	\$ 205
4. Evaluation/Audit	Direct AID Contract	Direct Payment	\$ 150
5. Project Liasion Officer	Direct AID Contract	Direct Payment	\$ 500
6. Seminars/Training/ Publications	Direct Purchase	Direct Payment	\$ 750
		TOTAL	<u>\$15,000</u>

5. Financial Analyses

a. NGO Credit Reflows

A. I. D. will grant credit funds to FUNADEH and ASEPADE to capitalize their lending programs. The Project will seek to prevent the decapitalization of the PVOs' credit funds, due to loan loss and inflation, through a dual system of management assistance and recapitalization from interest earnings.

Coupled with A. I. D.'s fundamental objective of supporting self-financing credit programs for SSEs is the need to establish a market-based interest rate structure to allocate scarce resources to the most efficient users and to maintain the value of the credit funds in relation to inflation. Thus, NGOs will be required to impute a cost of funds for their credit funds and recapitalize them, by effecting payments from loan interest generations.¹ By the end of the Project (and each individual grant), the imputed cost-of-funds rate will equal the cost of borrowing from financial institutions (presently 17%). The initial imputed cost of funds will be determined taking into account the estimated level of inflation for the period and the effective cost of funds to financial institutions. The initial imputed cost of funds to NGOs will be no less than the effective cost of fund for financial institutions, which at present is 12% per annum.

NGOs will be required to increase that rate over the LOP to reach a rate equal to the cost of borrowing from financial institutions. This mechanism will maintain the real value of the credit funds and will require the NGOs to institute a lending rate structure to cover the recapitalization of the credit funds, loan losses, and transaction and administrative expenses. Under the imputed system, the NGOs will manage A. I. D. grant funds separately from other donor resources.

A. I. D. grant advances will go into the NGO's "A. I. D. Grant Lending Fund." The NGO will manage, use, and report on these funds for the same conditions, purpose, and requirements of the Project for three years

¹ Through this "imputation" process, the NGOs will agree to set aside a fixed percentage of the spread they earn from their lending programs to recapitalize their credit funds, i.e., they will not be able to use this percentage to cover operating or administrative expenses. This process in essence works in the same fashion as a loan that the NGO would obtain from a bank. For example, an NGO receives a disbursement of \$100,000. From its reflows, the NGO agrees to set aside 12% of its spread (or \$12,000) to recapitalize the credit fund. If an NGO is lending at 17%, this means that it would have to cover operating, administrative, and technical assistance expenses from the remaining 5%. The mechanism will provide incentive to the NGOs to charge the highest interest rate that the market will bear, permitting them to access commercial loans for the future expansion of their programs. By the PAOD, the NGOs should be self-sufficient and the imputed cost should equal the amount that the banks will charge them.

following the end of the Project. The NGO will be eligible to withdraw funds from the "A. I. D. Grant Lending Fund" account only to make loans in accordance with the agreed terms and conditions. Furthermore, the NGO will make monthly interest payments to the account of the A. I. D. lending fund. The amount of the interest payment is a simple calculation of the average outstanding amount borrowed by the NGO from the lending fund for the month, times the monthly equivalent of the annual imputed rate of interest.

All principal reflows will be deposited by the NGO back into the lending fund. The NGO will make principal payments to this fund regardless of its actual collection performance.

Any and all losses from the NGO's lending operations must be covered by each NGO from its spread between the imputed cost of funds charged by the lending fund and the lending rate that the NGO charges to its borrowers. The same will be required for administrative and operating expenses. This system will insure the integrity of the lending fund and will enforce financial discipline by the NGOs.

Previous analyses, financial reviews and evaluations, provided sufficient evidence in the design stage of the Project for the Mission to expect that PUNADEH and ASEPADE will be able to achieve self-sufficiency in their credit programs. The methodologies currently being used by the NGOs to project financial flows and to calculate self-sufficiency indicators will be tested and refined by independent experts during the first two months of Project implementation. The findings which result from this review will form the basis for developing a technical assistance plan with the PTU to assure that both NGOs will reach self-sufficiency in their credit programs by the PACD.

b. Loan Fund and Guarantee Fund Analysis

The Mission analysis presented below has determined that the Loan Fund is viable and has verified that the stream of projected income will in fact cover the expenses of the Fund. Moreover, the surplus will be capitalized to create a self-sustaining credit mechanism.

1. Loan Fund Analysis

The FOFEME analysis presented in Table 5 below is based on assumed levels of disbursed portfolio. During the first year of operation, the PFIs will disburse about \$2.1 million in credit funds, of which the FOFEME will finance \$1.5 million dollars (70%). By year five, the entire \$14.0 million managed by the Fiduciary Agent will have been drawn down, yielding a composite portfolio of almost \$21.7 million (\$15.2 million financed by the Trust Loan Fund and \$6.5 million by the PFIs).

The Credit Fund will have a spread of 12%, which is equal to the cost of money of the banks. Total income is calculated by multiplying the total trust portfolio by the 12% that is charged to the PFIs and dividing it by two, since the portfolio is not disbursed upfront at the beginning of the year.

The operating expenses of the Fiduciary Agent have been projected as a yearly flat fee of \$200,000. During the first year of Project implementation the fund will have an operating loss of approximately \$110,000. This will be covered by FOPEME capital. From then on, all profits will be reinvested producing a return of 12%, which will take the total loan portfolio to its peak size with an outstanding portfolio of \$24.5 million by year ten.

2. Guarantee Fund Analysis

In the design of the Project, very conservative assumptions have been used in the financial projections of the Guarantee Fund, given the lack of experience in this type of operation in Honduras. Experience may prove that the assumptions used here are too conservative. Any change of direction of conditions will be subject to a thorough review after the Fund has been operational for some reasonable period of time.

Depending on the liquidity of the banking system, the Guarantee Fund may increase the Loan Fund's leverage considerably, since PFIs may decide to use their own credit resources (liquidity permitting) and only reduce their exposure by securing 70% of the loan with the Guarantee Fund.

The model assumes that the Guarantee Fund is capitalized with a \$1.0 million initial fund which is invested and obtains a return of 8%. Automatic guarantees are issued for 70% of the outstanding uncollateralized portion of the loan. The Guarantee would have a one-time 6% premium collected in advance. The average life of the loan would be three years and bad debts would be 5.0% of the total amount of outstanding guarantees per year. Under these assumptions the Guarantee Fund would be self-sufficient, accumulate profits and increase its capital and reserve to about \$3.1 million in year ten (see Table 5). This would demonstrate to the insurance companies that the guarantee business is profitable, and the GOH and USAID would then proceed to privatize the Guarantee Fund by the PACO.

If the Guarantee Fund is profitable, USAID will encourage the GOH to initially reinsure the fund with one or several private insurance companies or sell it to one or various commercial insurance companies after a track record has been established.

B. Administrative Feasibility and Institutional Analysis

1. Administrative Feasibility

The overall institutional configuration developed for the Project, presented in Figure I, is the result of considerable analysis and discussion, both within the Mission and between the Mission and a large number of the potential participating entities. This institutional configuration consists of A. I. D. direct grants to (initially) three NGOs; an A. I. D.-GOH Bilateral Project Agreement which will include procedures for the implementation of the Private Financial System Loan and Guarantee Programs; and an A. I. D. direct contract with a U. S. consultant (or consortium) which will comprise the Project Technical Unit and who will provide TA to the participating NGOs and PFIs.

- 56 -

FINANCIAL PROJECTIONS OF THE LOAN FUND (0000s)

(0000s)

21-Jun-88

ASSUMPTIONS

- 12.00%.....TRUST FUND'S SPREAD
- \$200FIDUCIARY AGENT OPERATING EXPENSE, PLUS PROFIT
- 70%.....PORTFOLIO FINANCED BY PFIs
- \$30,000AVERAGE LOAN SIZE IN DOLLARS
- \$5,000AVERAGE EMPLOYMENT GENERATION PER AMOUNT OF CREDIT
- \$14,000USAID/LOAN IN \$000s

BCH/USAID DISBURSEMENT SCHEDULE IN \$000s

- \$1,500YEAR 1
- \$2,000YEAR 2
- \$3,000YEAR 3
- \$3,500YEAR 4
- \$4,000YEAR 5

DESCRIPTION \ YEARS	1	2	3	4	5	6	7	8	9	10
TOTAL PFIs PORTFOLIO	\$2,143	\$4,843	\$9,262	\$14,823	\$21,696	\$23,602	\$26,834	\$28,726	\$31,726	\$35,868
NO. OF NEW LOANS PER YR.	71	114	289	317	442	386	463	520	556	625
NO. OF NEW JOBS PER YR.	429	683	1254	1901	2654	2317	2777	3121	3339	3747
TOTAL L/TRUST PORTFOLIO	\$1,500	\$3,390	\$6,483	\$10,376	\$15,187	\$16,521	\$18,224	\$20,108	\$22,208	\$24,547
TRUST FUND	\$0	\$1,500	\$3,390	\$6,483	\$10,376	\$15,187	\$16,521	\$18,224	\$20,108	\$22,208
PROJECT DISBURSEMENT	\$1,500	\$2,000	\$3,000	\$3,500	\$4,000	\$0	\$0	\$0	\$0	\$0
PREVIOUS YRS LOSS/PROFIT	\$0	(\$110)	\$93	\$392	\$812	\$1,334	\$1,783	\$1,885	\$2,100	\$2,339
INCOME	\$90	\$293	\$592	\$1,012	\$1,534	\$1,903	\$2,085	\$2,300	\$2,539	\$2,805
FIDUCIARY AGENCY FEE	\$200	\$200	\$200	\$200	\$200	\$200	\$200	\$200	\$200	\$200
PROFIT (LOSS)	(\$110)	\$93	\$392	\$812	\$1,334	\$1,783	\$1,885	\$2,100	\$2,339	\$2,685
CUMULATIVE PROFIT	(\$110)	(\$17)	\$376	\$1,187	\$2,521	\$4,224	\$6,108	\$8,208	\$10,547	\$13,153

=====

=====

PROJECTIONS OF THE GUARANTEE FUND (\$ 0 0 0 s)

=====

ASSUMPTIONS

- 70.8%.....LOAN PORTFOLIO GUARANTEED
- 6.8%.....UP-FRONT GUARANTEE PREMIUM
- 5.8%.....ESTIMATED BAD DEBT
- 8.8%.....RETURN ON CAPITAL AND ACCRUED INCOME
- 3AVERAGE TERM OF LOANS IN YEARS
- \$1,000UP-FRONT DISBURSEMENT OF THE GUARANTEE FUND

DESCRIPTIONS\YEARS	1	2	3	4	5	6	7	8	9	10
TOTAL G/TRUST PORTFOLIO	\$1,500	\$3,390	\$6,483	\$10,376	\$15,187	\$16,521	\$18,224	\$20,100	\$22,200	\$24,547
PORTFOLIO INCREASE/DECREASE	\$0	\$1,890	\$3,093	\$3,892	\$4,812	\$1,334	\$1,703	\$1,805	\$2,100	\$2,339
REPLACEMENT (1)										
1	\$0	\$500	\$797	\$1,463	\$2,217	\$3,096	\$2,704	\$3,240	\$3,642	\$3,895
2	\$0	\$0	\$500	\$797	\$1,463	\$2,217	\$3,096	\$2,704	\$3,240	\$3,642
3	\$0	\$0	\$0	\$500	\$797	\$1,463	\$2,217	\$3,096	\$2,704	\$3,240
4	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
5	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
TOTAL NEW GUARANTEES	\$1,500	\$2,390	\$4,390	\$6,652	\$9,289	\$8,111	\$9,720	\$10,925	\$11,685	\$13,116
CAPITAL POSITION (BOY)	\$1,000	\$1,095	\$1,157	\$1,293	\$1,463	\$1,673	\$1,800	\$2,136	\$2,416	\$2,726
TOTAL INCOME	\$170	\$231	\$356	\$503	\$674	\$620	\$734	\$826	\$894	\$1,005
PREMIUM	\$90	\$143	\$263	\$399	\$557	\$487	\$583	\$655	\$701	\$787
INTEREST ON CAPITAL AND PROFITS	\$80	\$88	\$93	\$103	\$117	\$134	\$151	\$171	\$193	\$218
TOTAL EXPENSES (2)										
BAD DEBT	\$75	\$170	\$220	\$333	\$464	\$486	\$486	\$546	\$584	\$656
NET CASH POSITION	\$95	\$62	\$136	\$170	\$210	\$215	\$248	\$280	\$310	\$349
NET CAPITAL POSITION	\$1,095	\$1,157	\$1,293	\$1,463	\$1,673	\$1,800	\$2,136	\$2,416	\$2,726	\$3,075

=====

(1) THIS IS THE REPLACEMENT OF THE GUARANTEE PORTION THAT WAS PAID OF DURING THE YEAR

(2) OPERATING EXPENSES ARE SUB-SUMED IN LOAN FUND OPERATING COST ESTIMATES.

THE AVERAGE TERM OF LOAN FOR THIS MODEL IS LIMITED TO 5 YEARS ONLY.

PROJECTIONS OF THE GUARANTEE FUND (\$ 0 0 0 0 s)

ASSUMPTIONS

- 70.0%.....LOAN PORTFOLIO GUARANTEED
- 6.0%.....UP-FRONT GUARANTEE PREMIUM
- 5.5%.....ESTIMATED BAD DEBT
- 8.0%.....RETURN ON CAPITAL AND ACCRUED INCOME
- 3AVERAGE TERM OF LOANS IN YEARS
- \$1,000UP-FRONT DISBURSEMENT OF THE GUARANTEE FUND

DESCRIPTIONS\YEARS	1	2	3	4	5	6	7	8	9	10
TOTAL G/TRUST PORTFOLIO	\$1,500	\$3,390	\$6,483	\$10,376	\$15,187	\$16,521	\$18,224	\$20,108	\$22,208	\$24,547
PORTFOLIO INCREASE/DECREASE	\$0	\$1,890	\$3,093	\$3,892	\$4,812	\$1,334	\$1,763	\$1,885	\$2,100	\$2,339
REPLACEMENT (1)										
1	\$0	\$500	\$797	\$1,463	\$2,217	\$3,096	\$2,704	\$3,240	\$3,642	\$3,895
2	\$0	\$0	\$500	\$797	\$1,463	\$2,217	\$3,096	\$2,704	\$3,240	\$3,642
3	\$0	\$0	\$0	\$500	\$797	\$1,463	\$2,217	\$3,096	\$2,704	\$3,240
4	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
5	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
TOTAL NEW GUARANTEES	\$1,500	\$2,390	\$4,390	\$6,652	\$9,289	\$8,111	\$9,720	\$10,925	\$11,685	\$13,116
CAPITAL POSITION (BOY)	\$1,000	\$1,009	\$1,131	\$1,244	\$1,377	\$1,533	\$1,696	\$1,881	\$2,086	\$2,311
TOTAL INCOME	\$170	\$230	\$354	\$499	\$667	\$609	\$719	\$806	\$868	\$972
PREMIUM	\$90	\$143	\$263	\$399	\$557	\$487	\$583	\$655	\$701	\$787
INTEREST ON CAPITAL AND PROFITS	\$80	\$87	\$91	\$100	\$110	\$123	\$136	\$150	\$167	\$185
TOTAL EXPENSES (2)										
BAD DEBT	\$83	\$186	\$241	\$366	\$511	\$446	\$535	\$601	\$643	\$721
NET CASH POSITION	\$88	\$44	\$112	\$133	\$157	\$163	\$184	\$205	\$225	\$250
NET CAPITAL POSITION	\$1,088	\$1,131	\$1,244	\$1,377	\$1,533	\$1,696	\$1,881	\$2,086	\$2,311	\$2,562

(1) THIS IS THE REPLACEMENT OF THE GUARANTEE PORTION THAT WAS PAID OF DURING THE YEAR
 (2) OPERATING EXPENSES ARE SUB-SUMED IN LOAN FUND OPERATING COST ESTIMATES.
 THE AVERAGE TERM OF LOAN FOR THIS MODEL IS LIMITED TO 5 YEARS ONLY.

518

This institutional configuration is designed to combine effective achievement of Project objectives with management efficiency, institutional capabilities, and maximum use of the private sector. The arrangement is reasonable and analyses of the participating intermediaries confirm that each has the basic management capabilities and organizational experience to meet the responsibilities assigned to them in the Project implementation. Where weaknesses have been identified which may limit the performance of any participating entity, the PTU will provide technical assistance as well as specific training for the entity's staff.

A key issue which has been thoroughly analyzed during intensive review is whether the Project's institutional arrangements are sufficiently simple and straightforward to ensure effective implementation. Viewed from a different perspective, the issue has been whether the incorporation of numerous implementing entities and institutional relationships is too complex and difficult to manage. The conclusion of the Project Design Team is that institutional arrangements are in fact efficient. A Project involving numerous implementing institutions tends, of course, to be more complex. But the Team feels that responsibilities are sufficiently clear, and that the incorporation of some Project elements, e.g., the PTU, will result in expeditious implementation.

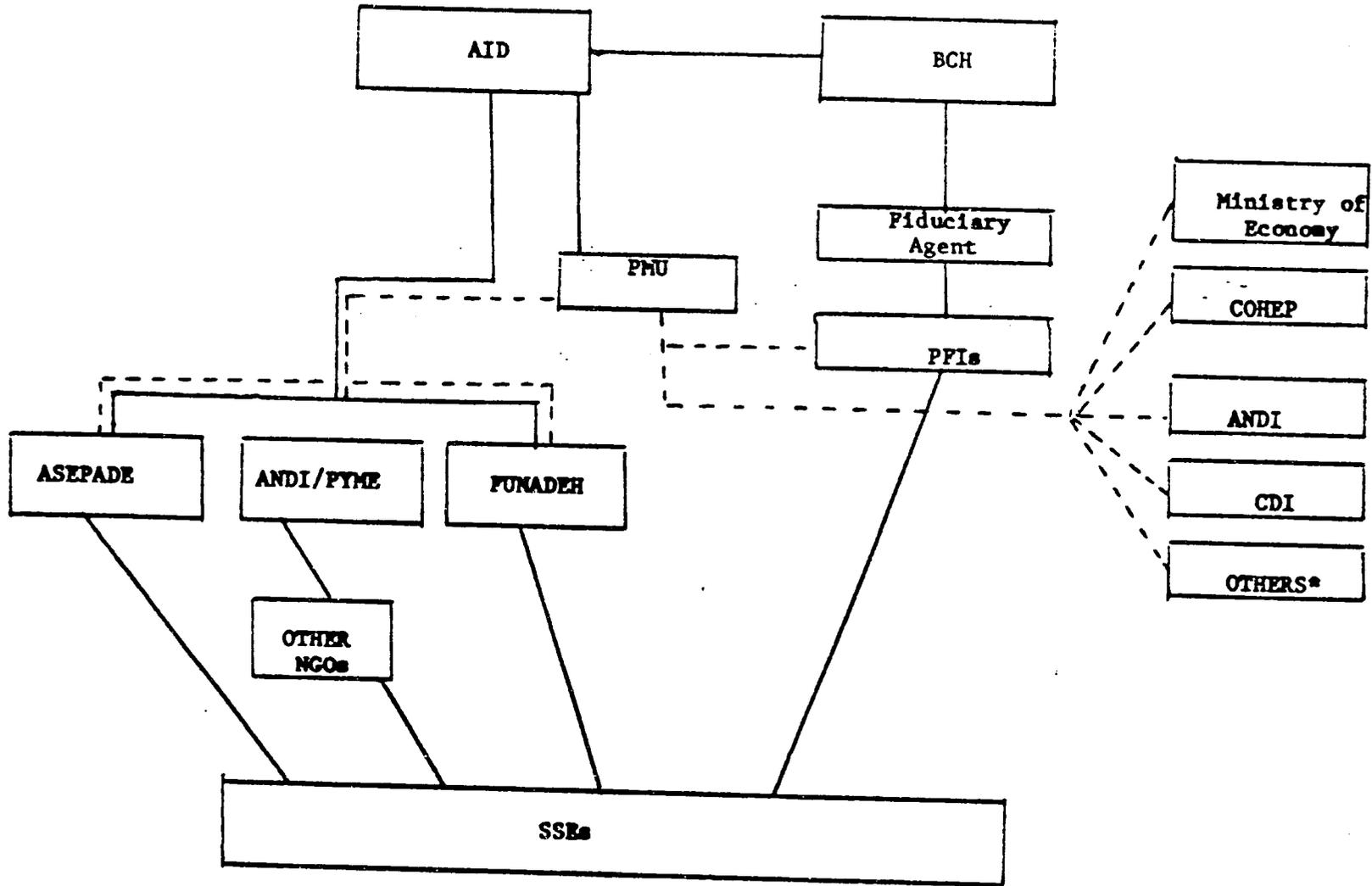
Early in Project design, the Mission examined the possibility of reducing the number of principal implementing agencies by either establishing a new institution through the Project or using an existing institution to implement the Project, i.e., to serve as the "umbrella" organization which would channel resources to other participating entities. The advantage of this model was that it would reduce the number of implementing institutions that A.I.D. would directly deal with to perhaps one (other participating NGOs would deal with the selected implementing entity). In fact, the Project PID presented this type of framework.

While this umbrella model was ideal in theory, we reached the conclusion that it was not practical. First, after more careful analysis and dialogue with Hondurans from different sectors, the establishment of a new "super" institution was not seen as viable by A.I.D., the GOB, or the private sector, especially given the plethora of organizations that already exist to serve SSEs. Attention then focused on existing institutions. Reviews of key institutions--FIA, ANDI/PYME, FOPRIDEH, the Central Bank, and other entities--concluded that no existing entity could effectively play this umbrella role. The Project objective is to expand significantly the number of SSEs with access to various types of services. None of the existing organizations presently has, nor will they have in the near term, the capacity to provide the amounts of assistance required by the universe of SSEs. However, working together to provide these services, several capable institutions can have the desired impact. And, together with the private financial institutions, an even greater number of beneficiaries can be reached since the PFIs will provide the greatest amounts of credit.

Although A.I.D. will have to monitor three individual OPGs, the use of the PTU to help monitor the Project will expedite implementation. The Mission currently does not have the capacity to implement this ambitious program. But the addition of the PTU and a PSC Project Liaison Officer to be contracted with Project funds will enable us to effectively manage Project activities.

Figure 1

SMALL BUSINESS II
INSTITUTIONAL CONFIGURATION



* Policy and/or opinion-making institutions related to policy component.

With respect to the operation of the PFI credit and guarantee program, it is our conclusion that the use of an agent for this purpose is necessary and will actually expedite program implementation. As noted in Part IV.C.1., it is the intent of the Project that the private sector will eventually assume management of the guarantee program after an adequate record of self-sustaining operations has been established.

2. Institutional Analyses

a. Financial System, Participating Banks and Fiduciary Agent¹

Honduras has a relatively large number of financial institutions for the size of the country:

- 14 Private Commercial Banks (of which 2 are foreign-owned)
- 2 State Development Banks
- 1 Private Agro-industrial Finance Corporation
- 8 Savings and Loan Institutions
- The Central Bank of Honduras (BCH)

Excluding the Central Bank, the 25 financial institutions operate 320 branches throughout the country.

Private commercial banks are by far the largest component of the capital market. They hold 60% of the assets in the financial system, 75% of deposits, and over 70% of short-term external liabilities. The banks obtain 73% of their resources from private sector deposits, 12% from BCH rediscount lines financed primarily by international donors, and the remaining 15% from their own capital and other sources. Rediscount operations have grown dramatically in recent years, however. The Central Bank now manages no less than 35 rediscount programs. Moreover, a growing concern by A.I.D., IBRD and other international and Honduran institutions is that these rediscount programs provide resources to banks at substantially below their cost of mobilizing resources, thereby inhibiting savings mobilization. About 83% of funds are used for lending: 61% to the private sector, 22% to the public sector.

One of the 12 locally owned banks is owned by the Armed Forces Social Security Fund and the rest are divided into five shareholder groups, reducing effective competition. Nevertheless, smaller banks have gained market share from the larger banks in the past five years.

The banking system is shallow since bank services are traditional and mostly limited to larger enterprises in what are perceived as less risky sectors such as commerce and real estate. Interest rates are asymmetrical for deposit rates and loan rates since deposit rates have been free since 1980. In 1988, savings attract interests of 10% to 12% (inflation was officially 5%). Loan rates are subject to a ceiling of 17% which banks charge on their

¹ Data in this section is taken primarily from the "Country Memorandum for Honduras", 1986; IBRD.

own funds. Government bonds attract \$100 million equivalent, a 600% increase over the past five years due to high yields. Besides these government bonds, very few long-term instruments are available to savers. Thus, banks lend mostly short-term.

The term structure of bank loans made from deposits is 65% under 18 months, 20% between 18 months and five years, and 15% longer than five years. The major source of term lending is the Central Bank through its rediscount lines. The availability of long-term credit is severely limited, forcing entrepreneurs to self-finance most investments. Self-financing represents approximately 32% of all investment. SSEs are at a particular disadvantage in this respect, since they have more difficulty in raising sufficient funds for their initial investment.

Over the past five years, the deterioration in the economy has been reflected in the financial sector. Bank profits have decreased along with the quality of their portfolios. While the financial system has recuperated and financial deepening is taking place, the system is still in many ways not conducive to promoting investment, particularly among SSEs.

Inadequate access to credit for small producers--agricultural and industrial--is an important structural issue that needs to be addressed in Honduras. Commercial banks usually require security, generally in the form of mortgages on urban properties. Access to formal credit could be expanded for small producers through the elimination of the ceiling on interest rates and the introduction of variable interest rates to permit commercial banks to cover the higher costs associated with small-scale lending. Though the rates for small producers could rise, more resources would be available to them at rates substantially below the rates charged by money lenders, who are currently the principal source of credit for such producers. In addition, the producers would benefit from the longer-term repayment of the investment credit lines compared to money-lender terms.

The principal distortion to commercial bank lending is the incentive for commercial banks to maintain excess reserves in the form of a 10% tax-exempt government bonds. The government's economic policy dilemma is how to promote economic activity in the context of an overvalued exchange rate, balance of payments shortfalls, and serious public sector deficits. The monetary policy requirements are contradictory: a liberal monetary policy to promote growth and a restrictive monetary policy to cope with the lack of fiscal discipline. For the commercial banks, this dilemma produces a restrictive monetary policy in general which induces the financial system to restrict lending in favor of diverting loanable funds from the private sector to the public sector.

In order for the financial sector to play a more constructive role in Honduras' development, it needs to increase its efficiency in intermediation; that is, it must attract additional domestic savings and direct them to productive investments at lower costs. To permit the increase in efficiency by the banking sector, the Central Bank is accepting A. I. D. and IBRD suggestions to liberalize interest rates as part of a medium-term structural adjustment program.

It is the consensus of the Project Design Committee that the SB II Project's PFI loan and guarantee program is in line with the Honduran financial system, i.e., the component has been designed taking into account the current practices, constraints and dynamics of the financial system, improving on these procedures through the implementation of the loan and guarantee programs as well as discrete training activities.

The program will contribute to the increasing the efficiency of the financial system. Resources from the Loan Fund will be provided to participating institutions at the approximate cost of mobilizing savings, halting a trend of cheap credit to the commercial banking system which, over the long run, can seriously disrupt the system. Nonetheless, the program provides sufficient incentives to participating PFIs to lend to small business, particularly through the Guarantee Fund.

As noted earlier in this document, the SB II Project is also the first step in a long-term USAID effort to address financial sector constraints. Seminars, training programs, and greater experience cannot in and of themselves, solve these constraints. But they can significantly contribute to a greater understanding of problems and an important first step in the process of establishing a more dynamic private sector.

The three institutions selected to participate initially in the Loan and Guarantee Fund component are the Financiera Industrial y Agropecuaria (FIA), Banco La Capitalizadora Hondurena, S.A. (BANCAESA) and Banco de Occidente. These institutions have been selected based on their interest in the SSE sector and their potential to expand their SSE credit portfolios significantly. The Mission consulted the PFIs and a number of other commercial banks on potential candidates to carry out the role of Fiduciary Agent under the Project. While consideration was given to contracting a private fiduciary bank, based on FONDEI's recent performance and proven responsiveness to the financing needs of small and medium industries, an agreement was reached with FONDEI to manage the Loan and Guarantee components of the Project.

FONDEI was established in 1978 as a trust fund charged with managing industrial development credit programs for the GOH. It operates largely as an autonomous department within the BCH. FONDEI is headed by an Executive Director who is responsible for managing day-to-day operations and who reports to an Executive Committee composed of the President of the BCH, the Minister of Economy, a representative of the commercial banks and FONDEI's Executive Director. It has a staff of 35 professionals organized into two central departments (one covering evaluation and supervision, the other finance and administration), a regional office, and a technical assistance unit.

All of FONDEI's financing to date has come either from the World Bank (three projects totaling \$82 million since 1979) or from its own resources (capitalization of L.18 million from the GOH). In December 1987, a World Bank project evaluation team concluded that FONDEI has developed into a sound second-tier institution which has already contributed significantly to industrial development in Honduras, and which finances a substantial part of

commercial banks' industrial portfolios.¹ Further, they found that FONDEI's organizational structure has proven to be satisfactory to date, information systems and loan procedures are adequate, and accounting system and controls have been strengthened through a technical assistance component of the World Bank loan. To assure that it efficiently meets all its responsibilities as Fiduciary Agent, FONDEI will establish a project implementation unit staffed with seasoned professionals who will be assigned no duties other than those related to this Project.

3. Participating NGOs

As part of the Project design process, the Mission Controller's Office has undertaken an analysis of each NGO to determine the quality of their administrative and financial capabilities (unattached Annex III, Exhibit H). The Controller's Office has verified that each institution has acceptable control systems in place, although, given the various levels of institutional development and experience, each entity will need to enhance their systems further as their programs expand to reach more beneficiaries. Accordingly, in order to make their systems more effective, technical assistance provided by the PTU will strengthen the specific systems in order to eliminate any potential problem area. As the PTU/NGO relationship matures, the PTU will increasingly assist the NGO to identify strengths and weaknesses of the institution and their expanding programs and, therefore, continually provide TA or identify other appropriate sources of training, both local and regional. Finally, the NGOs have been registered in accordance with A. I. D. procedures.

Complete institutional analyses of ANDI/PYME, FUNADEH and ASEPADE appear as unattached Annex III, Exhibits E-G. The following sections briefly summarize institutional profiles of these institutions.

a. ANDI/PYME

In response to a social concern, the National Association of Industrialists (ANDI) established the Small and Micro Enterprise Program (PYME) to assist Honduran entities (mostly PWOs) who provide services to small and microenterprises. This second-story framework was regarded as the best approach in order to reach the greatest possible number of SSEs over the long term. The establishment of the PYME program was supported by the Mission's Small Business Development Project (522-0205).

ANDI/PYME has done a commendable job of providing funds to SSE assistance organizations in the form of specific projects to enable them to execute training and TA programs among client SSEs, and to strengthen the assistance organizations themselves. PYME has a qualified staff, acceptable procedures, and good working relations with over 20 assistance entities. With its comparative advantage as the established second-level entity in the sector, it is the logical choice to continue implementing the business assistance network under the SB II Project.

¹ See Annex III, Exhibit J

While PYME is a part of ANDI and thus under the overall direction of ANDI's Board of Directors, PYME is run through an independent board, the PYME Committee. The PYME Committee is responsible for approving specific projects, for hiring and dismissing staff, and for defining specific program direction. ANDI's Board of Directors sets overall policy and the Executive Secretary of ANDI reviews and approves all project proposals before they go to the Committee.

At present, PYME's staff consists of four professionals and three support staff. Lines of responsibility are loosely drawn and while the staff is well qualified, project managers are spread thin and overworked. An increase in staff is fundamental for future PYME growth combined with greater definition of internal lines of authority. Limited office space and lack of transportation facilities are other constraints to growth. In addition, automation of PYME's data base is essential if PYME is to expand and increase its effectiveness in the future. All of these areas will be addressed under SB II.

As confirmed by a recent Mission financial review, PYME's financial control and disbursement procedures are good. The only significant recommendation made for improving PYME's financial management was the need to develop a software application to allow PYME to produce automatically the auxiliary reports on budget execution which are now being prepared manually. PYME's procedures for reviewing project proposals are also sound. The level of review is adequate without being excessive and the time elapsed is reasonable. However, as PYME's project portfolio increases over the life of the Project, submission of projects for the review of the ANDI Executive Secretary may not be feasible.

The actual mechanism for processing of specific projects begins with the entity presenting a project proposal to ANDI/PYME detailing expected outputs and achievements against a program of activities and a budget request. In practice, PYME usually takes an active role in the design and management of projects with particular attention to monitoring and evaluation. The proposal is reviewed by the project manager and passed to the Executive Secretary of ANDI for review and approval. Review in the PYME Committee is the final stage of approval. In the three-and-one-half years ending March 31, 1988, PYME financed 69 projects for a total of Lps. 2.2 million. While PYME does not provide credit funds, many of the projects covered operating expenses related to credit programs of SSE assistance organizations.

In addition to providing institutional support, ANDI/PYME arranges training courses for personnel of the assistance entities. In total, nearly 600 persons have received PYME-arranged training.

ANDI/PYME has effected coordination among the many organizations providing services to SSEs with excellent results. Another important innovation introduced by ANDI/PYME is that formal linkages have been created for the first time between small entrepreneurs and the large industrialist members of ANDI, and between PVOs and industrialists.

PYME's five-year plan presents targets of generating 12,000 new jobs (one job for each L1,374 in PYME funds expended) and a L5 million increase in national production. The plan estimates that some 11,000 SSEs will be directly assisted by the PYME network and that 42% of them will be women-owned. PYME expects to increase the number of service organizations benefitting from institutional strengthening under the program from 22 to 35 in the five-year period of the Project. To achieve these targets, PYME will work in 13 areas of activities, including some that are new to them.

Under its five-year plan, PYME projects a budget of just slightly under L12 million, with Project grant funds covering 76% of that budget. As now constituted, it is not realistic to expect PYME to achieve self-sufficiency during the life of the Project. It should be pointed out, however, that the 76% figure is a significant reduction from PYME's current 99% dependence on A.I.D. funding. In response to concerns regarding the role of PYME after SB II is completed, PYME has planned several revenue generating activities and has begun to diversify its donor base. Final negotiations are being carried out with several new donors including the Inter-American Foundation, the European Economic Community, and the Inter-American Development Bank.

While PYME has considerable proven capabilities in project management, financial management, and reporting, it will need additional TA in order to carry out its expanded role. It has no experience in such areas as contracting with institutions outside of Honduras, participant training, research, collective marketing ventures and transfer of technologies. Project funding and new activities should be gradually phased in following a rational growth pattern with the assistance of the PTU.

At ANDI/PYME, there is a noticeable enthusiasm, a sense of mission, and a professional approach toward achieving results. ANDI/PYME has the capability to perform well in carrying out the tasks and responsibilities assigned to it in the implementation of the Project.

b. FUNADEH

The Honduran Development Foundation (FUNADEL) has been operating a successful SSE program since early 1985. FUNADEH provides credit, TA, and training to SSEs in the San Pedro Sula area. It has a qualified staff, operates efficiently, and its credit program is over 79% self-sufficient.

FUNADEH is composed of 175 prominent businesspersons from San Pedro Sula. A Board of Directors oversees FUNADEH's operations and approves personnel changes. FUNADEH members volunteer their services for credit committees and oversight functions.

Current staff consists of an Executive Director, five professionals, and two support staff. Each job is well-defined and criteria are established to avoid overload. However, with the recent increase in loan applications, the staff is beginning to feel work-load pressure. Under the Project, FUNADEH will hire several additional promoters.

FUNADEH's loan processing system works very well and rapidly. The Foundation has computerized many of its operations, including data on each loan and accounting records. With its basic systems in place, FUNADEH will have no problem expanding its program over the five-year life of Project. It is reasonable to assume that FUNADEH can grow to a L4.4 million portfolio by the end of 1989 and between L6 and 7 million by the end of 1991.

FUNADEH will achieve self-sufficiency in its credit program at a L4 million portfolio level assuming that the interest rate charged to borrowers remains at 17%, that the bad debt reserve will not utilize more than 3%, that promoters will continue to cost 7.6% of the portfolio, and that operating costs will remain at about L. 240,000. It is crucial that FUNADEH keep loan arrearages low if self-sufficiency is to be achieved. Currently 8% of the portfolio is past due and FUNADEH has begun to take legal action against those borrowers who are in default.

FUNADEH's traditional program has been to provide credit to small but established SSEs in the production sector. Credits may be for working capital, investment capital, or a combination of both. Recently, FUNADEH initiated credits to entrepreneurs to start new businesses, and a pilot credit program for small commercial businesses. FUNADEH's growth rate has been rapid. The loan portfolio doubled during 1987 and increased to L. 2.6 million as of March 31, 1988. The Foundation's credit policy does not allow FUNADEH members or their immediate relatives to benefit from the loan program.

Virtually all FUNADEH loan applicants appear at the organization's door. Each is assigned a Promoter who assists the applicant to complete the loan application form. The Promoter conducts certain financial analyses and checks references and guarantors. The loan is then presented to the Credit Committee which is made up of FUNADEH member volunteers who approve or reject the loan. A check is issued once the loan is approved and the Promoter follows up until the loan is repaid. The Promoter also collects information on borrowers' performance in the course of monitoring visits.

In addition to its credit programs, FUNADEH provides TA and training in two forms. As described above, each client is assigned a Promoter who provides credit-specific TA to assure the credit is utilized as planned and is paid back. The second type of TA is geared toward improving the operations of the business and consists of formal courses and one-on-one visits by experts.

FUNADEH has demonstrated that it has the management capabilities, staffing, and organizational experience necessary to assure good performance as an participating intermediary in the Project.

c. ASEPADE

Asesores Para el Desarrollo (ASEPADE) has more than ten years' experience in managing development programs for the most marginal strata of the self-employed in Honduras. Its programs are creative and have been generally effective. In recent years, ASEPADE has expanded its programs and geographic service area, improved training, established evaluation and monitoring systems, and begun to computerize operations.

ASEPADE has a total of 50 full-time employees working in a decentralized organizational structure. There is a small central office in Tegucigalpa, with an Executive Director, two other professionals and four clerical staff. Regional offices in Tegucigalpa, San Pedro Sula, and Choluteca each have a regional manager, a cadre of promoters, and several support staff. Staff are dedicated and capable.

Starting from its first year, ASEPADE has initiated and implemented development projects in two basic categories: integrated rural development projects in poor isolated areas; and small business assistance programs among market vendors, microindustries, and other marginal urban groups. The latter activity has been supported by A. I. D. since July 1986 through a two-year OPG with Accion International/AITEC. The grant finances TA for ASEPADE from Accion; provides funds for expanding ASEPADE's credit portfolio in two programs, CREME and CREDISOL; and assists in covering certain of ASEPADE's operating and program expenses.

CREME, the credit program for individual microenterprises, and CREDISOL, the credit program for solidarity groups, are becoming well-known by their target groups. The processing of a loan under both programs is similar. With the help of promoters, the applicant fills out a loan application form which is reviewed by the promoter then passed on to the regional manager. Each borrower must have references and a guarantor who are investigated. The regional manager approves the loan applications which then go to the volunteer Regional Assistance Committee. The application process takes one to two weeks and the processing of the check takes one week. For subsequent credits, approval can be handled in one day.

While past due loan rates have been held to very low levels in the CREME and CREDISOL programs established in San Pedro Sula and Choluteca, high arrearage rates are a problem in Tegucigalpa. CREME showed a 14% rate, and CREDISOL a 20% rate as of March 31, 1988 for Tegucigalpa borrowers. Though part of the high rates could be the result of a serious crackdown on street vendors by municipal authorities, clearly there is a collection problem. ASEPADE recognizes the problem and has replaced the Tegucigalpa Regional Manager and has been assessing the productivity of each staff member. The Project will provide assistance to ASEPADE in this critical area.

ASEPADE is aware of the need to make its credit projects self-financing and is making good progress in that direction in the CREME and CREDISOL programs. Preliminary estimates of the level of self-financing of these two programs are 63% and 72% respectively.

ASEPADE, more than any other Honduran NGO has been highly successful in diversifying its sources of funding. They currently receive funds from five other donors, including the Inter-American Foundation, the Inter-American Development Bank, the Swiss Development Cooperation, Wetus (Belgium), and CEBEMO (Holland). Multiple donor funding has also presented some problems however. In particular, complementarity of programs has been an issue, as has been accounting in terms of managing different sources of funds.

Timing and conditions attached to funding by the various donors have been such that ASEPADE has been forced to juggle activities based on funding availability rather than on the greatest needs or on long-term plans. Further complicating matters, ASEPADE keeps financial records by donor and by project, thus making it difficult to obtain a clear picture of the financial viability of individual projects, much less that of the overall program of ASEPADE.

Consolidated financial statements are a must for understanding ASEPADE's financial situation and for calculating self-sufficiency. Automation of the accounting records, as well as the data generated by the evaluation system, is crucial for ASEPADE's institutional development. Other areas for improvement in ASEPADE's accounting and financial analysis system have identified by in-house, independent, and A.I.D. audits of ASEPADE. The Financial Analysis Review Section (FARS) of the Mission concludes that the institution has used funds properly and, while significant improvement of ASEPADE's performance in this area is expected as a result of the technical assistance to be provided, ASEPADE is now a suitable recipient for an A.I.D. grant.?

The long-term TA provided by Accion has been extremely useful in helping ASEPADE to gain a better understanding of the microenterprise sector, better define its CREDISOL and CREME projects, expend these projects to other urban areas, improve its monitoring and evaluation systems, and establish training programs. Though ASEPADE now has a solid base for further expansion and greater probability of performing well under the Project, a significant amount of TA is built into the Project through the PTU and ANDI/PYME to reduce potential bottlenecks which could constrain the growth of the organization.

C. SUMMARY SOCIAL ANALYSIS

Conclusions drawn from the social soundness analysis confirm that the Project is targetted appropriately and will promote economic growth with equity. Further, the Project will maximize benefits in terms of employment generation, increased income, and greater distribution of national income to the working poor. The complete social analysis is found in Annex II, Exhibit G.

1. Beneficiaries

The direct beneficiaries of the Project will be some 20,000 owners and employees of micro, small, and medium enterprises operating throughout Honduras in non-agricultural sectors. SSEs in general (estimated at approximately 200,000 enterprises) will benefit from the improved policy environment and strengthening of local institutions that provide services to SSEs.

For purposes of the Project, microenterprises are defined as those businesses that use labor-intensive technology, have fixed assets of less than \$10,000 and employ up to 10 persons. Microentrepreneurs are characterized by very low education levels and limited technical abilities. They are generally 31 to 50 years of age with an average of seven family members, some of whom are likely to work in the business with the entrepreneur.

In 87% of the cases of one sample of microenterprises studied by Michigan State University in 1987, the firms constituted the only source of income for the entrepreneurs. Observed monthly per capita family income generated by the microenterprises was Lps. 113 when only the owner worked, and Lps. 193 when other family members participated in the business. At such income levels, these people represent the working poor.

Within the context of the Project, small businesses are defined as those with fixed assets of between \$10,000 and \$50,000, have 11 to 25 employees, and preferably use labor-intensive technology in some stages of the manufacturing process.

In an investigation of 100 small enterprises carried out by Fajardo in 1985, it was found that in 78% of the cases the small business was being run by the owner and constituted his/her only source of income. Small business owners typically have completed a secondary education or some technical school.

Other studies provide a general picture of the target group. The socio-economic characteristics of 146 employees of FIA-assisted small businesses were studied in 1986 by Blayney. In the sample, 58% were male, 54% single, and the average age was 25 years old. The mean number of years of schooling was 6 years and the adults surveyed had an average of two dependents each. Many of the employees were single mothers. The average weekly salary for the sample was Lps.63.

Data presented in previously cited DAI study (1987) indicated that small firms have the best growth and employment generation potential while microenterprises function as an important means of employment maintenance until graduating up the scale to small business. It is also clear from the data that the main obstacles to growth are financial liquidity problems and access to banking resources. The continuation and expansion of credit, TA, and training to owners and workers of SSEs are warranted when we look at the positive results achieved in the past by similar projects in Honduras and other countries of the region.

Medium-sized enterprises are also targetted under the Project's PFI lending and guarantee programs. While the owners of these enterprises are for the most part outside of the target group, numerous studies have highlighted the importance of establish a broad infrastructure of medium-scale enterprises for economic development. For example, these enterprises not only employ the working poor, but, through backward linkages, create demand for the products of SSEs. Medium-sized enterprises are also important conduits for technology transfer and worker training. In sum, their incorporation into the Project's financial sector lending program, is fully in line with the Project's principal objective of increasing employment opportunities for the working poor.

2. Socio-Cultural Feasibility

The Project faces no major obstacles to implementation from the point of view of socio-cultural feasibility. The potential beneficiaries (represented by the organizations which support SSEs) have been involved in the process of

problem identification, strategy formulation, and project design. Thus wide and significant participation of the poor in the development process is assured and will continue in the implementation and evaluation phases.

Recent programs established to support SSE development, such as the ANDI/PYME network, are helpful in resolving difficulties which are inherent to the firm. Now, by providing credit through the commercial banking system, and by attempting to institutionalize a policy reform capability, the Project begins to resolve difficulties external to the firm which are a function of the socio-cultural context in which Honduran SSEs operate. Contextual variables affecting small business development are related to the interests and value system represented by law and policy makers who make decisions without adequate participation of SSE representatives. The SSEs' lack of influence and bargaining power before the prevailing practices of the private banking system is another feature of the socio-cultural landscape which hinders the growth of SSEs.

The Project develops the capacity of the SSEs to speak out and defend their interests before Honduran society. Increased informational activities (newsletters, promotional bulletins, inter-institutional coordination meetings, national conferences to attract media coverage) will permit the diffusion of SSE problems and concerns to the public. In addition, SSE representatives will develop skills to deal effectively with public and private sector agencies, the media, and public opinion in general. Strengthening of the organizations that provide services to the SSEs will add to the power potential of the SSEs as a group.

The motivation of the private financial institutions to provide credit under flexible conditions must be, and will be, profit-based. However, in the case of PIA and Banco de Occidente, there exists special interest in supporting firms either owned by economically disadvantaged persons or playing an important role in generating employment. The Project design includes a financing mechanism which will assure profits for the participating banks and at the same time opens access to credit for micro and small enterprises by reducing collateral requirements via a guarantee feature. Training and TA will be provided to participating banks in order to upgrade the capacity of their personnel to deal with a new market segment, and to establish loan procedures and credit analysis functions appropriate to SSE lending.

Currently, linkages between SSE service institutions and the private banking system are minimal. The Project is designed to encourage NGO - bank ties, especially in the provision of TA and training to the beneficiary clients, and the graduation of microenterprises from NGO credit to commercial banks.

3. Impact, Spread Effects, and Replication

More than 20,000 SSE owners and employees will benefit from the Project activities. That is nearly a fourfold increase in the number of beneficiaries reached currently by our small business support activities. Forty percent of these beneficiaries will be women involved mostly in small trade and some in home-based production.

Available impact information on microenterprises indicates that considerable positive changes occur in monthly sales and net income after credit, TA and training programs are applied to the businesses. In addition, microenterprises benefitting from support programs have been able to keep their constant costs down, therefore making more efficient use of both labor and capital.

In the case of small businesses, an impact investigation of FIA's borrowers demonstrated impressive results particularly in terms of production and employment. Other evaluations of AID assistance to SSEs have demonstrated equally impressive results. Similar results can be expected from this Project which will continue and expand on many of these successful programs.

The most common micro and small businesses are those dedicated to the manufacture of foodstuffs, clothing, shoes, and furniture. Because of the anticipated backward linkages with Honduran producers of some of the raw materials needed by these industries, support for SSEs may create not only direct but also indirect employment.

By working initially with banks committed to Project objectives, it is expected that those banks will set an example for the more conservative banks, motivating them to replicate the experience. Indeed, Project activities will outlive the PACD if banks find it advantageous to commit higher proportions of their own resources to extend loans to the target group. The spread effects to other banks are likely to occur just as we have already seen a spread effect from NGOs to one private commercial bank, BANCAHSA. In the past year, BANCHASA has approached three NGOs which lend to SSEs, asking them to identify which of their beneficiaries would be potential clients for BANCAHSA.

Although no quantifiable data currently exist, mobilization of savings among the target population will also be important in terms of spread effects.

NGOs providing both loans and technical assistance or training services must create permanent funding sources to support their programs. While credit components are expected to become self-sufficient, TA and training are likely to continue to be subjects of donor support. Overall financial self-sufficiency may require charging higher interest rates for loans, expanding the type of services offered, and charging fees for them.

D. Economic Analysis

1. SSE Demand for Credit

It is conceptually difficult to estimate the SSE demand for credit and, in practice, not possible to quantify it and discriminate between the urban and rural credit demand in any statistically satisfactory fashion. Even rough estimates of the parameters and amounts involved, however, demonstrate that these failings are of no great consequence since it can be determined that the demand for credit far exceeds supply.

The quantity of credit demanded is a function of the price and other conditions of credit. The quantity of credit demanded by the SB II Project also depends on the availability and conditions of alternative sources of credit. In addition, the demand at any particular time depends on the general economic climate — macroeconomic conditions and investors' perceptions of economic prospects. Finally, in Honduras, monetary policy considerations prompt the Central Bank to impose ceilings on the amount of credit which the financial system is permitted to accommodate.

Nevertheless, an assessment of current data available suggests that the volume of potential SSE credit demand is large. For example, it can be deduced that the demand generated by simply replacing the current SSE capital stock is more than sufficient to warrant the SB II credit program and others that are currently available. Approximately 76% of manufacturing employment in Honduras is in firms with less than 50 employees (68% in firms with fewer than 10 workers)¹ Total manufacturing employment is about 125,000. This suggests that there are some 96,000 SSE employees (in the manufacturing sector). The 1974 Industrial Census shows that average gross fixed investment per worker in small firms was \$3,525 equivalent and \$7,055 for medium-sized firms. Using the lower figure, which will severely understate the stock of SSE fixed capital, we can estimate SSE gross fixed investment to be about \$800 million in 1987 prices.² A 20% depreciation would yield a replacement demand of \$200 million per year. A ten-year useful economic life of equipment would yield an estimate of \$100 million per year.

An alternative estimate can be based on a calculation of the relative demand of SSEs and of firms served by the commercial banking system. Cost per job created for small- and medium-scale enterprises range from \$1,500 to \$13,100, as compared with \$10,000-\$30,000 for large firms. The ratio of the extreme points between the two ranges is 0.05 (\$1,500 divided by \$30,000). On this basis, the potential SSE demand for credit would be approximately 16% of the effective demand for commercial bank credit, or about \$50 million per year.¹ A comparison based on the midpoints of the costs per job for SSE and larger firms would produce an estimate of \$115 million per year.³

It is recognized that there are large discrepancies between these and other estimates of demand. The fact is that the "true" demand for SSE credit cannot be quantified. But, as previously noted, these estimates confirm that

¹ Liedholm and Mead, Small Scale Industry in Developing Countries: Empirical Evidence and Policy Implications, Michigan State University, 1987.

² This is based on the BCH implicit GDP deflator of private sector investment.

³ (0.05) X the ratio of manufacturing employment in SME (76%) and in larger firms (24%) times the volume of new commercial bank lending for manufacturing in 1986.

the demand for SSE credit is considerable. It must be recognized that even large errors in the orders of magnitude of the parameters would not change this conclusion. It does seem very clear that the effective constraint on SME credit programs is not a lack of potential demand. The effective constraints have to do with policy, attitudes, and the credit delivery system which are discussed in other sections of this document.

2. Economic Analysis/Justification

The intensive review economic analysis performed by USAID/H indicates that the Small Business II Project will make a significant contribution to Honduras' economic development and to the achievement of Mission employment generation objectives. This conclusion is supported by the illustrative project impact analysis presented in unattached Annex III, Exhibit H and summarized in Table form in this same annex. The analysis explores the economic potential of small-scale enterprises (SSEs) by calculating the internal rates of returns implicit in the expansion plans of these firms, as well as the financial rates of returns that determine the business viability.

The economic analysis is based on two alternative scenarios, with and without the Project. Six firms provided information for the analysis. Three of the four SSEs analyzed and two medium-sized enterprises had economic rates of return higher than 50% for the with-project scenario. This means that allocating resources to small-scale enterprises have high returns to the economy. The with-project scenario reflects increases of over 40% in GDP, labor income, and tax revenues. Over 30% for employment and 20% in gross profits. Moreover, even when costs at the intermediary-level institutions (between 10 and 17 cents for each lempira lent) are taken into account, economic rates of return for model or typical enterprises remain higher than 50%. In addition, financial rates of return for five of the six enterprises analyzed are higher than 16%, with a mean rate of 46%, suggesting that owners of the enterprises are likely to find that their investments are highly profitable.

Nonetheless, the results of the economic and financial analysis underline the need for caution in managing the Project resources and, specifically, in the way the financial institutions and NGOs (which act as intermediaries in this project) select the firms which will ultimately benefit from the Project resources. The high rate of failures among newly established enterprises in many countries during the first years of life suggests that such unwarranted expectations are not uncommon. On the other hand, a sensitivity analysis of those firms reviewed indicated that the analysis results are very sensitive to relative small changes in costs and sales. The implication of the sensitivity analysis indicates that the allocation of resources to the SSEs should be done on the basis of strict business venture feasibility based on commercial credit criteria, as is contemplated under the Project.

VI. PROJECT MANAGEMENT AND IMPLEMENTATION

Administrative Arrangements

With assistance from the PTU, the USAID will have overall responsibility for administering the NGO grant and policy components. A Fiduciary Agent,

expected to be FONDEI, will have overall responsibility for managing the FOPEME Loan and Guarantee Fund programs. The Mission will monitor the credit and guarantee programs--but as noted above, overall responsibility for these funds will rest with the GOH through its agent, the BCH. This arrangement is fully in line with the A.I.D.'s revised local currency guidelines.

The Project will be implemented through Operational Program Grants (OPGs) to the three participating NGOs. One of these OPGs (to ANDI/PYME) will also reserve funds for in-country and international training opportunities related to the policy and PFI components and for limited international travel of private and public sector officials for training and workshops related to SSE development.

1. Grants to Participating NGOs

The OPGs will be implemented with FUNADEH, ASEPARE and ANDI/PYME in accordance with Handbook 13 procedures. As noted in Section VI. A. 2, advances will be provided on a 90-day basis directly by A.I.D. to the institution. Payment methods, which are well-defined in the Standard Provisions to be provided to each entity, will also follow traditional approaches used by A.I.D.

Although, the Mission will issue direct grants to the NGOs, as discussed earlier in Part IV.C., implementation oversight will be directed by the PTU which will need to establish close working relationships with each entity. In addition, the PTU will assist NGOs in project management, including monitoring and processing of project-related documents, e.g., vouchers, reports, action memos, project implementation letters. Although the PTU will prepare all documentation in draft, final approval and authority will rest with the Mission.

During Project implementation, the additional NGOs may be selected to participate in the core group, subject to prior written approval by USAID and a PP amendment to increase grant funding. No PP amendment will be required if the number of PFIs increases. While the PTU did not play a role in the design of the initial six core group members' proposals, it will play a key role in the selection of participating institutions in the expansion phase. Beginning in years two and three, the PTU, in coordination with the Mission, will initiate discussions with selected organizations to determine the most suitable candidates for participation. The PTU will ensure that their primary responsibility remain, however, in providing the necessary technical assistance to the initial core group entities, focusing specifically on the consolidation on their programs, particularly of the three NGOs. A list of potential candidates is provided in Annex II, Exhibit I. As outlined earlier in this document, participation will be determined by the availability of funds and based on the selection criteria outlined in Annex II, Exhibit G. However, it is not expected that this Project will help create any new NGOs.

2. Bilateral Agreement

As previously noted, a bilateral agreement between A.I.D. and the GOH will obligate funds such as those for evaluation, the Project Liaison Officer, and selected training and other activities which are not covered under the Grants to the NGOs. Given their nature, A.I.D. will act as the GOH's agent

in implementing these activities. Requests for PTU technical assistance or for training and other activities obligated through this agreement will be made in writing from these institutions to A. I. D.

3. PFI Credit and Guarantee Program

The bilateral agreement to be signed between A. I. D. and the Ministry of Finance and Public Credit will outline the general operating principles of POPEME and specific operating procedures and regulations for the Fiduciary Agent.

The Fiduciary Agent will:

- Examine on a selective basis the individual files of the loan made by the PFIs for adherence to the terms and conditions of the Participation Agreement;
- Cancel the share of the participation of the loan that is made in violation of the Agreement;
- Cancel the Participation Agreement of the PFIs in case of repeated violations of the Agreement;
- In case of default by a PFI, take all the necessary actions to recover the funds backed by the Central Bank;
- Select additional PFIs beyond the three that will initially participate, based on criteria outlined in Annex II, Exhibit H as well as other criteria to be agreed upon between the BCH and A. I. D.;
- Establish the Guarantee Premium;
- In case of default by an SSE, reimburse the PFI the guarantee amount;
- Maintain records of all loans and guarantees issued to the PFIs;
- Invest all reflows and surplus funds in safe and attractive short-term financial instruments.

Loans will be made by the Fiduciary Agent to the participating PFIs. The Fiduciary Agent will be responsible for administration and collection of loans from the PFIs. A. I. D.'s role will consist of active monitoring of the loan program. A. I. D., however, will not be a party to the loan agreement. Participation Agreements will be signed between the Fiduciary Agent and each financial institution. This Agreement will outline specific responsibilities of the two parties and operating procedures. A. I. D. will approve a standard document prior to the signature of the first Agreement which will serve as a model document for other Agreements with PFIs.

Again, as with the NGOs, the PTU will be responsible for providing the necessary technical assistance to the PFIs. Some needs have been identified in individual proposals presented by the PFIs to A. I. D. In addition, the PTU will conduct an assessment of bank TA and training needs during the initial start-up period. This assessment will form the basis of a formal training and technical assistance plan to be formulated by the PTU in conjunction with participating PFIs and other members of the banking community such as the National Association of Bankers (AHIBA).

3. Project Technical Unit

A. I. D. will be directly responsible for the contracting and day to day supervision and management of the PTU. A Project-financed liaison or Project

Officer located in the Office of Private Sector Programs will have overall responsibility for the PTU and all other Project activities.

Of critical importance to Project implementation is the establishment of effective linkages between the PTU and participating institutions. Approximately four months after arrival in country, the PTU will sign a TA and Training Plan with each NGO. Technical assistance plans between the PTU and each participating NGO will be signed annually to outline the tasks to be performed by PTU and the responsibilities of the parties. As noted above, the PTU will establish a similar arrangement with participating PFIs.

B. Procurement Procedures

The source and origin of goods and services to be procured under the OPGs will be in accordance with A. I. D. requirements applicable to Handbook 13 Grants. The source and origin of goods and services to be procured under the local currency loan and sub-loans will be in accordance with A. I. D. requirements applicable to intermediate credit institutions projects (See Handbook 1, Supplement B, Chapter 19). It is expected that commodity procurement will generally be limited to computer equipment (including appropriate hardware, software and training) and vehicles. Services may be required to provide TA additional to that provided by the PTU and to undertake specific studies/analyses. Since it is expected that total procurement per OPG, both for commodities and services, will be under \$250,000, actual procurement will be undertaken by the individual NGO. However, as necessary, the Mission will provide limited assistance in the procurement process.

A. I. D. will sign directly the institutional contract with payment being made by A. I. D. No deviation from established A. I. D. disbursement procedures is anticipated. A Project Agreement will be signed between the GOH and A. I. D. to obligate Project funds (apart from the funds obligated through individual OPGs) and will provide guidelines for the local currency Loan and Guarantee Funds.

C. Evaluation and Audit

1. Evaluation Plan

As part of the Project Technical Unit's monitoring responsibilities, regular reviews of the Project will be undertaken including reviews of all the core groups. The PTU will have a full-time specialist in monitoring and evaluation to design and guide the monitoring and evaluation of the Project. The first task of this specialist will be to design a monitoring and evaluation (M&E) system which will be an integral part of the Project.

The PTU will be required to use the following two documents in the design of the systems: A. I. D. Guidelines for Data Collection, Monitoring and Evaluation Plan for A. I. D. -Assisted Projects, (A. I. D. Program Design and Evaluation Methodology Report No. 9) and A Manual to Evaluate Small-Scale Enterprise Development Projects (A. I. D. Program Design and Evaluation Methodology Report No. 6). This contractor should work in conjunction with the Mission Evaluation Officer and the M&E system should be approved by this officer before its implementation.

This system will identify the types of data to be gathered and analyzed for decision-making and impact assessment, the users of this data, and timely efficient ways to report the data to its users. The system will assess both individual implementing entities and the overall Project for aggregate impact analysis and will ensure that the data systems used by the various entities are compatible with each other. The overall aggregate impact analysis will be based on the purpose, goal and output indicators specified in the Logical Framework of this PP. The M&E system will regularly collect data on the achievement of goal, purpose and output levels and all implementing entities will regularly collect and report data on these three levels. The monitoring and evaluation activity will be ongoing throughout the life of the Project. In addition, the Project will undergo two comprehensive evaluations/reviews (as deemed necessary) in the second and fourth years of implementation. Finally, the Project will also be subject to a series of issue-specific evaluations to be undertaken when required.

The first issue-specific assessment to be undertaken will likely focus on the implementation of the PFI credit mechanism and guarantee component and the linkage between the PTU and the NGOs. This review will be undertaken by an independent consultant at the beginning of the second year of the Project. It will focus on the effectiveness of the FOPEME loan and guarantee mechanisms, whether they are in fact contributing to greater commercial bank lending to SSEs and what, if any, corrective measures need to be undertaken.

The first comprehensive evaluation/review will be conducted in year two and will focus on administrative, management, and Project implementation issues as well as assessing the data on Project impact. Specifically, the independent evaluation team will review progress on Project and grantee activities and toward achievement of objectives identify problems which are inhibiting achievement of objectives, and recommend solution for these problems. This evaluation/review will also address the question of whether A.I.D. should expand the Project to include additional technical areas and core group members. The second evaluation/review to be carried out in year four, will focus more exclusively on the overall impact of Project activities, identify constraints encountered which may have prevented the Project from achieving its objectives, and provide recommendations as to further actions necessary to develop the small business system and hence increase employment. Special attention will be focused on employment generation and maintenance, success in the use of the financial institutions, and overall movement towards self-sufficiency of the first- and second-story institutions participating in the Project.

Evaluations and reviews will comprise an important element of Project design. Accordingly, the evaluation plan herein presented may be revised during Project implementation to conform to Project management needs.

2. Audit Plan

The Project may be audited by the Regional Inspector General (RIG). The Mission's Financial Analysis and Review Sections will conduct annual financial review of the grantees during the life of the Project. A stateside post-contract audit of U.S. direct contractors is normally conducted by the Defense Contract Audit Agency. Project funds are budgeted for audit purposes.

D. Implementation Plan

The life of Project will be five years from the date of the signing of the grant and loan agreements. Highlights of implementation activities for the life of project are presented below. Major events for the first year are listed in greater detail and those activities which will occur annually are so indicated.

<u>Action</u>	<u>Time Frame</u>
<u>YEAR 1</u>	
Request for Proposals Issued	May 1988
Technical Proposals Received	June 1988
Technical Proposals Evaluated	July 1988
PP Authorization	August 1988
OPG Grant Agreements Signed	August 1988
Bilateral Agreement Signed with GOH	August 1988
Technical Assistance Contract Signed	August 1988
First Long-Term Advisors (Contractor) Arrive	October 1988
NGOs' Budgets and Workplans Approved (annual)	October 1988
Completion of T.A. Contractor's Project Workplan	October 1988
Initial Policy Workshop ¹	January 1989
Donor Coordination Meeting (annual)	January 1989
PTU-NGO TA and Training Plans Signed (annual)	January 1989
PTU-PFI TA and Training Plans Signed	February 1989
First Bank Training Workshop	March 1989
Monitoring and Evaluation Workshop for NGOs	March 1989
Follow-up Workshop on Policy Constraints	April 1989
Marketing Workshop for NGOs	May 1989
Training Workshop for NGOs	June 1989
<u>Years 2-5</u>	
First Issue-specific evaluation (PFI Loan and Guarantee Fund component)	November 1989
Second Review to Consider Expansion	November 1989
Completion of Marketing Assessment	September 1989
Third Workshop on Policy Constraints	February 1990
Training Seminar for PFIs	March 1990
Interim Comprehensive Project Review	June 1990
NGO mid-term Evaluation	December 1990
RFP for Technical Assistance Contract (New or Extension)	February 1991
Final Workshop on Policy Constraints	April 1991

¹ It should be noted that workshops will not be limited specifically to core group members. Other institutions may participate as determined by the PTU and Mission.

<u>Action</u>	<u>Time Frame</u>
TA Contract Signed	July 1991
National Conference on SSE Development	December 1991
Second Comprehensive Project Impact Evaluation	September 1992
Post-Contract Audit of TA Contract	July 1993
Project Closeout	September 1993

E. Gray Amendment Considerations

The Mission will take fully into account Gray Amendment considerations in the procurement of goods and services. Particular attention will be paid to small businesses in the selection of the institutional contractor(s) under the Project Technical Unit (PTU). To the extent possible, the Mission will encourage joint ventures with small, minority, and disadvantaged firms and universities.

F. Environmental Concerns

The proposed Project will foster changes that do not have adverse implications for the human or natural environment of Honduras. Accordingly, the Mission made a negative IIE determination. A negative determination for the Environmental Threshold Decision has been concurred in by the LAC Environmental Officer. This determination appears in Annex I, Exhibit D.

VII. NEGOTIATION STATUS

A. Conditions Precedent to Disbursement

Given the nature of the Project, the only conditions precedent to disbursement that will be required are the designation of official representatives by the participating NGOs. Given the Mission's experience in working with these institutions, including thorough reviews of accounting and management practices in the course of implementing previous USAID-supported programs, it is our assessment that the NGO programs can begin immediately after obligation. In line with OPG regulations, the Grants will not have formal covenants. The Grant Agreement will, however, clearly specify the nature and purpose of the Grant and, therefore, cover covenant-type concerns.

As the Expanded Financial Institutional Lending Component is financed from ESF-generated local currency for which CPs are normally not required. There are, of course, a number of intermediary steps that will have to be taken before funds are disbursed from the Central Bank to the Fiduciary Agent and to participating PFIs, e.g., Letters of Participation must be signed between the Fiduciary Agent and the PFIs. A.I.D. will approve these documents. They are, however, implementation procedures rather than CPs per se.

Through the bilateral Agreement, the GOB will concur with the PFI program and will establish official representatives (expected to be the Minister of Finance and Public Credit and the President of the Central Bank).

B. Negotiation Status

Representatives of NGOs have worked closely with the Mission in developing individual proposals and in the overall design of the Project. Numerous meetings have been held with the participating NGOs to discuss, for example, the role of the PTU, and the Project objective of increasing greater NGO-commercial bank linkages and other elements included in Project design. Similarly, the Mission has discussed the PFI lending component with the Central Bank and the initial participating PFIs, as well as with several commercial banks regarding their possible participation as Trust Banks. These discussions have been instrumental in the design of the component and in the proposed management configuration of the program.

In sum, there are no major issues outstanding which will require substantive negotiation. Draft Grant Agreements have already been prepared for the NGO component, as well as a draft bilateral Project Agreement. These draft documents will be discussed and negotiated immediately after authorization with the appropriate entities. In sum, it is expected that all agreements will be signed shortly after authorization.

ANNEX I
EXHIBIT A

CERTIFICATION PURSUANT TO SECTION 611 (e) OF THE
FOREIGN ASSISTANCE ACT OF 1961, AS AMENDED

I, John A. Sanbrailo, the principal officer of the Agency for International Development in Honduras, having taken into account among other factors the maintenance and utilization of projects in Honduras previously financed or assisted by the United States, do hereby certify that in my judgement Honduras has both the financial capability and the human resources capability to effectively maintain and utilize the capital assistance project: Small Business II.

This judgement is based upon the implementation record of the previous projects implemented in Honduras, and the quality of the planning which has gone into this new project.


John A. Sanbrailo
Director, USAID/Honduras

Date: 8/26/88

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; B(2) applies to projects funded with Development Assistance loans; and B(3) applies to projects funded from ESF.

The country checklist for FY88 was prepared by LAC/CEN.

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

A. GENERAL CRITERIA FOR PROJECT

1. FY 1988 Continuing Resolution Sec. 523; FAA Sec. 634A. If money is sought to obligated for an activity not previously justified to Congress, or for an amount in excess of amount previously justified to Congress, has Congress been properly notified?
A Congressional Notification was submitted by A.I.D. on July 13, 1988.
2. FAA Sec. 611(a)(1). Prior to an obligation in excess of \$500,000, will there be (a) engineering, financial or other plans necessary to carry out the assistance, and (b) a reasonably firm estimate of the cost to the U.S. of the assistance?
Items 2(a) and 2(b) have been completed.
3. FAA Sec. 611(a)(2). If legislative action is required within recipient country, what is the basis for a reasonable expectation that such action will be completed in time to permit orderly accomplishment of the purpose of the assistance?
No further legislative action required.

4. FAA Sec. 611(b); FY 1988 Continuing Resolution Sec. 501. If project is for water or water-related land resource construction, have benefits and costs been computed to the extent practicable in accordance with the principles, standards, and procedures established pursuant to the Water Resources Planning Act (42 U.S.C. 1962, et seq.)? (See A.I.D. Handbook 3 for guidelines.) N/A
5. FAA Sec. 611(e). If project is capital assistance (e.g., construction), and total U.S. assistance for it will exceed \$1 million, has Mission Director certified and Regional Assistant Administrator taken into consideration the country's capability to maintain and utilize the project effectively? 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. NO
7. FAA Sec. 601(a). Information and conclusions on whether projects will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, 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. The project will encourage 7(b), 7(c), and 7(e); will be neutral on 7(f); and take measures to prevent 7(d).
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). A major portion of the technical assistance will be procured from U.S. private sources.
9. FAA Secs. 612(b), 636(h). 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. Honduras has agreed to provide counterpart financing.

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? NO
11. FY 1988 Continuing Resolution 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? N/A
12. FY 1988 Continuing Resolution Sec. 552. Will the assistance (except for programs in Caribbean Basin Initiative countries under U.S. Tariff Schedule "Section 807," which allows reduced tariffs on articles assembled abroad from U.S.-made components) be used directly to procure feasibility studies, prefeasibility studies, or project profiles of potential investment in, or to assist the establishment of facilities specifically designed for, the manufacture for export to the United States or to third country markets in direct competition with U.S. exports, of textiles, apparel, footwear, handbags, flat goods (such as wallets or coin purses worn on the person), work gloves or leather wearing apparel? N/A
13. FAA Sec. 119(g)(4)-(6). Will the assistance (a) support training and education efforts which improve the capacity of recipient countries to prevent loss of biological diversity; (b) be provided under a long-term agreement in which the recipient country agrees to protect ecosystems or other wildlife habitats; (c) support efforts to identify and survey ecosystems in recipient countries worthy of protection; or (d) by any direct or indirect means significantly degrade national parks or similar protected areas or introduce exotic plants or animals into such areas? NO

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 expenditure of project funds (either dollars or local currency generated therefrom)? N/A
15. FY 1988 Continuing Resolution. If assistance is to be made to a United States PVO (other than a cooperative development organization), does it obtain at least 20 percent of its total annual funding for international activities from sources other than the United States Government? N/A
16. FY Continuing Resolution Sec. 541. If assistance is being made available to a PVO, has that organization provided upon timely request any document, file, or record necessary to the auditing requirements of A.I.D., and is the PVO registered with A.I.D.? YES
17. FY 1988 Continuing Resolution Sec. 514. If funds are being obligated under an appropriation account to which they were not appropriated, has prior approval of the Appropriations Committees of Congress been obtained? N/A
18. FY Continuing Resolution Sec. 515. If deob/reob authority is sought to be exercised in the provision of assistance, are the funds being obligated for the same general purpose, and for countries within the same general region as originally obligated, and have the Appropriations Committees of both Houses of Congress been properly notified? N/A
19. State Authorization Sec. 139 (as interpreted by conference report). Has confirmation of the date of signing of the project agreement, including the amount involved, been cabled to State L/T and A.I.D. LEG within 60 days of the agreement's entry into force with respect to the United States and has the full text of the agreement been pouched to those same offices? (See Handbook 3, Appendix 6G for agreements covered by this provision).

B. FUNDING CRITERIA FOR PROJECT**1. Development Assistance Project Criteria**

- a. FY 1988 Continuing Resolution Sec. 552 (as interpreted by conference report). If assistance is for agricultural development activities (specifically, any testing or breeding feasibility study, variety improvement or introduction, consultancy, publication, conference, or training), are such activities (a) specifically and principally designed to increase agricultural exports by the host country to a country other than the United States, where the export would lead to direct competition in that third country with exports of a similar commodity grown or produced in the United States, and can the activities reasonably be expected to cause substantial injury to U.S. exporters of a similar agricultural commodity; or (b) in support of research that is intended primarily to benefit U.S. producers?

N/A

- b. FAA Secs. 102(b), 111, 113, 281(a). Describe 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, dispersing investment from cities to small towns and rural areas, and

The Project will strength and expand the small business community in Honduras through providing employment for a disadvantaged group, and increasing income among the poorest. Participation of women is an important focus women entrepreneurship predominate among micro enterprises in the commercial sector. The businesses comprising the target group are generally labor-intensive and in many cases are organized into industrial cooperatives applying appropriate technology.

85

insuring wide participation of the poor in the benefits of development on a sustained basis, using 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.

By promoting the small business sector, this project supports the self-help efforts of Hondurans.

- c. FAA Secs. 103, 103A, 104, 105, 106, 120-21. Does the project fit the criteria for the source of funds (functional account) being used? YES
- d. FAA Sec. 107. Is emphasis placed 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)? YES
- e. FAA Secs. 110, 124(d). Will the recipient country provide at least 25 percent 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)? N/A
- f. FAA Sec. 128(b). If the activity attempts to increase the institutional capabilities of private organizations or the government of the country, or if it attempts to stimulate scientific and technological research, has it been designed and will it be monitored to ensure that the ultimate beneficiaries are the poor majority? YES

[Handwritten mark]

- g. FAA Sec. 201(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.
- The technical assistance and training components of the project will enhance Honduras administrative, technical and managerial skills at the beneficiary level as well as at the institutional level.
- h. FY 1988 Continuing Resolution Sec. 538. Are any of the funds to be used for the performance of abortions as a method of family planning or to motivate or coerce any person to practice abortions?
- NO
- Are any of the funds to be used to pay for the performance of involuntary sterilization as a method of family planning or to coerce or provide any financial incentive to any person to undergo sterilizations?
- NO
- Are any of the funds to be used to pay for any biomedical research which relates, in whole or in part, to methods of, or the performance of, abortions or involuntary sterilization as a means of family planning?
- NO
- i. FY 1988 Continuing Resolution. Is the assistance being made available to any organization or program which has been determined to support or participate in the management of a program of coercive abortion or involuntary sterilization?
- NO
- If assistance is from the population functional account, are any of the funds to be made available to voluntary family planning projects which do not offer, either directly or through referral to or information about access to, a broad range of family planning methods and services?
- N/A

- j. FAA Sec. 601(e). Will the project utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise? YES
- k. FY 1988 Continuing Resolution. What portion of the funds will be available only for activities of economically and socially disadvantaged enterprises, historically black colleges and universities, colleges and universities having a student body in which more than 20 percent of the students are Hispanic Americans, and private and voluntary organizations which are controlled by individuals who are black Americans, Hispanic Americans, or Native Americans, or who are economically or socially disadvantaged (including women)? Competitive procedure will encourage participation of these groups.
- l. FAA Sec. 118(c). Does the assistance comply with the environmental procedures set forth in A.I.D. Regulation 16? Does the assistance place a high priority on conservation and sustainable management of tropical forests? Specifically, does the assistance, to the fullest extent feasible: (a) stress the importance of conserving and sustainably managing forest resources; (b) support activities which offer employment and income alternatives to those who otherwise would cause destruction and loss of forests, and help countries identify and implement alternatives to colonizing forested areas; (c) support training programs, educational efforts, and the establishment or strengthening of institutions to improve forest management; (d) help end destructive slash-and-burn agriculture by supporting stable and productive farming practices; (e) help conserve forests which have not yet been degraded by helping to increase production on lands already cleared The Project complies with the environmental procedures set forth in A.I.D. Regulations A categorical exclusion was recommended at the threshold decision.

98

or degraded; (f) conserve forested watersheds and rehabilitate those which have been deforested; (g) support training, research, and other actions which lead to sustainable and more environmentally sound practices for timber harvesting, removal, and processing; (h) support research to expand knowledge of tropical forests and identify alternatives which will prevent forest destruction, loss, or degradation; (i) conserve biological diversity in forest areas by supporting efforts to identify, establish, and maintain a representative network of protected tropical forest ecosystems on a worldwide basis, by making the establishment of protected areas a condition of support for activities involving forest clearance or degradation, and by helping to identify tropical forest ecosystems and species in need of protection and establish and maintain appropriate protected areas; (j) seek to increase the awareness of U.S. government agencies and other donors of the immediate and long-term value of tropical forests; and (k) utilize the resources and abilities of all relevant U.S. government agencies?

- n. FAA Sec. 118(c)(13). If the assistance will support a program or project significantly affecting tropical forests (including projects involving the planting of exotic plant species), will the program or project (a) be based upon careful analysis of the alternatives available to achieve the best sustainable use of the land, and (b) take full account of the environmental impacts of the proposed activities on biological diversity?

N/A

- n. FAA Sec. 118(c)(14). Will assistance be used for (a) the procurement or use of logging equipment, unless an environmental assessment indicates that all timber harvesting operations involved will be conducted in an environmentally sound manner and that the proposed activity will produce positive economic benefits and sustainable forest management systems; or (b) actions which will significantly degrade national parks or similar protected areas which contain tropical forests, or introduce exotic plants or animals into such areas? N/A
- o. FAA Sec. 118(c)(15). Will assistance be used for (a) activities which would result in the conversion of forest lands to the rearing of livestock; (b) the construction, upgrading, or maintenance of roads (including temporary haul roads for logging or other extractive industries) which pass through relatively undegraded forest lands; (c) the colonization of forest lands; or (d) the construction of dams or other water control structures which flood relatively undegraded forest lands, unless with respect to each such activity an environmental assessment indicates that the activity will contribute significantly and directly to improving the livelihood of the rural poor and will be conducted in an environmentally sound manner which supports sustainable development? N/A
- p. FY 1988 Continuing Resolution If assistance will come from the Sub-Saharan Africa DA account, is it (a) to be used to help the poor majority in Sub-Saharan Africa through a process of long-term development and economic growth that is equitable, participatory, environmentally sustainable, and self-reliant; (b) being provided in N/A

accordance with the policies contained in section 102 of the FAA; (c) being provided, when consistent with the objectives of such assistance, through African, United States and other PVOs that have demonstrated effectiveness in the promotion of local grassroots activities on behalf of long-term development in Sub-Saharan Africa; (d) being used to help overcome shorter-term constraints to long-term development, to promote reform of sectoral economic policies, to support the critical sector priorities of agricultural production and natural resources, health, voluntary family planning services, education, and income generating opportunities, to bring about appropriate sectoral restructuring of the Sub-Saharan African economies, to support reform in public administration and finances and to establish a favorable environment for individual enterprise and self-sustaining development, and to take into account, in assisted policy reforms, the need to protect vulnerable groups; (e) being used to increase agricultural production in ways that protect and restore the natural resource base, especially food production, to maintain and improve basic transportation and communication networks, to maintain and restore the natural resource base in ways that increase agricultural production, to improve health conditions with special emphasis on meeting the health needs of mothers and children, including the establishment of self-sustaining primary health care systems that give priority to preventive care, to provide increased access to voluntary family planning services, to improve basic literacy and mathematics especially to those outside the formal educational system and to improve primary education, and to develop income-generating opportunities for the unemployed and underemployed in urban and rural areas?

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. FAA Sec. 602(a). Are there arrangements to permit U.S. small business to participate equitably in the furnishing of commodities and services financed? Yes, normal A.I.D. procedures will be followed.
2. FAA Sec. 604(a). Will all procurement be from the U.S. except as otherwise determined by the President or under delegation from him? YES
3. FAA Sec. 604(d). 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? Honduras does not practice such discrimination.
4. FAA Sec. 604(e); ISDCA of 1980 Sec. 705(a). If non-U.S. procurement of agricultural commodity or product thereof 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.) N/A
5. FAA Sec. 604(q). Will construction or engineering services be procured from firms of advanced developing countries which are otherwise eligible under Code 941 and which have attained a competitive capability in international markets in one of these areas? (Exception for those N/A

countries which receive direct economic assistance under the FAA and permit United States firms to compete for construction or engineering services financed from assistance programs of these countries.)

6. FAA Sec. 603. Is the shipping excluded from compliance with the requirement in section 901(b) of the Merchant Marine Act of 1936, as amended, that at least 50 percent 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 such vessels are available at fair and reasonable rates? NO
7. FAA Sec. 621(a). If technical assistance is financed, will such assistance be furnished by private enterprise on a contract basis to the fullest extent practicable? Will the facilities and resources of other Federal agencies be utilized, when they are particularly suitable, not competitive with private enterprise, and made available without undue interference with domestic programs? YES
8. International Air Transportation 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? YES
9. FY 1988 Continuing Resolution 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? YES
10. FY 1988 Continuing Resolution Sec. 524. If assistance is for consulting service through procurement contract pursuant to 5 U.S.C. 3109, are contract expenditures a matter of public record and available for public inspection (unless otherwise provided by law or Executive order)? YES

B. CONSTRUCTION

1. FAA Sec. 601(d). If capital (e.g., construction) project, will U.S. engineering and professional services be used? N/A
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? N/A
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), or does assistance have the express approval of Congress? N/A

C. OTHER RESTRICTIONS

1. FAA Sec. 122(b). If development loan repayable in dollars, is interest rate at least 2 percent per annum during a grace period which is not to exceed ten years, and at least 3 percent per annum thereafter? N/A
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? N/A
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? YES

4. Will arrangements preclude use of financing:
- a. FAA Sec. 104(f); FY 1987 Continuing Resolution Secs. 525, 538. (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 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 sterilizations as a means of family planning; or (4) to lobby for abortion? YES
 - b. FAA Sec. 483. To make reimbursements, in the form of cash payments, to persons whose illicit drug crops are eradicated? YES
 - c. FAA Sec. 620(g). To compensate owners for expropriated or nationalized property, except to compensate foreign nationals in accordance with a land reform program certified by the President? YES
 - d. FAA Sec. 660. To provide training, advice, or any financial support for police, prisons, or other law enforcement forces, except for narcotics programs? YES
 - e. FAA Sec. 662. For CIA activities? YES
 - f. FAA Sec. 636(i). For purchase, sale, long-term lease, exchange or guaranty of the sale of motor vehicles manufactured outside U.S., unless a waiver is obtained? YES

- g. FY 1988 Continuing Resolution Sec. 503. To pay pensions, annuities, retirement pay, or adjusted service compensation for prior or current military personnel? YES
- h. FY 1988 Continuing Resolution Sec. 505. To pay U.N. assessments, arrearages or dues? YES
- i. FY 1988 Continuing Resolution Sec. 506. To carry out provisions of FAA section 209(d) (transfer of FAA funds to multilateral organizations for lending)? YES
- j. FY 1988 Continuing Resolution Sec. 510. To finance the export of nuclear equipment, fuel, or technology? YES
- k. FY 1988 Continuing Resolution Sec. 511. 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? YES
- l. FY 1988 Continuing Resolution Sec. 516; State Authorization Sec. 109. To be used for publicity or propaganda purposes designed to support or defeat legislation pending before Congress, to influence in any way the outcome of a political ~~action~~ in the United States, or for any publicity or propaganda purposes not authorized by Congress? YES

ASEPADO

05-72

7

ASESORES PARA EL DESARROLLO

TEUCIGALPA, D. C. HONDURAS, C. A.
 APARTADO POSTAL No. 644
 OFIC. PRINCIPAL TELS. 22-7100 - 22-0724

OFFICE	ACTION	INFO
MD		
DJD		
EYO		
EIO/P		
EYO/D		
L2		
Uc		
ICNT		
HJ		
HD		
HD/E		
HD/H		
HD/P		
HR/CP		
HR/SP		
PSP		
EPA		
ESCH		
HIG		
RUUD		
CHRON		
READER		
OTHER		
GR		
DUE LATE		
ACTION TAKEN		
ATTACH		
INITIALS		
YES/NO		

W/att

Mayo, 1988

Senor James T. Grossman
 Oficina del Sector Privado
 AID/Honduras
 Ciudad

Estimado Sr. Grossman,

Me dirigo a Ud. en respuesta a su amable carta del 2 de Febrero en la cual solicitan ciertas aclaraciones sobre la propuesta enviada a su institucion en Diciembre, 1987. Fue de mucha utilidad para nosotros el poder conversar detalladamente con los funcionarios de la oficina de Programas para el Sector Privado, Mitsi Likar, Guillermo Bolanos, y Elvia Castellanos, con quienes mantuvimos una reunion el 2 de febrero del presente y cuyas valiosas sugerencias se toman en cuenta aqui.

El documento adjunto responde, punto por punto a las seis preguntas que enfoca su mencionada carta. Aprovecho la oportunidad para ademas recalcar algunos aspectos importantes del proyecto.

1. Asistencia Tecnica

Como se puede observar, la propuesta incluye un rubro para asistencia tecnica a tiempo completo durante los primeros dos anos del proyecto, y a tiempo parcial durante el tercer ano. Es importante en esta ocasion subrayar la importancia de tener acceso a esta asesoria durante los primeros dos anos y medio del proyecto.

Como es de su conocimiento, durante los ultimos dos anos se ha contado con la asesoria tecnica de Accion Internacional a traves de su asesor principal en Honduras. Esta asesoria ha facilitado la expansion del programa, el fortalecimiento de las actividades de evaluacion y capacitacion, el establecimiento de sistemas computarizados, la mejoría de los conocimientos del personal, y otras areas claves para el funcionamiento eficaz del programa. Adicionalmente, se ha contado con la asesoria de otros funcionarios de Accion

Los ingresos provenientes de la donación de AID serán utilizados por Área programática así:

DESARROLLO DE SERVICIOS DE ASISTENCIA EMPRESARIAL	L.7,428,000.00
FORMACION CAPACITACION PERSONAL OPDs.	40.000.00
RED INFORMATIVA SAE	96.800.00
EVALUACION Y MONITOREO	145.000.00
COORDINACION	1.704.805.00

T O T A L	L.9.414.605.00

El financiamiento proveniente de organismos internacionales cuantificado en L. 603.000.00 se ha presupuestado de acuerdo a compromisos formales establecidos con los mismos mediante notas que ya fueron enviadas, estando pendiente la respuesta de Inter American Foundation y del Banco de la Capitalizadora Hondureña, S.A. (BANCAHSA), las cuales remitiremos a ustedes posteriormente.

La aportación de ANDI, cuantificada en Lps.932,425.00 se explica así: Lps.187,500.00 en efectivo y Lps.745.425.00 en especie, este componente consiste en la valoración dada al tiempo aportado al proyecto por los miembros del Comité PYME y de la Junta Directiva, totalizando un monto de Lps.408.000.00 valor que ha sido establecido razonablemente en base a Lps.100.00 por participante en cada sesión. El Overhead que ANDI dejará de percibir de los fondos de AID, para cubrir costos indirectos del programa, en el nuevo proyecto son financiados por ANDI; incluye sueldo proporcional al tiempo dedicado del Proyecto por la Secretaria Ejecutiva, sueldo correspondiente al 50% de la recepcionista, aseadora y conserje pago de energía eléctrica, tiempo del asesor legal, agua y otros (gastos de atenciones).

El alquiler de las oficinas donde está ubicado el Programa PYME, continuará siendo cubierto por AID, debido a la total imposibilidad por parte de ANDI en cubrir este costo, en tanto no se realice el proyecto de construcción de local propio, lo que tenemos proyectado a muy corto plazo, estando en trámite la compra del terreno adecuado para que la institución cubra todas las necesidades de acuerdo a los programas que actualmente se implementan.

En el desarrollo de este nuevo proyecto consideramos necesario contar con el servicio de asesoría externa en forma permanente, para lo cual solicitamos que AID incluya el costo de esta asistencia dentro del presupuesto del Proyecto.

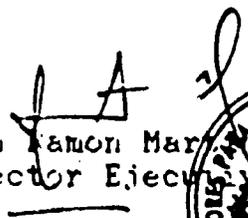
Los términos de referencia de la asesoría solicitada están en proceso de elaboración y una vez concluidos serán presentados a AID.

fondo de credito, y US\$ 212,000 para asistencia tecnica por dos años y tres meses. Se incluye aqui el rubro de asistencia tecnica aun cuando estamos concientes que AID podra escoger otro mecanismo para proporcionarla. El monto total del proyecto es de Lps. 6,086,000 y US \$212,000. Estas modificaciones toman en cuenta las necesidades para mantener el valor de la cartera y para ampliar el fondo de reserva para deudas incobrables. Como se indica en el texto adjunto, si adicionalmente se requiere que los intereses generados cubran el costo real del dinero para el quinto año, como se habia conversado con algunos funcionarios de su institucion, entonces se haran las modificaciones del caso para lograrlo. De todos modos, este cambio afectara el nivel de autosuficiencia planificado en el programa. Esperamos sus indicaciones en este respecto.

Asi tambien adjuntamos una revision cuidadosa de nuestras metas en la entrega de credito y capacitacion las cuales, como se habia conversado en el pasado, se encontraban demasiado ambiciosas, especialmente en el caso de Choluteca.

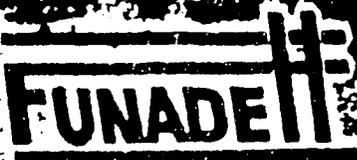
Esperamos esta informacion sea la necesaria para continuar nuestras conversaciones sobre esta propuesta. En espera de su respuesta, me suscribo,

Atentamente,


Juan Ramon Marín
Director Ejecutivo



cc: Archivo



FUNDACION NACIONAL PARA
EL DESARROLLO DE HONDURAS

1104/88

San Pedro Sula, 17 de mayo de 1988

Sr. James T. Grossman
Oficina del Sector Privado
Ag. para el Desarrollo Internacional
Tegucigalpa, D.C.

Estimado Señor Grossman:

Tal como lo solicitaron, nos complace remitirles la
nueva Propuesta de FUNADEH, que cubre el periodo de
los próximos cinco años (1988 - 1992)

Esperando que todo esté correcto, nos suscribimos de
ustedes.

Muy atentamente,



ANTONIO BOSCH PAREDES
Presidente

ABP/bfdep

ADJ: OPG

FUNADET

**FUNDACION NACIONAL PARA
EL DESARROLLO DE HONDURAS**

05-10

1100/88

San Pedro Sula, 13 de mayo de 1988

Sr. James Grossman
Oficina del Sector Privado
Agencia para el Desarrollo
Internacional - A.I.D.
Tegucigalpa, D.C.

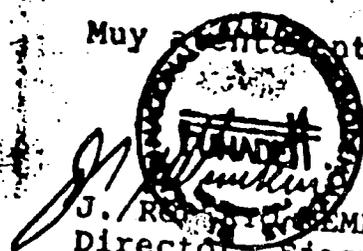
Estimado Señor Grossman:

Adjunto a la presente encontrará fotocopia de nues-
tra carta No.1078/88 enviada a usted el día 22 de
abril de 1988, la cual contiene las modificaciones
a nuestra propuesta OPG 1988-1992, según su solici-
tud mediante carta del 22 de diciembre de 1988 y
que no recibieran.

En fecha próxima les enviaremos una nueva propuesta
modificada, tal como ustedes lo solicitaron.

Sin otro particular, nos suscribimos de usted.

Muy atentamente,


J. REMBERTO EMBRENO
Director Ejecutivo

JRM/bfdep

**OFFICIAL
FILE COPY**

W/att

FILE	ACTOR
MD	
DMD	
EXO	
EXO/P	
EXO/B	
DP	
DP	
CONT	
RD	
HRD	
HRD/S	
HRD/B	
HRD/P	
HRD/FFP	
HRD/SP	
PSP	
EPA	
E-OR	
RIG	
RHU/D	
CHRON	
REAR/R	
OTHER	
C&R	
DUE DATE	
ACTIO. 1/1/84 MAN	
ATTACHM. YES/NO	
INITIALS <i>W/att</i>	

1078/88

22 de abril, 1988

Sr. James Grossman
USAID/HONDURAS
Tegucigalpa, D.C.

Estimado Sr. Grossman:

La presente es un adendum a nuestra propuesta OPG para el periodo 1988-1992 la cual incluye el nuevo presupuesto, flujo de caja y demas modificaciones solicitadas segun su carta del 22 de diciembre, 1987.

Como es de su conocimiento, en junio de 1987, FUNADEH presento a la Agencia Internacional de Desarrollo-AID una propuesta OPG-AID/Honduras para el periodo 1987-1990 por un monto de Lps.3,600,000.00. Sin embargo, en vista de que en ese tiempo AID se encontraba desarrollando su estrategia para la pequeña empresa se le sugirio a la fundación presentar una solicitud de ampliacion al OPG No. 522-0263 a 10 meses por Lps.1,000,000.00 y posteriormente la presentacion de una propuesta OPG a cinco años.

En noviembre de 1987, despues de haber recibido Lps.1000,000.00 de la ampliacion, FUNADEH presento la propuesta OPG 1988-1992 por Lps.3,050,000.00 a la cual el departamento financiero de AID recomendo incrementar la reserva para prestamos incobrables y destinar un porcentaje como reserva de capitalizacion del fondo de prestamos.

En funcion a lo anterior estamos presentando un nuevo presupuesto general para el periodo 1988-1992, el cual incluye un desglose de gastos por departamentos y por concepto (ej. Gastos en personal, local, operacion, etc.) Asi mismo, tambien se ha incluido la provision para perdidas sobre prestamos y la reserva de capitalizacion por Lps.278,500.00 y Lps.580,000.00 respectivamente, para un periodo de cinco años. En sintesis se le esta solicitando al AID Lps.4,000,000.00 adicionales.

Con el proposito de un mejor analisis se incluye un flujo de caja proyectado que comprende los años 1987-1992, presentando el año 1987 con propositos comparativos el cual incluye Lps.500,000.00 correspondientes al OPG No.522-0263 y Lps.1000,000.00 de la ampliacion al mismo OPG.

Sr. James Grossman
Pag. No. 2
22 de abril, 1988

Tambien queremos hacer de su conocimiento que FUNADEH continuamente esta investigando nuevas fuentes para el programa de prestamo y otros programas, especialmente desde nuestro reciente interes en nuevos programas de apoyo a la microempresa, como ser el establecimiento de tiendas de comercializacion y centros de acopio como los desarrollados por la Fundacion Carvajal, Cali, Colombia.

Finalmente, hacemos notar que las proyecciones contemplan un prestamo por \$ 500,000.00 y una donacion de \$75,000 del BID, cuya posibilidad de concretarse se ven cada dia mas remotas en virtud del serio impase generado en la determinacion del BID al fijarnos una tasa de interes del 15%. FUNADEH no puede aceptar esta condicion por considerarla una tasa subvencionada con los siguientes agravantes: complica las operaciones de la fundacion al tener que manejar dos tasa de interes, abre la posibilidad de que otros programas exijan su propia tasa de interes, y finalmente consideramos una falta de etica poner a competir los fondos de diferentes instituciones a traves de diferentes tasas. Dado el caso de que no se llogue a un acuerdo con el BID, FUNADEH se vera en la obligacion de buscar nuevas fuentes, incluyendo el AID, para reponer dichos fondos.

Con estas nuevas proyecciones FUNADEH asegura alcanzar su punto de equilibrio y autosuficiencia así como la continuidad y crecimiento de sus programas.

Atentamente,


J. Roberto Membreno
Director Ejecutivo

Flujo de Caja Proyectado de: FUNDACION NACIONAL PARA EL DESARROLLO DE HONDURAS

CONCEPTO/MES	1987	1988	1989	1990	1991	1992	TOTAL
Saldo Inicial	150000	452147	1666785	1999905	1447055	1369645	150000
INGRESOS:							
Ingresos Operacion							0
Membresia	120000	120000	120000	120000	120000	120000	720000
Donaciones AID	1500000	2000000	1400000	200000	200000	200000	5500000
Otras Donaciones	186000	750000	350000	50000			1336000
TOTAL DISPONIBLE	1956000	3322147	3536785	2369905	1767055	1689645	7706000
EGRESOS:							
Administracion	171195	220445	238130	256300	274050	293700	1453820
P. Prestamos	166577	337865	425900	449550	506160	543100	2429152
Unidad Promocion	79507	84106	85850	95000	101200	104950	550613
Unidad Capacitacio	110185	150946	200000	250000	275000	300000	1286131
Menos Dep. y Amort.	24000	27000	30000	33000	36000	39000	189000
Rserv. Ptmos	0	100000	120000	120000	120000	120000	580000
Total Costos	503464	666362	799880	897850	1000410	1082750	4950716
Inversiones	20000	15000	15000	15000	15000	15000	95000
Intereses s/Ptmos		7000	10000	10000	10000	10000	47000
Total Egresos	523464	688362	824880	922850	1025410	1107750	5092716
SALDO DISPONIBLE	1432536	2633785	2711905	1447055	741645	581895	2613284
CARTERA PRESTAMOS							
Desembolsos/Ptmos.	1800000	2500000	3000000	3000000	3000000	3000000	16300000
Recuperaciones	513611	1000000	1500000	2000000	2500000	3000000	10513611
Intereses	306000	533000	788000	1000000	1128000	1170000	4925000
SALDO DEL MES	302147	1214638	333120	-552850	-77410	382250	1601895
SALDO ACUMULADO	452147	1666785	1999905	1447055	1369645	1751895	1751895

101

FUNDACION NACIONAL PARA EL DESARROLLO DE HONDURAS

PRESUPUESTO GENERAL CONSOLIDADO DE TODAS LAS UNIDADES AÑOS 1988 1992

CONCEPTO	1988	1989	1990	1991	1992	TOTAL AÑO	FONDOS AID	FONDOS IAF	FONDOS BID	FONDOS INTERESES	FONDOS PRESTAMOS
ADMINISTRACION GENERAL	220445.31	238130.00	256300.00	274050.00	293700.00	1282625.31	199800.00	8000.00	5854.00	1068971.31	0.00
PROGRAMA DE PRESTAMOS	337864.72	425900.00	449550.00	506160.00	543100.00	2262574.72	277500.00	10000.00	44146.00	1930928.72	0.00
UNIDAD DE PROMOCION	84106.03	85850.00	95000.00	101200.00	104950.00	471106.03	77700.00	0.00	0.00	393406.03	0.00
UNIDAD DE CAPACITACION	150946.19	200000.00	250000.00	275000.00	300000.00	1175946.19	861500.00	0.00	100000.00	214446.19	0.00
	793362.25	949880.00	1050850.00	1156410.00	1241750.00	5192252.25	1416500.00	18000.00	150000.00	3607752.25	0.00

PRESUPUESTO GENERAL CONSOLIDADO 1988-1992 POR RUBRO

CONCEPTO	1988	1989	1990	1991	1992	TOTAL AÑO	FONDOS AID	FONDOS IAF	FONDOS BID	FONDOS INTERESES	FONDOS PRESTAMOS
GASTOS EN PERSONAL	357537.25	419050.00	453950.00	522860.00	572450.00	2325847.25	477900.00	9650.00	33600.00	1804697.25	0.00
GASTOS EN LOCAL	26100.00	27800.00	28800.00	29800.00	30800.00	143300.00	26000.00	975.00	0.00	116325.00	0.00
GSTS. DE OPERACION Y OFIC	96750.00	113780.00	122000.00	133250.00	148000.00	613780.00	200900.00	3875.00	8400.00	400605.00	0.00
GASTOS DE PROMOCION	35615.00	34900.00	41050.00	44750.00	45500.00	201815.00	35000.00	0.00	0.00	166615.00	0.00
GASTOS DE ADIESTRAMIENTO	120860.00	159350.00	205050.00	225750.00	245000.00	956010.00	676700.00	0.00	100000.00	179310.00	0.00
PERDIDAS S/ PRESTAMOS	49999.50	59999.40	59999.40	59999.40	59999.40	289997.10	278497.10	3500.00	8000.00	0.00	0.00
RESERV. CAPITALIZ PTMOS	100000.50	120000.60	120000.60	120000.60	120000.60	580002.90	580002.90	0.00	0.00	0.00	0.00
INTERESES PAGADOS	6500.00	15000.00	20000.00	20000.00	20000.00	81500.00	0.00	0.00	0.00	81500.00	0.00
	793362.25	949880.00	1050850.00	1156410.00	1241750.00	5192252.25	2275000.00	18000.00	150000.00	2749252.25	0.00

PRESTAMOS	2500000.00	3000000.00	3000000.00	3000000.00	3000000.00	14500000.00	1725000.00	50000.00	1000000.00	1500000.00	10000000.00
	3293362.25	3949880.00	4050850.00	4156410.00	4241750.00	19692252.25	4000000.00	68000.00	1150000.00	4249252.25	10000000.00

501-



BANCAHSA

Apdo. Postal No. 344

Telex 1162 HO

Tegucigalpa, D. C., Honduras, C. A.

ANNEX 1
EXHIBIT C.5



Mayo 17, 1988

Señores
AGENCIA INTERNACIONAL PARA
EL DESARROLLO -AID
Presente

Estimados señores:

Por este medio presentamos para su consideración nuestra propuesta de participación en El Proyecto de La Pequeña Empresa II, mediante el cual, con dichos recursos esbozados, complementaremos nuestro programa de crédito, asistencia y asesoría administrativa, capacitación y asistencia técnica a la Micro-Pequeña Empresa.

Según se detalla en la propuesta el financiamiento solicitado comprende lo siguiente:

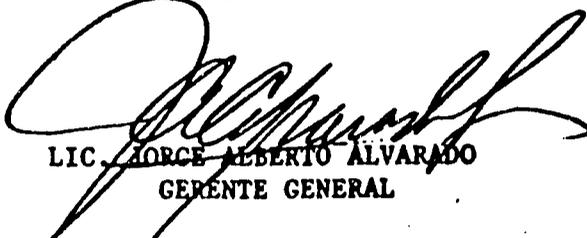
- Fondo para Crédito
- Capacitación Empresarial
- Supervisión Empresarial y Administrativa
- Cooperación para el fortalecimiento Institucional

Asimismo, se les solicita que la parte proporcional de los intereses correspondientes a un 3% del total a pagar al Banco Central (12%) pueda ser retenido por BANCAHSA, para su aplicación.

A la vez, les solicitamos la asistencia del grupo asesor, según se defina posteriormente, para implementar el programa de asistencia empresarial y la coordinación de la asistencia Institucional.

Agradeciendo su atención a la presente, de ustedes.

Atentamente,



LIC. JORGE ALBERTO ALVARADO
GERENTE GENERAL

/dipz

cc: archivo

7



RECEIVED
USAID/HONDURAS
C&F UNIT

07-56

-9 JUL 88 16 37

FINANCIERA INDUSTRIAL Y AGROPECUARIA, S.A. DE C.V.

Tegucigalpa, D.C.
Julio 8, 1988

Señor
BERNEI VELARDE
Sector Privado
AID/Tegucigalpa, D.C.

OFFICE	ACTIVITY	INFO
MD		
DUD		
EXO		
EXO/P		
LZO/D		
DP		
DF		
U.S.T		
RD		
Ex.D		
HND/J		
H B / J		
HND/P		
HRL		
HS /		
FCP		
LPA		
E		
RIG		
RUC J		
Ch.G.I		
READER		
OTHER		
C&F		
DUE DATE		
ACTION TAKEN		
ATTACHM.		YES/NO/IT

Ref.: Necesidades de Asistencia Técnica de FIA

Estimado Señor Velarde:

En el documento de propuesta de ampliación de recursos para FIA titulado "Proyecto AID 522-0205 Segunda Etapa" presentado oportunamente, hacemos un estimado de los fondos requeridos para el renglón de asistencia técnica directa a FIA. Dicho monto, calculado en US\$250.000.00, tiene como fundamento la cantidad aprobada para FIA en la primera etapa y las estimaciones de ciertas actividades, en las que la Institución quiere convertirse en el beneficiario directo. Un desglose preliminar de estas actividades y/o asesorías podrían ser:

- a) Realización por profesionales especializados, locales y/o extranjeros de un estudio de mercado que determine en donde FIA tiene que dirigir sus esfuerzos a mediano y largo plazo. Esta actividad recomendada en la ultima evaluación externa de la Financiera se inició internamente, sin embargo, considerando aspectos tales como cobertura del estudio, importancia del mismo, etc. pensamos que es preferible contar con asesoría especializada.
- b) Asesoría especializada para que FIA elabore la factibilidad económica y financiera de esquemas que le permitan obtención de recursos de otras fuentes tales como: emisión de bonos, instrumentos que permitan utilizar la ventaja de tener cinco bancos accionistas ya sea en la compra de cartera u otros esquemas, etc.
- c) Entrenamiento de nuestro personal tanto localmente como en el extranjero en áreas de evaluación de proyectos, capacitación, créditos, asistencia técnica, etc.
- d) Viajes especializados para el estudio de financieras en países que cuentan con una mejor infraestructura en este sentido.

OFFICIAL
FILE COPY

108

FINANCIERA INDUSTRIAL Y AGROPECUARIA, S.A. DE C.V.

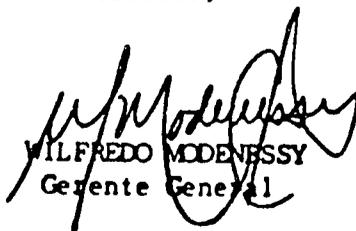
-2-

- e) Asesoría local o extranjera en el mejoramiento de sistemas de informática de la Institución.

Esperamos que el resumen anterior pueda servir de alguna base al AID para cuantificar la cantidad de recursos orientados al renglón de Asistencia Técnica a FIA en el nuevo proyecto de apoyo al sector de pequeña y mediana empresa del país.

Sin otro particular, me es grato saludarle,

Atentamente,


WILFREDO MODENESSY
Gerente General

cc:arch.



SECRETARIA DE HACIENDA Y CREDITO PUBLICO
REPUBLICA DE HONDURAS

Tegucigalpa, D.C. 24 de agosto de 1988.

CP-0860

Señor
JOHN A. SANBRAILO
Director Agencia para el
Desarrollo Internacional (AID)
Presente

Señor Director:

La Secretaría de Hacienda y Crédito Público en nombre del Gobierno de la República de Honduras solicita a la Agencia para el Desarrollo Internacional (AID) una donación de hasta US\$1.650,000 que sería utilizada en la ejecución del Proyecto de la Pequeña Empresa II, orientado al fortalecimiento y expansión del sistema institucional a fin de aumentar y mejorar el suministro de crédito, capacitación, asistencia técnica y otros servicios a las pequeñas empresas; así como también mejorar las políticas y su ambiente regulatorio donde operan. Específicamente, la donación solicitada complementaría los programas en pro del micro, pequeño y mediano empresario, que se llevarán a cabo con instituciones hondureñas sin fines de lucro e instituciones financieras legalmente establecidas en el país.

De acuerdo al Plan Nacional de Desarrollo, la asistencia a la pequeña y micro empresa está considerada como prioritaria, ya que propicia la creación de nuevos empleos, el aumento de los ingresos de los sectores más pobres y el incremento del valor agregado a la producción nacional. La duración del programa en mención sería de cinco años, que incluiría además de la cooperación solicitada por el Gobierno a la AID, la donación de US\$13.350,000 a las instituciones privadas hondureñas sin fines de lucro que llevarán a cabo los programas de pequeña y micro empresa que permitirá financiar la contratación de asistencia técnica; de modo que la donación total de la AID será de US\$15.000,000. Nuestro Gobierno programará recursos de los fondos ESF del 50% del Sector Privado por un valor de US\$16.075,000 como fondos de contraparte durante el tiempo de ejecución del proyecto. Esta contraparte sería utilizada primordialmente para establecer un Fondo de Pequeña y Mediana Empresa (FOPEME), con el fin de fomentar este importante sector.

...2/

110-



SECRETARIA DE HACIENDA Y CREDITO PUBLICO
REPUBLICA DE HONDURAS

...2/

CP-0860

Aprovechamos la oportunidad para reiterar al Señor Director las
muestras de nuestra consideración y estima.

Atentamente,



Blanca Lizzeth Rivera de Paz
BLANCA LIZZETH RIVERA DE PAZ
Secretaria de Crédito Público y
Administración.

CFC/dr

-111

AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON DC 20523

LAC-IEE-88-15

ENVIRONMENTAL THRESHOLD DECISION

Project Location : Honduras

Project Title : Small Business Development II

Project Number : 522-0241

Funding : \$15 million (Grant)

Life of Project : Five years (FY88-93)

IEE Prepared by : Lynn Sheldon,
USAID/Honduras

Recommended Threshold Decision : Categorical Exclusion

Bureau Threshold Decision : Concur with Recommendation

Comments :

Copy to : John A. Sanbrailo, Director
USAID/Tegucigalpa

Copy to : Lars Klassen, USAID/Honduras,

Copy to : Frank Zaoroga

Copy to : Richard Whelden, LAC/DR

Copy to : IEE File

James S. Hester Date JUN - 9 1988

James S. Hester
Chief Environmental Officer
Bureau for Latin America
and the Caribbean

ENVIRONMENTAL THRESHOLD DECISION

Project Location:	Honduras
Project Title and Number:	Small Business Development II 522-0241
Funding:	\$15,000,000 (Grant)
Life-of-Project:	Five Years (FY88-93)
IEE Prepared By:	Lynn Sheldon, Environmental Officer, USAID/Honduras
Recommended Threshold Decision:	Categorical Exclusion
Bureau Threshold Decision:	Concur with Recommendation

Lynn Sheldon
Lynn Sheldon
Environmental Officer
USAID/Tegucigalpa

Date 5/23/88

John A. Sanbrailo
John A. Sanbrailo
Mission Director
USAID/Tegucigalpa

Date 5/27/88

_____ Date _____
James S. Hester
Chief Environmental Officer
Bureau for Latin America
and the Caribbean

ENVIRONMENTAL CONSIDERATION

The purpose of the Small Business Development II Project is to strengthen and expand an insitutional system that will improve the supply of credit, technical assistance, training and and services to micro and small businesses; and to improve the policy and regulatory environment in which small-scale enterprises operate.

Under the Project, over 20,000 micro and small business owners and employees will receive credit and technical assistance provided through intermediate credit and technical assistance institutions which the Project will help support and capitalize.

Technical assistance and credit activities are among those actions categorically excluded from the general requirement for an IEE under paragraphs (i) and (x) of Section 216.2 (C)(2) of A.I.D.'s Environmental Procedures. Accordingly, an IEE has not been prepared for the Project.

0207T 5/18/88

114

PROJECT DESIGN SUMMARY
LOGICAL FRAMEWORK
522-0241

Life of Project: \$40 million
From FY 88 to FY 93
Total U.S. Funding: \$15 million

Project Title & Number: Small Business II (522-0241)

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
<p>Program or Sector Goal:</p> <p>The broader objective to which this project contributes:</p> <p>To increase employment opportunities and expand production through small-scale enterprise development.</p>	<p>Measures of Goal Achievement</p> <ul style="list-style-type: none"> - Number of Jobs created; - Number of Jobs maintained; - Production value-added increases; - Increase in SSE investment; - Increase in loan approvals by private sector financial institutions. 	<ul style="list-style-type: none"> - National Income; - Employment Surveys; - Impact Evaluation(s); - Central Bank and Ministry of Economy data; - Progress Reports 	<p>Assumptions for achieving goal targets:</p> <ul style="list-style-type: none"> - No further deterioration of economic or political conditions in Honduras. - Public and private sector resources are available in adequate quantities. - Economic policies more favorable to growth are adapted by the GOH.

115-

PROJECT DESIGN SUMMARY
 LOGICAL FRAMEWORK
 522-0241

Life of Project: \$40 million
 From FY 88 to FY 93
 Total U.S. Funding: \$15 million

Project Title & Number: Small Business II (522-0241)

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
<p>Project Purpose:</p> <ol style="list-style-type: none"> 1. Strengthen and expand an institutional system that will increase and improve the supply of credit, training, technical assistance and services to the small-scale enterprise sector. 2. Improve the policy and regulatory environment in which SSEs operate. 	<p>A self sustaining financial mechanism in place, that 1993 will be capable of;</p> <ul style="list-style-type: none"> - Approving 450 loans per year. - Stimulating the creation of 2,800 jobs per year. - Permitting PVO's to have access to commercial credit. - A self sustaining credit guarantee mechanism securing up to 70% of the loan. 	<ul style="list-style-type: none"> - Impact Evaluation; - Records of participating institutions including loan records; - Audited bank statements; - Funds made available from other sources (private, public sector; multi-, bi-lateral donors). 	<ul style="list-style-type: none"> - Reduction in risk and increases in yields will motivate the financial intermediaries to provide 30% of the credit fund. - Demand for small business loans is large enough to achieve the self sufficiency of the financial components. - COH support continues under new government following election of 1989. - Provision of loan guarantee mechanism will remove the major obstacle (lack of collateral to a private sector lending program. - Credit programs maintain sound financial practices including realistic lending to sub-borrowers. - Technical assistance provided to participating entities is affective.

116

PROJECT DESIGN SUMMARY
 LOGICAL FRAMEWORK
 522-0241

Life of Project: \$40 million
 From FY 88 to FY 93
 Total U.S. Funding: \$15 million

Project Title & Number: Small Business II (522-0241)

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
<p>Outputs:</p> <p>1. A self sustaining loan fund managed by Fiduciary Agent capable of financing 450 new loans per year though existing PFIs and PVOs.</p> <p>2. A self sustaining credit guarantee mechanism permitting access to commercial credit.</p> <p>3. PVOs strengthened and providing training and technical assistance to SSEs.</p> <p>4. Macro and sectoral level policy and regulator, analysis and dialogue undertaken.</p>	<p>Magnitude of Outputs:</p> <p>1. No. of loans year 5 in Portfolio 968</p> <p>Outstanding Portfolio \$21.7 million</p> <p>No. of PFIs Participating 8</p> <p>2. Amount of Portfolio Guaranteed \$15.2 million</p> <p>3. No. of SSEs increasing TA/Training 3,000</p> <p>No. of bank training seminars given 10</p> <p>4. Research and studies conducted 10</p>	<p>1. Management Information Systems of the participating institutions.</p> <p>- Annual Report of the Intermediaries. - No. of Participation Agreements signed.</p> <p>2. Guarantee premium received by Fiduciary Agent.</p> <p>- Amount of Guarantee certificates issued.</p> <p>3. PVOs Management Information System; - No. of firms that receive TA. - No. of attendants to seminars.</p> <p>4. Policy reforms undertaken.</p>	<p>1. Level of demand sufficient to generate enough revenues for self-sufficiency.</p> <p>2. Guarantee will eliminate principle obstacle to credit for SSEs.</p> <p>- Default can be held to projected levels.</p> <p>3. Training and TA is capable of improving SSEs operation; TA is available and at low cost.</p> <p>4. Policy recommendations will receive priority within the GOH.</p>

PROJECT DESIGN SUMMARY
 LOGICAL FRAMEWORK
 522-0241

Life of Project: \$40 million
 From FY 88 to Fy 93
 Total U.S. Funding: \$15 million

Project Title & Number: Small Business II (522-0241)

ARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS			MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
	A.I.D.	Sources			
Inputs:		GOH	Private Sector		
SSE Support System				- A.I.D. and counterpart disbursement records and audit reports	- Project authorized and funds allotted. - Conditions Precedent to Project implementation met by counterpart institutions.
a. Grants to NGOs	8,600	-	4,540		
b. PFI Credit & Guarantee Program	500	15,000	4,435		
Research and Policy Analysis	200	1,000	-		
Project Technical Unit	4,800	-	-		
Technical Assistance Support Fund	250	-	-		
Evaluations/Audits	150	25	-		
Project Liaison Officer	500	-	-		
TOTAL PROJECT COSTS	15,000	16,025	8,975		

ACTION MEMORANDUM FOR THE MISSION DIRECTOR

FROM: Margaret Kromhout *MK* DF
THRU: *Lawrence Klassen*, Director, O/DF
SUBJECT: Small Business II Project (522-0241) PP Review
DATE: July 14, 1988

ACTION REQUESTED: Your signature is required to authorize the subject PP.

BACKGROUND: On June 1, 1988, a meeting was held to review the Small Business II Project Paper (PP). A brief Project description is presented below.

Life of Project Funding: \$40 million
(\$15 million A. I. D. DA Grant funds; \$25 million COH/private sector contribution)
PACD: July 31, 1993
Implementing Institutions: ANDI/PYME, FUNADEH, ASEPADE, Private Financial Institutions

The Project goal is to increase employment and expand production. The Project purpose is to: (1) strengthen and expand an institutional system that will increase and improve the supply of credit, training, technical assistance, and services to SSEs; and (2) improve the policy and regulatory environment in which SSEs operate.

In order to create employment and increase incomes in Honduras, the proposed Small Business II Project (SB II) will implement an expanded program for the development of small-scale enterprises (SSEs) as Honduras enters the 1990s. The Project will build on the valuable experience and lessons learned from previous USAID-supported SSE programs.

The Project is composed of two interrelated components:

- * an SSE Support System component to strengthen and expand the programs of Honduran institutions, both Non-governmental Organizations (NGOs) and Private Financial Institutions (PFIs), which direct credit, technical assistance, and training resources to the SSEs;
- * an SSE Research and Policy Analysis component to focus primarily on research, data collection, and analysis efforts to assist policy-making institutions in the formulation of recommendations for policy changes which will lead to an improved policy environment for SSE development.

DISCUSSION: The following decisions and conclusions were reached during the review which was based on the issues paper prepared to serve as the agenda for the meeting.

A. Institutional Complexity and Selection

In reply to the question of whether the Project is dealing with too many institutions, the Project Design Committee (PDC) responded that the Project's institutional configuration conforms to specific circumstances in Honduras and the need to develop a comprehensive small-scale enterprise (SSE) program. In the case of Honduras the need for assistance in SSE section is sufficiently high and the assistance coverage of any one Non-Government Organization (NGO) is sufficiently low as to warrant the participation of the institutions cited in the PP.

In order to address the questions raised during the discussion on the selection of the initial participating organizations and the scenario for expansion, the PP includes a clear statement of why the institutions chosen for the core group were selected and why other organizations which might have been candidates were not selected. The fact that institutions were selected because they were the organizations having the strongest ongoing programs and the best potential for expansion and self-sufficiency is also discussed in the PP.

The conditions under which additional intermediaries will be selected for participation in the SB II Project is laid out in the PP. Specifically, it was agreed in the June meeting that no newly established NGOs will be eligible to participate in the Project. While the proliferation of new and non-viable NGOs is not to be encouraged, the participation of additional financial institutions is highly desirable and will be freely encouraged by flexible conditions for entry into the Project.

B. Financial Component

Various issues were raised with regard to the financial component. It was decided that EPA, PSP and DF would meet and clarify the issues on the guarantee fund mechanism, but in principle, there was agreement to move ahead with a guarantee fund on a pilot basis.

The issue of the desirability of another directed credit program was discussed. While it was recognized that directed credit can be an intervention that distorts the market, it was accepted that financial distortions in the proposed mechanism are minimal; i.e., credit is provided at market rates, and unlike other directed lines of credit, this line will not impact negatively on savings mobilization due to its costs, which are equivalent to those for mobilizing resources of banks. Moreover, there was a consensus the approach in the PP is consonant with language from the U.S. Congress, which has mandated that credit be directed to small and microenterprises. Finally, DF, PSP and EPA have negotiated an agreement in principle with Central Bank regarding the interest rate cap on local currency loans made by Private Financial Institutions (PFI's). Under that agreement, PFI's will be able to increase the rate in excess of the cap, or add on special fees to the interest rate which will result in a combined rate higher than the cap rate. The procedural details for effecting this agreement are

being worked on now by PSP and the Central Bank, and will be continued in the fiduciary agreement to be used in managing the local currency for the PFI credit fund.

An issue was raised on whether the proposed maximum loan amount (\$125,000) would allow too much of the credit resources to flow to larger enterprises. The PDC indicated that the objective of the program is employment creation and that the size of loans, or the specific targetting of loans, was not a primary objective. Nonetheless, it was decided that the section in the PP dealing with loan size would emphasize that the expected average loan made by the PFI's will be approximately \$30,000, and the justification for the determination of a \$125,000 maximum will be further strengthened in the PP. Average loan sizes for NGOs will be in the \$300 to \$5,000 range.

PSP, DF and EPA met shortly after the Project review and reached an agreement regarding several financial component issues raised during the review. It was agreed that an initial fund may be necessary to begin the guarantee program but that it should be kept small. Moreover, it was agreed that the guarantee fund will be successful to the extent that the fund does not need to tap the base after the first year of operation.

C. NGO Financial Self-Sufficiency

The issues paper questioned why the Project does not set a goal of self-sufficiency in all activities for the three participating NGOs, rather than assuming that self-sufficiency is likely only in the credit programs carried out by two of the NGOs. The decision was made not to change the goal as described in the PP, but at the same time, it will be made clear to the NGOs that they are expected to strive for full self-sufficiency and that additional funding after the completion of this project is not to be expected. A special provision will be included in each OPG Agreement requiring the NGOs to develop a self-sufficiency strategy to be reviewed by A. I. D. and the PTU.

As a result of the discussion on ANDI/PYME and its future after the PACD, two additional issues were raised. Will ANDI/PYME be able to provide the required 25% in counterpart funds? And, is a contract a more appropriate instrument for funding the activities ANDI/PYME will carry out? Calculations of counterpart contained in ANDI's proposal were reviewed and the Project Design Committee has determined that ANDI will fall just short of the counterpart requirement. Non-A. I. D. sources account for 22.6% of the project's cost, therefore a waiver of the 25% minimum requirement has been prepared for the Mission Director's approval. While ANDI will fall short of the counterpart requirement, it has made significant progress in increasing non-A. I. D. contributions compared to the previous project which was financed 99% with A. I. D. funds.

ASEPADE and FUNADEH meet counterpart requirements based on projected contributions from other donors. These projections are supported by ASEPADE's and FUNADEH's proven track records in generating other donor financing and are documented by letters of intent from other donors for new or expanded support. Compliance by all three NGOs with counterpart contributions will be tracked during project implementation.

121-

DF and PSP also met to discuss the appropriateness of a contract, OPG or Cooperative Agreement to fund ANDI's activities and came to the conclusion that because the proposed program aims to strengthen the institutional capacity of ANDI and support its on-going programs; and A.I.D. will not have a large oversight role, an OPG is the most appropriate mechanism, a contractual relation is not necessary.

D. Method of Obligation

It was agreed that there will be five obligating instruments - three OPGs, one contract and a Project Agreement with the GOH.

E. Availability of Financing

In reply to the question on availability of financing, it was stated that if any shortfall occurs, the Project will be amended to add Dollars or projectized Economic Support Funds.

F. Clarifications/Other Concerns

Clarifications and concerns outlined in the issues paper were satisfactorily resolved and/or were incorporated in the final version of the PP.

RECOMMENDATION: The issues raised during the review have been adequately addressed. Consequently, it is recommended that you sign the attached PP facesheet and Project Authorization.

APPROVED: _____

John Paul

DISAPPROVED: _____

DATE: _____

8/26/88

STEPS REQUIRED TO REGISTER A SMALL BUSINESS IN TEGUCIGALPA -
FRANCISCO MORAZAN

I. FOR INDUSTRIES WITH CAPITAL INVESTMENT UNDER L.5,000

STEPS	APPROXIMATE TIME REQUIRED	COST
1. The entrepreneur presents a request to operate his business on stamp paper (first class) or on paper which has the equivalent value in stamps.	1	L.2 (stamp paper)
2. If the entrepreneur owns the house in which his business operates, he must pay real estate taxes. Such taxes are established by the Municipality in accordance with zoning regulations.	1	Taxes vary from L.25-100/year depending upon location.
3. After paying the real estate tax, the businessperson must go to the Department of Cartography to get his Cadastral Code stamped and signed.	1	
If the business is located in a marginal area where houses have not been surveyed by the GOH, the entrepreneur must go to the Office of Social Labor which is part of the Municipal government. This office issues a note which states that the entrepreneur owns property. He then takes this note to the Office of Ejidos to receive his cadastral code.	1	
5. After receiving his Cadastral Code, the entrepreneur must go to the cashier within the Municipality and buy 2 certificates of L.5 each (one for zoning and one for the Cadastral code).	1	L.10

5.	He takes both certificates plus a card which states that he has paid all municipal taxes due to the Planning Section of the Municipality to obtain a permit to operate his business for 2 months. The entrepreneur does not have to pay sales tax during this two month period. At the beginning of the third month the entrepreneur must pay his 5 percent sales tax; after he begins to pay his sales taxes, his operating permit is issued.	5 - 10	Personal Municipal tax. L.25-100/year
7.	If the business involves food processing or preparation the owner must bring a sample of his product for analysis by the Food Control Department of the Ministry of Health. Health officials must inspect his place of business; to be approved the enterprise must meet sanitary requirements which include: a tile floor, running water, a separate room for food preparation activities, special clothes to be worn during work, ventilation and general cleanliness. After being approved, he must request a registration number on stamp paper (first class) and pay a fee of L.100-150 (or more) for a registration number.	10 - 15	L.100-150
	TOTAL	9 - 29	62 - 362

II. FOR INDUSTRIES WITH CAPITAL INVESTMENT OVER L.5,000

1.	The entrepreneur must contact a lawyer and give him power of attorney to present a request (made on stamp paper, first class) to open his business.	1 - 3	L.500 L.2(stamp paper)
----	---	-------	---------------------------

25

TABLE 6.1 -- continued

2.	If the entrepreneur owns the property on which his business operates, he must pay the corresponding real estate tax to the municipality's treasury as established in the "Plan de Arbitrios" and the Zoning Regulation.	1	varies
3.	After paying his real estate tax, the lawyer must go to the Department of Cartography to get the respective Cadastral code stamped and signed.	1	
4.	Then he must go to the Financial Department to pay for the right to hang a sign in front of the business as well as a tax on the business itself.	1	L.10 + business tax
5.	After paying these fees and taxes, the entrepreneur must proceed to the treasury of the Municipality to pay the Municipal tax and buy 2 certificates (one for zoning and one for Cadastral code).	1	L. 10
6.	After paying these charge, the entrepreneur must bring proof that he has paid all taxes to the Planning Department. He then receives a permit to operate his business.	1	
7.	After receiving his permit, the owner must organize his accounting system and go to the Income Tax Department of the Ministry of Finance and in the Municipality to have them authorize his accounting books. Each page of the ledgers must be stamped by the proper authority.	30 - 60	
TOTAL		36 - 68 plus taxes	L. 522 plus real estate/business taxes

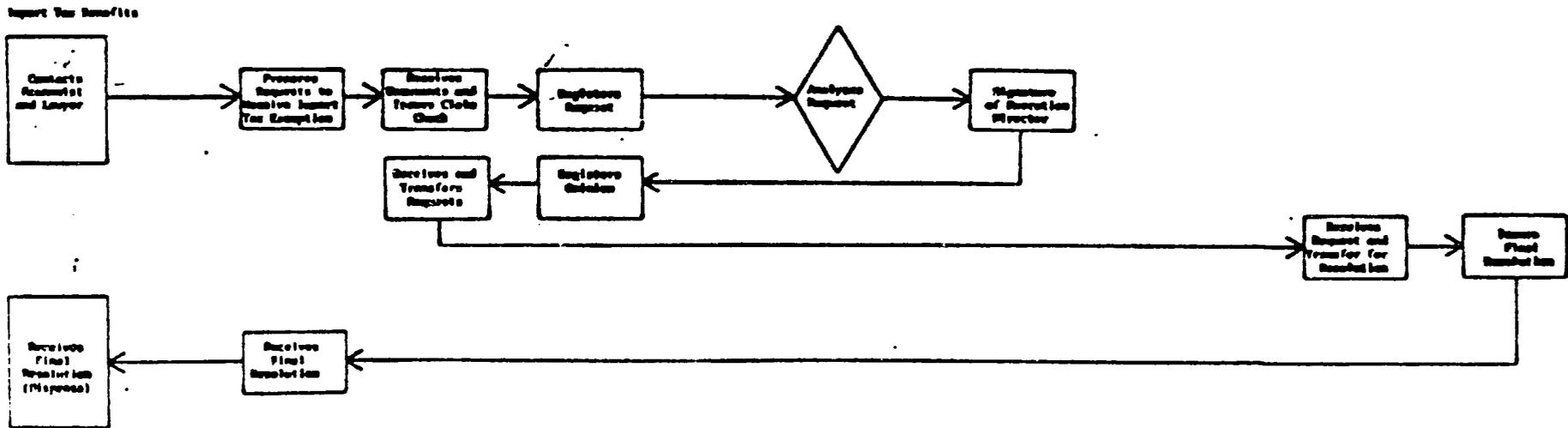
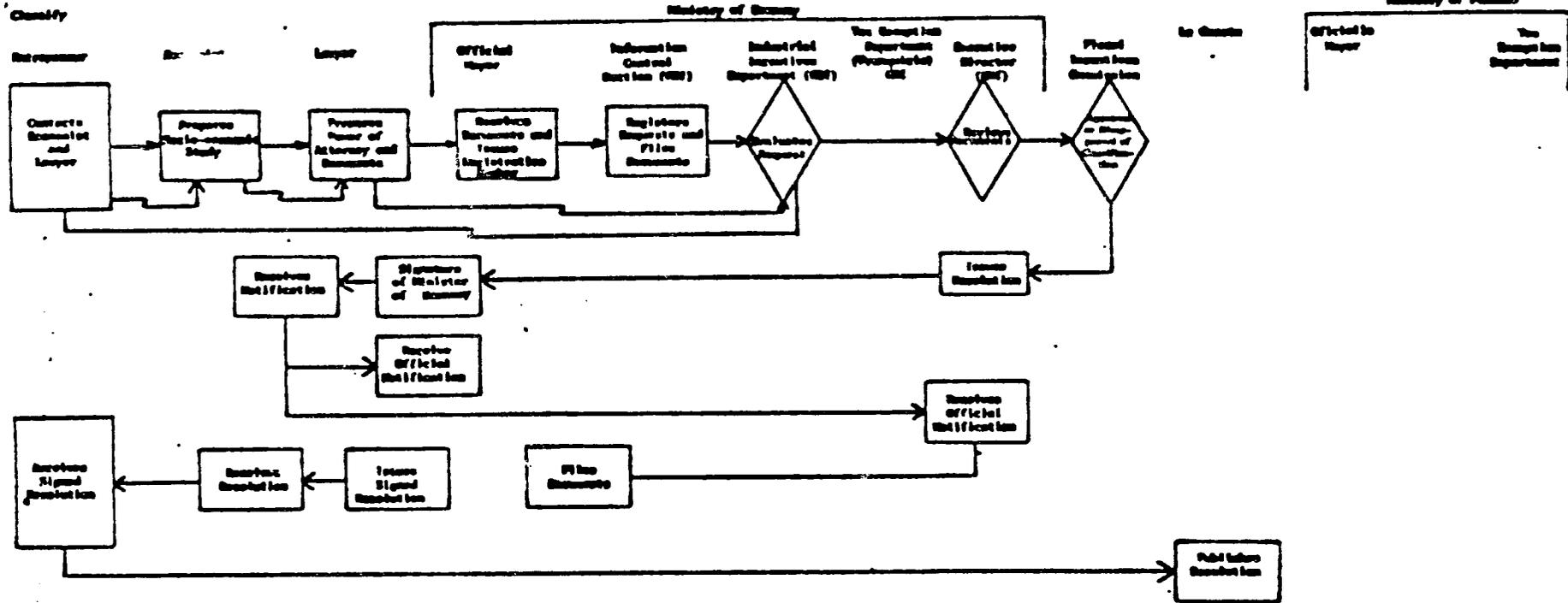
126

STEPS REQUIRED TO REGISTER A SMALL BUSINESS IN SAN PEDRO SULA

STEPS	APPROXIMATE TIME REQUIRED	COST
1. The entrepreneur receives an application form from the Income Division of the Municipality. After completing the form, he must buy a L. 1 stamp and a L. 2 certificate.	1	L. 3
2. He presents the form to the Municipal secretary for review.	1 - 2	
3. The Municipal secretary sends the form to the Department of Tax Control within the municipality. The latter inscribes the business on its list and determines whether the firm owes any past taxes since the beginning of its operations.	1 - 2	
4. The Tax Department sends the request to the "Vocalia de Policia" to inspect the establishment. If it doesn't meet requirements or is used for other than business purposes then the department may deny the registration request. The request then goes to the Department of Tax Control.	3 - 5	
5. If the results of the inspection are positive then they pass the request to the Urban Planning Department. This Department sends officials to inspect the business to determine whether it conforms to zoning regulations. If not, the request is denied.	3 - 5	

6. After Urban Planning approves the request, it goes to the Commission of Public Works and Town Planning for the final recommendations and judgement.		
7. If favorable, the Municipal Corporation discusses and analyzes the recommendations at a semi-monthly meeting. The Corporation is authorized to give final approval.	1 - 15	
8. The request is referred to the Municipal secretariat for certification.	1 - 2	
9. The secretariat sends the certified request to the Income Control division which prepares a bill which itemizes the value of taxes and when they are due.	2 - 3	
10. The entrepreneur pays the following taxes one month after becoming registered: Municipal tax, garbage pick-up, real-estate (if he owns property) and sales tax.		
11. If the business is involved in food-processing then the entrepreneur must receive permission from the Ministry of Health.	15 - 20	
TOTAL	13 - 54 plus taxes	L. 3 plus taxes

STEPS REQUIRED TO CLASSIFY A FIRM TO RECEIVE BENEFITS OF INDUSTRIAL INCENTIVE LAWS 49 AND 681



- ◇ = Decision level
- = Communication level

129

THE EFFECT OF POLICY UPON
SMALL INDUSTRY DEVELOPMENT IN HONDURAS*

EXECUTIVE SUMMARY

The Honduran industrial sector has been in a state of recession throughout this decade. While discrete project initiatives may help to revive the economy, they cannot match the impact of policy change. Projects may reach a limited number of enterprises; but policy changes affect all firms. Although industrial promotion efforts abound, surprisingly little analysis has been done on the effect of Honduran financial market, labor, fiscal, and trade policies on industrial development. The purpose of this mission was to analyze the impact of these policies specifically on smaller-scale manufacturing firms.

Our main finding is that Honduran economic policy and the administration of regulatory procedures greatly favors large over small firms. Another finding, based on empirical data, is that Honduran small and medium firms are more economically efficient than large firms. Existing policies, therefore, promote an inefficient structure of industrial production.

An examination of the size distribution of firms in Honduras reveals a disturbing gap: the industrial sector is characterized by a few dominant large firms and a multitude of micros. Medium-sized firms and larger small firms are relatively scarce. The question then becomes: Why don't microenterprises grow?

The answer is complicated and differs by subsector and even according to each individual firm. The microenterprise's lack of managerial and technical expertise, credit and entrepreneurship can be cited as culprits. But a more hidden, yet pervasive, influence is the effect of macroeconomic policies and regulations which inhibit small firm growth.

Financial market policies cap the maximum lending rate, thereby providing a disincentive for banks to lend to smaller clients. Most small firms only have access to informal credit at rates much higher than those charged by the banks. Exchange rate policy supports an overvalued lempira which benefits primarily larger enterprises that have access to foreign exchange at the official rate. Smaller firms must purchase imported inputs through dealers that often do not have access to foreign exchange through official channels and add the customary markups. In effect, both financial market and exchange rate policies lower the cost of capital for larger firms and hurt the competitive position of small firms.

Another less explicit aspect of Honduran trade policy also hurts smaller firms. The enormous quantity of smuggled goods entering the country with the implicit approval of customs officials is destroying firms in the shoe production, textiles, and clothing industries -- subsectors dominated by large numbers of microenterprises. The costs of Honduras's progressive labor legislation also affects the more labor-intensive smaller firms disproportionately to their financial means.

The implementation of these policies is plagued by bureaucratic inefficiency. This red tape, or *tramites*, saps the resources of all firms but particularly inhibits the progress of small firms. The process is sufficiently complicated and costly to discourage smaller firms from attempting to receive benefits under the Industrial Incentives Laws to import products directly or, to a lesser degree, to export. Although it is illegal to be unregistered, the cost of legality includes paying all back

*Prepared for USAID Honduras by Development Alternatives Inc., September, 1987.

taxes due since the firm began operations. Thus, unregistered microenterprises must leap over a high barrier of costs to join their formal sector counterparts and grow.

Our approach does not begin with the presumption that policy should be tipped in favor of the small, any more than it should swing in the opposite direction. We sought to examine the differential impact of policy on small, medium, and large firms to determine if it was neutral with respect to size. It is not. Our policy recommendations are geared to redressing this imbalance. A general recommendation which underpins the following is for the Government of Honduras (GOH) to maintain fiscal and monetary discipline. Other key recommendations include:

Financial Policies

- Remove the 17 percent ceiling on loan interest rates, as well as reduce the 32 percent reserve requirement. At a minimum, the mission should allow the Industrial and Agricultural Finance Corporation (FIA), which is not subject to the BCH interest ceiling on loans, to raise its rates above the current 17 percent maximum level;
- Provide ongoing support to specialized private sector credit institutions such as FIA, ASEPARE, and the National Development Foundation (FUNADEH) as long as they maintain adequate financial performance and repayment rates. If feasible, these credit institutions should also mobilize savings from their clients;
- Limit the scope of rediscount programs directed toward priority sectors -- including small and medium enterprises -- since they introduce distortions in financial markets and create disincentives to mobilize savings. Such lines should be geared toward the promotion of investment credit and be combined with policies that encourage banks to mobilize term resources. Given these caveats, a special small enterprise lending program might be designed for the Banco de Occidente, a unique and encouraging example of what a commercial bank can do to assist smaller firms; and
- Set interest on government bonds at levels dictated by the market, possibly through an auction system. Also, these bonds should not be redeemable at sight.

Labor Policies

- Revise the Labor Code to: (1) lengthen the probationary period of employment from two to six or eight months; (2) exempt family workers *de jure* from all provisions of the code other than those dealing with personal health and safety; and (3) absolve smaller firms from the financial and other obligations of the Labor Code for several years;
- Restrain wages and hirings in the public sector and press ahead actively on the privatization program; and

- Overhaul and strengthen the human resources training programs in worker education and management fields.

Fiscal Policy

- Reform the tax system so that firms may constitute reserves for their contingent labor liability (*pasivo laboral*) on an annual basis. This accounting change would result in a more realistic portrayal of their financial condition and reduce their taxable income;
- Substitute the policy of classifying enterprises to receive special tax exemptions with one that provides more equal treatment to small and large firms;
- Introduce a loss carryover provision that would allow firms to carry losses from one year's operations forward to offset tax liabilities in subsequent year and thereby reduce the decapitalizing effects of the existing tax system; and
- Increase the zero tax bracket in the income tax structure to some multiple of its present level to enhance the capital accumulation possibilities for smaller firms.

Trade Policy

- Conduct a thorough, independent analysis of the effect of the overvalued exchange rate on the Honduran economy. If study results agree, then devalue the lempira to its free market rate to increase the international competitiveness of Honduran nontraditional exports;
- Reduce protection levels so that Honduran producers can compete more effectively against their Central American counterparts; and
- Control the influx of contraband goods into the country.

Regulatory Procedures

- Eliminate the penalties incurred by enterprises when they register to enter the formal sector;
- Streamline GOH procedures required to register a firm, assess and collect taxes, classify a firm, and import or export products. The GOH should not require firms to hire lawyers to tackle these procedures.

A critical constraint to sound policy making is the scarcity of skilled economists within the public and private sectors. Honduras can boast of only a handful of local Ph.D. economists working in the country. The ministries concerned with policy making do not have the technical capacity required to perform this

function. In addition, several ministries have overlapping functions, follow contradictory policies, and are plagued with frequent turnover of staff due to political influence. Private sector lobbying groups also lack the expertise to analyze the effect of economic policy and practice upon their constituents. Building capacity to analyze and formulate economic policy is a long-term process that should receive the highest priority. Foreign technical assistance may help to alleviate this problem in the short-term but it is no substitute for the lengthy process of training selected Hondurans overseas in advanced degree programs.

Note:

The findings and recommendations of this study are based upon interviews with key informants scattered within government agencies, lobbying groups and private businesspeople, and data found in secondary sources. The primary source of information for most of the findings is derived from two sources; raw, confidential data on 216 classified enterprises (graciously provided by the GOH), and structured interviews conducted by the team with 47 micro, small, medium and large enterprises. To focus our study, we decided to interview the four most dominant industrial subsectors -- food processing, clothing, leather shoes, and wood furniture. This approach enabled us to get a much clearer view of the efficiency and differential impact of policy upon small versus large industries.

LIST OF DOCUMENTS REVIEWED FOR PP DESIGN

1. . Rural Technologies Project Evaluation. Winrock International. Morrilton, Arkansas. June 1986.
2. . Urban Small Enterprises Development Project Paper. USAID/Peru, 1982
3. . Small Business Development Project Paper. USAID/Honduras. April 1984.
4. . Small Industry Development. USAID/Dominican Republic. September 1982.
5. . Report on the Workshop on Private Voluntary Organizations: Small-Scale Enterprise Development. A.I.D. Program Evaluation Discussion Paper No. 22. July 1985.
6. Ashe, Jeffrey. The PISCES II Experience, Volumes I and II. Accion International/AITEC. Cambridge, Massachusetts. April and December 1985
7. Blaney, Robert and Clark, Heather. Honduras--A Small and Micro Enterprise Development Strategy, Volumes I and II. Washington, D.C. Robert R. Nathan Associates, ARIES Project, March 1987.
8. Blaney, Robert and Clark, Heather. Small Business Development Project Evaluation. Robert R. Nathan Associates, ARIES Project, April 1987.
9. Blaney, Robert and Otero, Maria. Small and Micro-Enterprises: Contributions to Development and Future Directions for AID's Support. Washington, D.C. November 1985
10. Bremner, Jennifer; Cole, Elizabeth; Irelan, William; Rourke, Philip. A.I.D. Program Evaluation Report No. 14. A Review of AID's Experience in Private Sector Development. Robert R. Nathan Associates. April 1985
11. Brown, Jason. Small-Scale Bank Lending in Development Countries. April 1984
12. Goldmark, Susan, et.al. The Effect of Policy Upon Small Industry Development in Honduras. Washington, D.C. Development Alternatives, September 1987.
13. Haggblade, Steve, Liedholm, Carl, Mead, Donald. The Effect of Policy and Policy Reforms on Non-Agricultural Enterprises and Employment in Developing Countries: A Review of Past Experiences. REPA Discussion Paper No. 1. Washington, D.C. March 1986
14. Heinzen, James. Mid-Project Evaluation of the National Development Foundation of Honduras (FUNADEH). October 1986
15. Herman, Chris. Flexible Project Design Approaches: AID/Washington Views and Examples from the Philippines. A.I.D. Evaluation Occasional Paper No. 3. January 1986.
16. Hunt, Robert. A.I.D. Evaluation Special Study No. 27. Private Voluntary Organizations and the Promotion of Small-Scale Enterprise. Illinois State University. July 1985
17. Hunt, Robert and Mirero, S.M.A. End of Project Evaluation of the Small Business Scheme of the National Christian Council of Kenya. Illinois State University. March 1985
18. Kilby, Peter and D'Zaura, David. A.I.D. Evaluation Special Study No. 28. Searching for Benefits. Wesleyan University. June 1985
19. Liedholm, Carl and Mead, Donald. Small Scale Industries in Developing Countries: Empirical Evidence and Policy Implications. Michigan State University, East Lansing, Michigan. 1987.

1741

Social Analysis
Small Business II Project

Orlando Hernandez
May 5, 1988

TABLE OF CONTENTS

A.	Introduction	1
B.	The Micro and Small Entrepreneur	1
	1. The Micro-Entrepreneur	1
	2. Small Entrepreneurs	5
	a. Owners and Firms	5
	b. Employees	9
C.	Magnitude of Intended Effort Through the Project	12
D.	Contextual Variables Affecting the Performance of Micro and Small Firms	14
	1. Industrial Registration and Classification	15
	2. Tax and Trade Policy	16
	3. Lending Practices	17
	4. Implications for the Project	18
E.	Support for Micro and Small Enterprises Through More Progressive Banks	20
	1. Overall Picture	20
	2. FIA	21
	3. BANCAHSA	21
	4. Banco de Occidente	23
	5. Implications for the Project	24
F.	Participation of Beneficiaries	25
	1. Basic Rationale for the Approach Adopted in this Section	25
	2. Classification of Institutions	25
	2. Relating Openness and Efficiency	28
	3. Implications for the Project	30
G.	Sustainability and Spread Effects	30
H.	Major Conclusions	31
	References	37
	Persons Interviewed	38
	Annex 1 - Interview Guide for Employees	39
	Annex 2 - Tables	40

SOCIAL ANALYSISSMALL BUSINESS II PROJECT

by Orlando Hernandez
May 4, 1988

A. Introduction

This analysis will deal with several topics. These topics are: (1) the general socio-economic profile of micro- and small entrepreneurs; (2) the type of employment that support for small and medium-sized enterprises through recent AID funded project has generated; (3) the implications of the new Small Business II Project for the small business sector given the level of effort intended; (4) contextual aspects of the Honduran setting that could influence the development of small enterprises; (5) the attitudes of more progressive banks regarding the small business sector and their involvement in the project; (6) the participation of beneficiaries in past similar projects and ways to enhance it through this intervention; and (7) the possible project spread effects. A section on conclusions is included at the end.

Quantitative and qualitative data for this analysis come from an array of sources. Among them, the most important are: studies carried out from the early to the mid 80's to depict SMEs; impact evaluation reports of partially or fully AID funded projects supporting SMEs; and data gathered by the author of this report through structured questionnaires or free interviews.

B. The Micro and Small Entrepreneur1. The Micro-Entrepreneur

Since 1986, ASEPADÉ, with support from several donors including AID, has implemented a credit program for micro-enterprises. The latter are defined as businesses using labor-intensive technology, having less than L10,000 in liquid assets and up to ten workers. Such are the criteria to participate in the program.

Cruz (1987) conducted a study of a sub-population of project beneficiaries. This was a sub-population characterized by its stability. Stability was defined as having at least three years in operation and having received at least three loans from the program. The intent in making this selection was to have a better ground for isolating the impact of credit. The hypothesis was that in the case of more stable businesses, intervening factors such as lack of markets, owner's experience, etc. would be under control. From this sub-population a sample of 85 firms was selected. Chosen firms came from three strata: woodshops, tailor shops and shoe making.

Preliminary results of the Cruz (1987) study indicated that the vast majority of interviewed entrepreneurs are between 31 and 50 years old, have 6 dependents, and have some degree of elementary education. 39% of them have gone to high school and only 3% of them have participated in training courses related to technical and administrative aspects of their business.

For 87% of them, their firms constitute their only source of income. That is, no secondary income generating activities were practiced. There are significant seasonal variations in income. This is explained by two reasons. One, May, June, July and August are months of poor sales, if any at all. And two, the vast majority of entrepreneurs interviewed have no fixed monthly salary throughout the year. They pay themselves based on the firm's net earnings per month. In 32% of the cases, income is complemented by the earnings of other family members.

The average monthly income of an interviewed entrepreneur (in the better earning months) is L790. When other family members work, they may have (in those same months) an additional average monthly income of L561. With families having on the average seven members, this represents an estimated per capita monthly income of L113⁴ for those families where the entrepreneur is the only source of income. It represents an estimated per capita monthly income of L193⁵ when family members work. The per capita income in families with only one breadwinner is comparable in constant lempiras to that detected in families living in the less poor marginal barrios of Tegucigalpa (Zuniga et. al., 1985).

It is difficult to say how much of the earnings are reinvested in the firm. The reported average level of monthly expenditures is similar to that of monthly earnings, when family members do not work, however. Separating certain family expenditures from business expenditures may not always be easy. For example, 72% have their shop in their home, and almost 50% are currently either renting or paying for their house. The fact that other family members besides the entrepreneur work may be indicative of a family strategy allowing a constant flow of income to the household, irrespective of how minimal this could be. Such flow could be of importance particularly during those months when firm sales drop.

In the sample, firms have been in operation an average of 4 years, and in 80% of the cases the business was started with personal savings. Currently, average fixed assets are L2,911.

85% of these firms employ an average of 4 permanent employees. In the other 15%, all employees are temporary. Firms having permanent

⁴ L790// family members = L113 per member

⁵ L790+ L561 = L1351// family members = L193 per member

employees also hire temporary laborers, particularly for the months when orders increase. Among these firms, there are cases when the number of temporary employees could be as high as that of permanent workers. 58% of firms interviewed do not use any family labor. 87% of the entrepreneurs interviewed estimate that they use semi-qualified labor. Yet, 50% reported that one of their more important labor problems in the business is the lack of workers and/or of adequately trained workers. It is known that some micro firms train their own workers. When this takes place, most apprentices are family members. Yet, some non-family members may also be trained. The technical limitations of the trainers are transmitted to trainees. In addition, forming personnel through apprenticeship programs is a lengthy process. The lack of trained workers may be most important during the period of high demand for the products that they manufacture, when temporary laborers need to be hired. The vast majority of micro enterprises in the Cruz (1987) study, 91%, pay workers by the piece of work produced. Only 5% are able to make social security contributions, and can afford paying the seventh day and/or the thirteenth month, as applicable.

Raw materials are bought from retailers in 73% of the cases. Micro-entrepreneurs interviewed tend to buy raw materials either daily or weekly. Production is scheduled based on orders placed or availability of funds. Lack of working capital and inadequate equipment and machinery are reported as the main obstacles to production.

85% keep no records at all, be they records regarding purchases, payment of services or sales. In addition, 93% indicate that prices for products are set based on experience, not on reliable data. In order of importance, however, in most cases the months of higher sales are associated with Christmas, the initiation of the school year, and the celebration of Independence Day. One of the major marketing problems perceived is the low prices at which they can sell their production due to the current level of contraband in Honduras.

Impact data for ASEPAD's CREME program were reported by Reichmann (1988). According to these data, beneficiaries of this program may be divided into two categories. The first category seems to be composed of firms that experienced growth in fixed assets, monthly sales and net income. In addition, these were firms where new jobs were generated. The second category seems to be composed of firms where stability was observed in most of the above mentioned indicators.

This categorization must be considered as analytical rather than statistical. One would have to have access to the raw data to determine the statistical validity of these categories. This validity would be crucial to determine sample behavior and assign firms into each one of the categories created. The current situation does not permit us to do so. However, despite the limitations that we face hypothetically it would seem that about 40% of the studied micro-enterprises would belong to the first category, and that the difference, 60%, would belong to the second.

Impact data in the case of firms where changes were observed indicate that: (a) fixed assets increased from 1% to 20%; (b) monthly sales increased by an average of 6%; (c) net monthly income increased by an average of 78%; and (d) the number of new jobs generated per firm ranged from 1 to 2.

Interpretation of these data must be done in the following context. When evaluated by Keichmann, the UKEME program had been in operation almost two years. Through this program, the average loan was L554. In addition, stability or change in firms may not be attributable to program factors alone. There are intervening variables affecting program performance, particularly of a contextual nature (e.g., general performance of the economy, policy framework under which small enterprises operate in Honduras, etc.).

Bearing this in mind, Keichman's impact data seem to suggest the following.

- (1) UKEME has had substantial impact on firms having experienced growth.
- (2) In the case of the latter firms, greatest change was observed in monthly sales and net income. This is understandable as many of the loans made through the program were used as working capital. As reported above, in Honduras lack of working capital is one of the major obstacles to growth in the micro and small business sector. UKEME, then, is providing a solution to this limitation.
- (3) Observed increments in net income are larger than those in gross income. This finding may lead us to suppose that some of the costs of studied firms were kept constant when working capital became available. As a result, such firms would have used more efficiently available resources, both capital and labor.
- (4) Firms showing stability may have confronted difficulties to operate if they had not received assistance from UKEME. From this information gathered, however, it is hard to determine how the firm's performance would have been affected had UKEME support not existed.

The Keichman study is suggesting that it would be inadequate to assume that all micro and small firms receiving assistance from a given program will show growth. As mentioned above, there may be factors outside the control of such program which will affect a firm's performance. These may be factors inherent to the firm or related to the context in which it operates. Koeser (1982) had suggested, for example, that limited market elasticity common in Honduras is an important constraint to small business growth. Although Koeser (1982) has arrived at this conclusion after studying rural businesses, extrapolations to urban settings are possible. Applying Koeser's findings to the UKEME program, we may argue that those UKEME beneficiaries that have experienced stability may have reached a certain plateau due to the share of the market that they are able to

control or the number of competitors that they face. Assistance from the CKEME program may have helped these firms retain the level of growth that they had reached prior to program involvement. What is being suggested here is hypothetical. Further investigation of the issue of stability of firms is warranted. This is an activity that may be carried out by the PMU.

Reichman was able to probe into the impact data gathered to begin offering explanations for the growth observed in about 40% of the firms investigated. She concluded that a common characteristic shared by the most successful firms in the impact study was the higher number of CKEME loans with respect to the norm that these firms had received. A selection criterion to participate in the impact study was to have received at least three loans. The most successful firms had received on the average six loans. This seems to suggest that in addition to access to working capital, continuous support for micro firms is a key element for growth. Such continuous support may imply not only having relatively constant access to funds, but also to the other services offered through CKEME (e.g., technical assistance and/or training). It is possible to hypothesize that continuous support from the different programs implemented through CKEME may help develop the potential of those firms not having yet reached the plateau of growth mentioned earlier.

2. Small Entrepreneurs

a. Owners and Firms

Rajardo et. al (1985) conducted an investigation among 100 firms classified as small enterprises according to the criteria established by the General Directorate of Industries. 50 of these firms were located in Tegucigalpa and 50 in San Pedro Sula. They came from the five most common production strata in the country for enterprises of this size: foodstuffs (mainly bakeries); clothing; wood furniture; printshops; and metalwork (mainly bars, and metal doors and fences).

Based on the definitional criteria utilized by the General Directorate of Industries, these were firms with fixed assets under L50,000. and up to 10 permanent employees.* In the case of firms

* As it will be further discussed in the section of conclusions of this report, institutions tend to have different definitions of micro and small enterprises. Similar, though not equivalent, criteria may be utilized by different institutions for different purposes. For example, both ASEPARE and the Directorate of Industries utilize the ceiling of ten employees to define target enterprises. In the case of ASEPARE it is utilized to define micro-enterprises. In the case of the Directorate of Industries, on the other hand, is utilized to define small enterprises. In addition,

visited, most employees were men. These were firms which had been in operation an average of 10 years. The distribution of the sample with respect to age is positively skewed, meaning that a large proportion of the firms investigated had been operating more than the average period reported.

In 78% of the cases, the firm was being run by the owner, and it constituted his only source of income. Only in 22% of the cases were firms in the hands of persons other than the owner, either close relatives or hired staff. In the latter situation, the owner was either managing another firm or practicing a given profession which constituted an additional source of income. Management of the firm by non-owners was more common in Tegucigalpa than in San Pedro Sula. Typically, the managers of the firms were high school graduates. However, 25% of them had only gone to elementary school. Managers of these firms tended to perform the main following functions: planning and control, personnel management, purchases and institutional linkages. In 45% of the cases, they relied on assistance from firm employees to market their products. In 88% of the cases, they relied mainly on contracted-out services to handle their accounting.

In order of importance, the more generalized problems reported by interviewed firms, independently of products manufactured are: lack of locally produced raw materials; lack of foreign exchange to purchase raw materials which are normally imported; and lack of adequately trained personnel. Locally produced materials are scarce, may not be available when needed, show significant variations in price, or do not meet quality standards required. In the sample, lack of foreign exchange was affecting particularly small industries manufacturing clothing and metal products. The majority of training for employees had been provided by the public sector. However, most of this training had been in industrial safety. Training in production related activities seems to be considered of higher importance. It was believed that such training must be geared to the specific needs of small enterprises. Training for workers, for example, was needed in: pattern use for the manufacturing of clothing; application of varnishes

ABERADE talks of 10 employees, without taking into account their stability within the firm. In the case of the Directorate of Industries, stability is important. The definitional criterion speaks of 10 permanent employees.

The implications of these definitional differences for the social analysis is that the categories of firms to which we make reference in this report are not necessarily mutually exclusive. What is presented in the social analysis is an integrated mosaic of findings. This has been done as not one single study carried out recently provided all the information needed for this analysis. Secondary sources of information were utilized to the extent possible.

and furniture finishing in carpentry shops; and milling in metal shops.

Goldmark et. al. (1987) reported the results of a field investigation which included 26 micro- and small manufacturing firms. According to these authors, labor quality is a problem shared by all firms", independently of their size. Labor quality has a direct impact on product quality. In turn, poor products are less marketable, making it more difficult for these firms to produce intermediary goods for larger firms with good export potential, or already selling their production abroad. The smaller the firm, the lower the possibility of having built-in systems to correct labor quality problems such as in-house training programs, adequate inspection of inputs and outputs, etc. For Goldmark et. al. (1987), integration of smaller and larger firms seems more difficult if the labor quality problem in the former is not resolved. Smaller firms, as in the case of micro enterprises reported above, may implement apprenticeship programs. However, through these programs results are produced slowly and do not always satisfy the needs of skilled personnel that these firms confront. In addition, the more skilled trainees, be they family members or not, often leave the firm where the training took place. They may be attracted by either higher paying jobs or the possibility of setting up their own business. For those authors, smaller firms should and would be the major beneficiaries of any measure related to the improvement of human resources.

The Fanconi et al. (1981) study provided some insights into the financial situation and marketing characteristics of these firms. These authors had also studied 105 firms defined as small and medium-sized according to the fixed-assets criterion established by the General Directorate of Industries. That is, less than L50,000 in assets for the small industries, and from L50,001 to L400,000 in the case of medium-sized. As in the study previously mentioned, these firms were located in Iquiquilpa and San Pedro Sula.

Financially, small firms seemed to confront two problems: lack of liquidity, and difficulty of access to financial institutions to obtain working capital. Liquidity problems are partially explained as in 88% of the cases seed and operating capital were provided by the owner, with all the limitations that such arrangement implies. This situation was aggravated by the fact that 27% of the firms had difficulty collecting from buyers who had purchased merchandise on credit, and that 27% had also reported that their inventory rotation was slow. On the other hand, during the year that the study was conducted, 64% of the small firms visited had presented loan applications to the banking system. In most cases, firms were requesting operating capital. Only 5% of them, however, had loans approved. The most common reason for denial of loans was the lack of sufficient collateral. At the time of the study, guarantees required by banks were equal to 150% of the loan amount. When asked about the potential use of loan funds if they were to be made available, 41% indicated that they would invest in machinery and equipment, 24% would use loans as operating capital (mainly to

obtain raw materials), and 22% spoke of their need to expand plant facilities.

With respect to marketing, 64% of the small firms reported that there is permanent demand for their products. This is due to the type of goods that they manufacture: foodstuffs, clothing and wood furniture. Among small entrepreneurs visited by Fanconi et. al. (1981), seasonal variations do exist. However, they are less common and of a lesser magnitude than those reported by micro-entrepreneurs in the Cruz (1987) study. 60% of the small enterprises visited by Fanconi et. al. (1981) manufactured goods based on orders placed. 42% estimated that demand for their products had good potential for growth, provided that both quality and prices improved. Improvements in the quality of goods manufactured is hindered by a series of factors including: poor quality of raw materials, characteristics of the machinery and equipment utilized in the manufacturing process, and poor skill level of employees. Obstacles to price improvement are mainly poor overall production planning, difficulty of keeping down costs, particularly the prices of raw materials, and limited knowledge of competitors. As a result of this, potential demand for goods manufactured by these firms remains untapped, forcing them in most cases to work only one shift per day.

When studying access to technical assistance, Goldmark et. al. (1987) found a clear cut distinction between large and medium-sized firms on one side, and smaller and microfirms on the other. As they put it, "the (division) turned on the problem of access". That is, in many of the large and medium-sized firms visited, owners or managers had received training abroad, were in permanent contact with technological advances overseas through their foreign partners, made visits to more developed countries, or had received assistance through special institutional arrangements made available through FIDE, INCAE, UNDP or similar agencies. Small and micro-enterprises, however, were in the opposite position. By and large, they are home grown and dependent on the limited local training opportunities for professional growth. As a result, they often showed ignorance of important aspects such as production layout, scheduling of production, and quality control. Great needs of technical assistance in the area of marketing were also detected. For Goldmark et. al. (1987), as expressed by small entrepreneurs themselves, "the small sell what they make rather than make what they can sell."

The data presented above indicate that small firms have growth potential, that small entrepreneurs are aware of this, and that there has been motivation to continue operating, and in some cases even improving and expanding operations. The average age of small firms investigated by Fajardo et. al. (1985) and the observed sample distribution with respect to age is probably indicative of the obstacles these firms have faced in order to grow; obstacles which in some instances, particularly in the Iquiquilpa area, may have forced small entrepreneurs to look for other sources of income. From the data presented above, it is also clear that the main obstacles for growth to

take place are related to financial liquidity problems and limited access to banking resources, difficulty in obtaining locally produced or imported raw materials, lack of sufficiently qualified personnel, and absence of adequate marketing strategies to overcome an apparently permanent, yet stagnant, demand for goods traditionally manufactured by small enterprises.

The continuation and expansion of programs including credit, technical assistance and training to managers and workers of small enterprises seems warranted. Experiences with programs of this nature in the past have shown to have positive results. The evaluation of the ANDI/PYME program carried out by Flores (198/a) indicates that with proper assistance, the growth potential of small enterprises can be developed. Through the mentioned program, a network of PVDs providing support to small businesses was created. In a period of over two years, institutions participating in the network were able to provide loans, technical assistance and training to approximately 3300 micro and small firms. Most of these were manufacturing firms producing clothing and shoes. 59% of these firms were owned by men. 41% were owned by women. Flores (198/a) studied the performance of 330 program participants. The study was carried out by comparing production and employment indicators for two three-year periods. One of these periods corresponded to the three years prior to program implementation. The other corresponded to the duration of the program. Results of this comparison indicated that from one period to the next, production had increased by 96% and employment had increased by 66%. It is assumed that most of these variations are attributable to the program.*

b. Employees

Five of the firms having benefitted from FIA loans in the Tequiquilpa area were selected to study the impact of those loans on employment. 3 were considered small according to FIA definitions for size. The other 2 were considered medium-sized. All five firms had one characteristic in common. These were firms where a higher than average number of jobs had been created. They were firms involved in different types of productive activities: broom sticks, furniture, bags and cases, candy, and bread. One of these firms was the supplier of an export company which after an additional processing stage sells its products mainly in the United States. Two of the firms visited work two shifts. In one of these firms, employees from both shifts were interviewed. In the other, however, interviews were limited to employees from one shift. The total number of employees interviewed in all five firms was 146. The interview guide utilized in this research

* The attribution of changes essentially to program factors would have even higher validity had the evaluation design included a control group. This would have permitted the isolation of the impact attributable to intervening variables (e.g., performance of the economy in general) from that attributable exclusively to the program.

appears in Annex 1.

The socio-economic characteristics of personnel employed as a result of FIA loans in these firms were the following. In the sample, 58% were male and 42% were female. Their average age was 25 years old. 54% were single, 42% were married, and the rest separated or widowed. 29% were 20 years old or less. Most of these employees were still living with their parents and helping them support the rest of the family. In the case of adults, the average number of dependents was 2. Many of the single parents were women. The mean number of schooling years was 6, meaning that most of these employees had just finished elementary education. 7% indicated that they were still going to school, generally attending night classes. 40% reported not having any specific qualifications. Among those that did, the most common trades were: carpenter, farmer, and baker/candy maker. 75% were working in production, 10% were working in administrative positions, and 11% in sales. 67% were permanently employed and 33% were holding temporary jobs. 65% reported having fixed salaries, 7% reported having a basic salary complemented by additional payments based on performance, and 24% received only piecework payment. With the exclusion of those dedicated to farming, among those who had had previous jobs, the average weekly salary was L63. In the sample, the present average weekly salary is also L63. The mean weekly salary earned by men is L69, while that earned by women is L56. This difference is partially explained by the fact that men are practicing either higher paying jobs or have higher paying positions (e.g., administrative vs. production related).

Detailed analysis of the data related to the current employment situation has permitted us to establish three distinct categories of employees. These are: (1) persons who have obtained their first job; (2) persons who were already employed and have been able to obtain temporary employment in firms receiving FIA loans; and (3) persons who have changed jobs going generally from one permanent position to another. A description of these three categories of beneficiaries follows.

- (1) In the sample, 18% reported being employed for the first time. Two thirds of them are female. On the average, they are 21 years old, have had 7 years of schooling and indicated not having a special occupation. Many of them are among those who still studying, taking night classes. 74% have found permanent employment and for their most part work in production. Their weekly salary averages L50.63. The main advantage of their current position is, as expected, having changed from the condition of unemployed to that of employed. Perceived benefits of that position are thus mainly of an economic nature.
- (2) 28% of those interviewed belong to the second category. They constitute a divided group as over two-thirds were holding jobs prior to their current one. The difference, on the

other hand, were holding permanent jobs. Employees in this category are on the average 23 years old, have had four years of schooling, and have either no special training or have normally practiced agriculture. Positions held are for their most part in production related activities. Average weekly salary earned is L53. More than half of them perceive advantages in their current position when compared to their previous one. The two most commonly cited advantages are higher income and reduced drudgery. In it in this category that we find farmers who at the time of the study were holding temporary sub-urban jobs to complement farm income.

- (3) 54% of the employees interviewed belong to this category. 54% are male and 46% are female. The mean age is 27 years old, and they have an average of 7 years of schooling. 50% of the employees in this category were workers with little or no qualification. 33% were qualified workers, 15% had received training to occupy management related positions, and 2% defined themselves as students. More than two-thirds are currently occupying positions in production. 30% are occupying administrative positions. The mean weekly salary in this category is L74. Those occupying administrative positions, however, earn an average weekly salary of L105. 78% of employees in this category consider that their current employments offer advantages over their previous one. The most common mentioned advantages are: higher earnings, an improved working environment, and employment stability.

The first category is composed of the newly integrated members of the labor force. The second category is composed of those who we may call the "scavengers". That is, a floating group of workers who have confronted and confront temporary employment. In some cases, this employment is seasonal, and it complements farm income. The third category seems to be composed of those who are trying to build careers and are striving for mobility.

Extrapolations of these data to the whole universe of persons employed as a result of the loans made by FIA should be done cautiously. Firms in the sample came from a specific sub-population of FIA beneficiaries: those generating more employment. This may be indicative of the growth potential of firms investigated. Taking this into account, we may say that FIA loans are providing employment to marginal sectors of urban and sub-urban Honduran society more prone to confront under- and/or unemployment problems, and to live under conditions of poverty. This group consists mainly of young persons, with limited education and skills, often bringing in secondary incomes to help support large families or supporting single-parent households. Although many of those hired as a result of these loans had been employed before, first employment opportunities are being made possible. Whether employed before or not, most of the jobs created are believed to be permanent positions. Precarious employment, then, is

the exception, rather than the rule. Those who we have named the scavengers constitute only 26% of the persons interviewed. Almost three-fourths belong to the other two categories discussed. In some cases, employees are benefiting from social security coverage. Increases in income have occurred. The career builders constitute the larger group in the sample. They are also the upward mobile employees interviewed. Among them, higher earnings is one of the reasons cited for current job satisfaction. For some of those previously employed, income has probably remained constant in current lempiras. This is particularly true of those working in production. In their case, higher skills seem to be a condition to higher earnings.

C. Magnitude of Intended Effort Through the Project

Table No. 1 is intended to give an indication of the magnitude of the relevance of the new project to the small business sector. It shows the number of beneficiaries of institutions currently supporting small businesses, and the anticipated number of beneficiaries as a result of the new project. Information is presented by separating participants and non-participants of the ANUI/PYME support network. It also distinguishes between the type of assistance provided and the recipient of the assistance.

The data should be read in the following context. First, beneficiaries reported here are persons rather than firms. One firm may receive more than one loan during the project. This is particularly true of micro-enterprises. Technical assistance and training may also be provided several times to the same firm during the project's life. Second, entrepreneurs may receive consecutive benefits from different project activities. That is, they could be involved in training activities during period X, and become participants in both technical assistance and credit activities during period Y. And third, information presented in that table assumes rotation of funds.

Table 1 - Expected Number of Beneficiaries
Before and After the Project by Type of
Beneficiary and Assistance

	Entrepreneurs			Train- ing for Workers:	Total
	Only Credit	IA and/or Training	Credit + IA/Training		
Small business Assistance Network Associated with ANDI/PYME ^(*)	741	717	4407	251	6116
Small Business Assistance not Associated with ANDI/PYME ^(*)	14	1175	132	None	1321
Sub-total ^(*)	755	1892	4539	251	7437
Expected Small Business Assistance Network Associated with ANDI/PYME		2335	8125	Undeter- mined	10460
Small Business Assistance not Associated with ANDI/PYME ^(*)	448	4544	15730	Undeter- mined	20722
Sub-total ^(*)	448	6879	23855	Undeter- mined	31182

^(*) ANDI/PYME estimates as of February 18, 1988.

^(*) Reported in Blaney and Clark's Honduras: A Small and Micro Enterprise Development Strategy, Appendix

^(*) Beneficiaries of current programs.

^(*) These data include expected beneficiaries of project activities implemented by BANCAHSA, Banco de Occidente, FUNADEM and ASEPADI. Proposals presented by the latter two agencies to become involved in project activities were utilized to calculate these estimates.

^(*) Beneficiaries of programs implemented through the new project.

Table 1 was constructed trying to avoid duplication of information to the extent possible. Under the first column, beneficiaries estimated to receive only credit are shown. In the second column, beneficiaries of strictly IA and/or training activities are reported. The third column refers to beneficiaries involved in programs including both IA/training and credit. These estimates indicate that as a result of the project the total number of beneficiaries would increase from 7437 to 31182. This is a four-fold increase in a period of five years. These estimates also indicate a tendency to favor the delivery of service packages rather than discrete services. That is, credit coupled with technical assistance and/or training instead of each one of those services in an isolated fashion. Currently, delivery of services as a package would be affecting 63% of the population of small entrepreneurs being targetted. Through the new project, that proportion will be 76%.

It has been estimated that about 40% of the micro- and small

entrepreneurs that will benefit from project activities will be women. Most of these women are involved in small trade. However, some also manage bakeries and tailor shops.

Project activities do not include training for workers. Due to the fact that lack of skilled labor is one of reported problems, which small firms are confronting, the project should be prepared to offer proper solutions. ANDI/PYME could play an active role in determining what those labor training needs are and in identifying mechanisms to satisfy them.

INFOP could make contributions in this respect. However, to date their clientele is composed mainly of medium-sized and larger industries. The technological level of these customary clients is not necessarily the same as that of smaller firms. Adaptations of curricula to the needs of project beneficiaries may be required. Recently, INFOP conducted a training needs assessment of firms of different sizes, small firms included. Once the data are analyzed, INFOP will dispose of the basic information that would be needed to modify their current curricula. If made, however, these modifications may not be implemented immediately. INFOP has a reputation of acting gradually in the implementation of any new program.

An alternative to INFOP is CADERH. Through Component II of the AID-funded CADERH II Project training needs assessments and training programs may be carried out. Although the intent of Component II is to make available funding for the training of new workers, skill development of persons already employed is an option to which CADERH managers may be receptive. Linkages between CADERH and ANDI/PYME need to be developed.

D. Contextual Variables Affecting the Performance of Micro and Small Firms

Recent programs established to support small enterprise development, such as the ANDI/PYME assistance network, are helpful in creating a new set of conditions under which small enterprises may operate. Through the provision of technical assistance and training, those programs are resolving difficulties which are inherent to the firm. By providing credit, however, they are resolving difficulties which are external to the firm and related to the prevailing banking practices in Honduras. In so doing, these programs are breaking through new territory and beginning to modify a context presenting constraints that hinder the development of small enterprises. It is to the analysis of this context and its constraints that this discussion now turns. Contextual variables that affect the performance of small firms to be studied here are related to the following topics: industrial registration and classification, tax and trade policy, and lending policies in the banking system.

1. Industrial Registration and Classification

To operate legally, a small firm needs to be registered. Registration must be done in the municipality where the firm is located. In the case of firms manufacturing foodstuffs, an additional registration with the Ministry of Health may be required. Through the registration procedure, the Municipality makes sure that the owner of the firms has paid all applicable municipal taxes, particularly estate taxes if the firm operates in a house owned by the entrepreneur himself. In addition, the registration process allows the local government to include the firm in its roster to eventually collect a 5% tax over gross sales. Municipalities may make the distinction between firms with capital investments below or above L5000. For firms with capital investments over that figure, a lawyer may be required to carry out the registration process. Time and money spent in registering a firm varies depending on the municipality where the registration process takes place. Table 2 summarizes the findings of the Goldmark et. al. (1967) study regarding the costs of firm registration in Tegucigalpa and San Pedro Sula. Data are broken down by firm size. The municipality in Tegucigalpa is obviously more demanding than in San Pedro Sula. If we were to extrapolate from the Cruz (1967) study which indicated that average fixed assets of micro-firms investigated was L2,911, we may conclude that the monetary cost of registering a firm in that town could be as much as 12% of fixed assets.

Table 2 - Time and Money Required to Register a Small Firm in Tegucigalpa and San Pedro Sula

	Firms with Capital Assets >L5000		Firms with Capital Assets <L5000	
	Time in days	Money	Time in days	Money
Tegucigalpa	9-29	L62-L362	36-68	L522 + estate and business taxes as required
San Pedro Sula	13-54	L3	13-54	L3

Artisans, small and medium-sized manufacturing firms in Honduras have the possibility of being officially classified as such. If they fall into any one of the size categories indicated, they have the right to certain benefits. Most important benefits include temporary exemption of income tax and consular and customs taxes on the imports of raw materials, semi-processed goods, tools, equipment, parts and accessories. Depending on the benefits, exemptions may vary from 4 to 12 years. Goldmark et. al. (1967) have indicated that small firms may have to spend from L3147 to L3647 and from 104 and 204 days to become

classified.

When the classification is issued, firms acquire certain obligations. Galindo (1981), after an analysis of the appropriate legislation, concluded that these obligations include: the payment of a fee to help fund the costs of enforcing the tax exemptions; the acceptance of the technical assistance offered by the public sector; rendering the equivalent of 10% of the tax exemptions to UDI for technical services that this institution must provide; and the acceptance to sell products according to price limitations for basic consumption goods that the government may issue.

The fact that the registration and classification processes are both tedious and costly, making firms become subject to government control and taxation, motivates many micro and small firms to operate underground. Most of these firms lack the adequate contacts, clout, and funds to pay or accelerate either the registration or the classification processes. Working underground seems more common in Tegucigalpa than in San Pedro Sula. The registration process in that city is not only simpler and cheaper, but the municipality is much more active and strict in enforcing registration regulations.

After being classified, the right to have benefit privileges must be renewed annually. Renewal of benefits is based upon the submission of detailed information regarding firm operations. Galindo (1981) has suggested that the type of report that needs to be submitted requires technical advice. Unfortunately, this is advice which is either not available or too costly for the small entrepreneur.

2. Tax and Trade Policy

The fact that many small firms are not classified forces them to be excluded from the tax exemptions mentioned above. These firms must buy needed imported raw materials and their often unsophisticated equipment from the local market. These purchases are made from retailers where goods purchased are offered as consumption goods. Higher tariffs are imposed to consumption goods as opposed to intermediate goods and capital goods. Goldmark et. al. (1987) have studied the differences in duties paid on certain commodities commonly used by small firms when introduced into the country as industrial goods or as consumption goods. The findings of that research are presented in table No. 3. As it can be observed, the differences are substantial. When studied commodities are imported as consumption goods rather than capital goods, duties could be as much as eight times higher. That is, duties may jump from 5% to 40% of the imported price of given goods. Prices of commodities purchased from retailers could also be higher than that which could have been paid had the commodities been imported directly by the small entrepreneurs, even as consumption goods. This is true for two reasons. First, the price of intermediation would have been avoided. And second, retailers often obtain in the parallel market the foreign exchange needed to import the commodities that they sell. Dollars purchased in the parallel

market may cost as much as 35% more than when purchased in the official market.

Table 3 - Duties on Certain Commodities
Classified as Industrial Goods or Consumption Goods¹⁴⁴

Commodity	Duty if Classified as Industrial Good	Duty if Classified as Consumption Good
Bakery equipment	5%	10 - 30%
Clothing manufacturing equipment	5 - 10%	30 - 40%
Refrigerators	10 - 20%	40%
Machinery in general	5%	40%

¹⁴⁴ Source: Goldmark et. al. (1987), p. 157.

The purchase of needed imported raw materials and equipment from retailers has a definite impact on the cost of production for micro and small firms. This in turn has an impact on the prices of commodities that they manufacture. Often, these prices are not competitive with prices of similar products that may be manufactured and purchased in neighboring countries. In fact, it is not unusual for lower- and middle-class urban dwellers in Honduras to make weekend trips to border towns in El Salvador to purchase textiles, clothing, and shoes. That is, goods often produced locally by small firms. In recent months, the press as well as entrepreneurs interviewed through different studies have often spoken about the flood of contraband from neighboring countries. Claims are that some of the goods imported illegally are also clothing and shoes. Firms visited by Goldmark et. al. (1987) in the clothing and shoe sectors anticipated drops in sales during 1987 due to contraband problems. Although larger firms in those sectors are looking for foreign markets for their products to compensate for the losses in local sales, smaller firms have reduced their output and employment.

3. Lending Practices

As reported by small entrepreneurs themselves, lending practices of commercial banks in Honduras limit the access of small enterprises to formal credit. These lending practices are characterized by high asset-based collateral requirements. As indicated above, 150% collateral has been reported, and Goldmark et. al. (1987) claim that it can reach as much as 200%. Collateral is generally required in the form of real estate property. A second option is inventory. Only very seldom machinery and equipment are accepted. Small entrepreneurs generally cannot satisfy collateral requirements established by banks. They do not always own property

153

and inventory is rarely stocked in sufficient quantities to serve as collateral. In the case of loans under L10,000, small entrepreneurs have the possibility of applying for a personal loan. For this type of credit, collateral required is usually two loan co-signers. This condition is easier to meet, and small entrepreneurs have been found to opt for this alternative. Such loans, nevertheless, are short-term and utilized to satisfy working capital needs. Generally, no long term loans for capital investments are available. Resorting to money lenders is more common among micro than among small entrepreneurs. However, this is an option also available to the latter. As in the case of micro-entrepreneurs, small entrepreneurs use informal credit sources to satisfy emergency-type needs. In the Goldmark et. al. study, annual compounded rates of these loans varied from 19.6% to 24%.^e That is, seven more points than the established ceiling for the banking system.

Funding for small enterprise development in Honduras comes from five different sources: (1) refinancing or discount windows established at the BCH; (2) public sector institutions whose mandate is to support small business development such as CUI; (3) specialized private sector institutions created for the same objective such as FIA and FUNADEH; (4) PVUS involved in credit programs, as is the case with most agencies included in the ANDI/PYME network; and (5) the more progressive banks. Assessing the status of these programs, Goldmark et. al. (1987) concluded that specialized private sector institutions, PVUS and the indicated banks have been more effective in reaching the target population and maintaining a healthy portfolio. Government institutions have reached the target population, but have been unable to keep loan delinquency down. Many of the firms benefitted through the rediscount windows at the BCH seem rather large, and probably they could have obtained financing through other mechanisms. The proportion of micro- and small firms reached by the more efficient agencies is small. Goldmark et. al. have argued that it represents only 5% of the total universe of micro- and small firms in the country. Thus, much of the demand, particularly among the most bankable micro- and small firms, remains unmet. This is true despite the current reported liquidity in the banking sector.

4. Implications for the Project

From a socio-cultural perspective, variables affecting small

^e Other studies such as Soto Baquero et. al. (1985) have suggested that such interest may be much higher. The reasons that may explain the results obtained by Goldmark et. al. (1987) may be several. Informal credit sources in this study may have been money lenders either related to loan recipients or registered with the Central Bank. Money lenders would charge less interest to borrowing relatives. In addition, the annual rate for loans made by registered money lenders has been fixed at 24% for unsecured loans.

business development are related to the interests and value system being represented by law and policy makers who may have decisions without adequate participation of small business sector representatives.

The current project needs to continue developing the capacity of the small business sector to speak out and defend its interests before Honduran society in general. Further development of the Business Assistance Network (BAN) within ANDI/PYME permitting the occurrence of inter-institutional meetings, the publication of newsletters and promotional bulletins with wide distribution inside and outside the sector, and the organization of national conferences with wide media coverage, seems warranted. In addition, ANDI/PYME should actively seek the involvement of small business sector representatives in talk shows, fora, and public and private sector commissions studying industrial development problems. This should permit the diffusion of sectoral problems and concerns. It would also allow for the development of skills of such representatives to deal with public and private sector development agencies, the media and public opinion in general. Funds should be made available for these activities.

There are policy agenda elements which may be dealt with outside the context of the project, but in support of project related activities. Among the most important are the need to simplify the small firm registration and classification processes to make them more expeditious and less costly. An effective strategy to fight contraband needs to be designed and implemented. Means of providing higher spread to banks for small enterprise (on)-lending need to be identified in order to allow them to cover the costs of administering smaller loans and protect themselves against riskier clients.

Within the context of the project, additional measures may be possible.

- (1) to continue channeling credit to small business through private sector development institutions such as FIA, FUNADEM, ASERPADE and others affiliated to the ANDI/PYME BAN network. In their case, collateral requirements have been relaxed or modified so that credit to solidarity groups is possible, the use of machinery and equipment as collateral may be accepted, required collateral may be limited to the amount of the loan requested, and long-term financing is made available. This permits reaching the smallest firms of the spectrum.
- (2) to improve the technical capacity of CUI to identify the more bankable projects and to collect arrearages.
- (3) to expand and replicate the ASERPADE experience regarding the payment of interest rates above the 17% ceiling for more than just emergency-type needs. As Heinzen (1986) suggested, an incentive for graduation to formal credit programs needs to exist for small enterprises. That incentive is absent if interest on bank loans is higher than

interest on loans obtained from other sources than banks, particularly FVUs.

- (4) Put to trial the idea of loan syndications suggested by Golomark et. al. (1967). That is, in the case of the more promising projects the funding for loans may be provided both by development agencies and banks. However, repayment of the bank's share in the loan would take precedence over that of the concerned development agency. In these cases, the banks should use their own resources to extend the loans.
- (5) Savings mobilization among clients of private sector development institutions can be enforced. This would allow such clients to accumulate funds for investments in the future.
- (6) Whenever possible, the wholesale purchase of raw materials and intermediate goods could be supported. This could take place if firms needing the same inputs got together to make their purchases. Solidarity groups among entrepreneurs fabricating similar products (e.g., shoes) could make this option viable. The need for this type of arrangement is more prevalent among micro-entrepreneurs. The ANDI/FYME proposal includes this possibility. It should be supported.

To ensure that the project reaches micro- and small firms, criteria to define them must be established. Since one of the objectives of this project is to generate employment, such criteria should also include employment generation elements. Criteria proposed to establish a working definition are the following. In the case of micro-firms, the suggestion is to define as such enterprises with an average of five permanent employees, fixed assets under L20000, and the use of labor-intensive technology. Small firms should be defined as those having an average of 20 permanent employees, less than L100,000 in fixed assets, and preferably using labor-intensive technology in some of the aspects of the manufacturing process.

E. Support for Micro- and Small Enterprises through More Progressive Banks

1. Overall Picture

FIA, BANCARSA and Banco de Occidente all provide credit to micro and small firms. The definition of beneficiaries utilized by these institutions varies from that utilized by FVUs such as ABEPAVE and FUNADEM. Although categorized as equivalent, firms of larger size are served more through banks than through the FVUs.

The motivation of financial institutions to provide this credit is, as expected, profit-based. However, in the case of FIA and Banco de Occidente it is tinted with social concerns. That is, there is an interest in supporting firms either owned by lower socio-economic strata or playing an important role in generating employment.

2. FIA

FIA has begun providing credit to micro-enterprises partially as a result of requests made by AID. It has become acquainted with the needs of micro-firms through the close relationship that it maintains with ANMPI. So far, its support for micro-enterprises is minimal. However, it is in the process of designing a pilot program for such firms. A special window for micro-enterprises will be created. Funds for this window will be provided on an equal basis by ANMPI and FIA. Total funding with which this window will operate will be L200,000. This window will be initially in operation for one year. For the most part, it is expected that clients that will benefit from this facility will be identified through ANMPI.

To become eligible for credit, entrepreneurs will have to show proof of having successfully completed management courses to be offered by GEMAH. During the life of the project, 90% of the costs of these courses will be paid by FIA. It is expected that the difference, 10%, will be funded through a donation from AID. Loans will be for a maximum of L20,000. Cosigners and machinery and equipment will be accepted as guarantees.

If credit supervision determines that loan recipients are experiencing loan management difficulties, training or technical assistance to solve them will be offered. It is expected that the costs of such assistance or training will be paid by the entrepreneur. If needed, loans at concessional terms (9%) will be made available to the entrepreneur to pay for these costs.

3. BANCAHSA

The support provided to micro- and small firms by BANCAHSA operates quite differently. The initiative to work with these enterprises was born within BANCAHSA. It is partially a result of the experience that the bank has had with small commercial firms which have developed their growth potential. It is also a consequence of the concept that small firms have been and will continue to be, in Honduras or elsewhere, the pillar of industrial development.

For some time, BANCAHSA has been in contact with the small business sector. The bank's Regional Director of Northern Honduras is a member of the FUNADEH Board of Directors. In addition, a credit officer in Tegucigalpa often advises ANMPI on credit matters, keeping frequent contacts with this institution. BANCAHSA is happy to service clients referred by ASEPADE either because the amount of the loan is too high for ASEPADE to handle, or because ASEPADE has already extended too many loans to the same individual and wants to extend loans to new clients. In turn, BANCAHSA refers to ASEPADE credit applicants requesting very small loans which BANCAHSA finds too expensive to supervise. No formal agreement between BANCAHSA and ASEPADE exists to date. Their working relationship is a result of mutual friendships. BANCAHSA feels that PVUS should not substitute

banks in providing credit. According to bank representatives, PVUS have neither the necessary experience nor the institutional support of banks to extend credit efficiently to small firms.

Nationwide field research has been recently conducted by BANCAHSA to determine the credit needs of micro- and small enterprises, the volume of sales within the sector, and the savings that can be mobilized. Through the investigation conducted over 200 firms were visited. Results of this research, extrapolated to the larger universe of small enterprises estimated to be made up of 2636 units, indicated that among micro and small firms the demand for bank credit is equal to L28 million. That amount may be broken down in the following manner: L8 million is needed by BANCAHSA clients, and L20 million by clients of other banks. The decision was made to create a window to satisfy the needs of small businesses. During the first year of operation, this window was to operate with a L0.8 million fund. During that year, BANCAHSA promoted credit among clients and non-clients. Credit was promoted among firms that had been visited through the field investigation conducted earlier. As a result of its promotion, that same year the bank was able to make 139 loans. The total amount of loans made was L1.2 million. That is, it exceeded the original fund by 50%.

To provide loans to micro- and small firms, BANCAHSA decided to be more liberal regarding guarantees as real estate collateral was not always required. To date, loan repayment has been high. BANCAHSA believes that credit recipients have not only a financial but also a moral obligation with the bank. Small firms often express gratitude toward the bank as if a once in a lifetime chance has been given to them. Funding needs have been so important for these firms that if they had not taken advantage of the opportunity offered by BANCAHSA, it would have been very hard for them to grow.

BANCAHSA indicated that about 90% of loans approved are being funded with their own funds. Loans using rediscount lines available at the central bank may take up to four weeks to process. Credit using BANCAHSA's own resources is offered at 1%. Credit using Central bank rediscount lines is offered at 16%. Micro and small entrepreneurs normally prefer to forego that 1% difference due to the opportunity cost that it implies having quick access to funding. As it was mentioned earlier, small enterprises are greatly affected by seasonal variations in sales. The request for loans is normally higher before the moments of higher demand. In addition, loan amounts are not high enough to make a 1% interest difference significant.

As part of the credit supervision process, BANCAHSA will be asking loan recipients to keep simple accounting records. A special format to that effect has been created. It is expected that loan recipients will register information on this form on a weekly basis. Loan officers will train loan recipients regarding the use of the form. This situation may be manageable now given the fact that the volume of loans approved to micro and small firms is still small. Were loan

volume to increase, however, loan officers would be involved in a time-consuming activity. BANCAHSA is aware of this. Yet, solutions are still on the drawing board (e.g., lower credit/loan officer ratios). BANCAHSA believes that its main function is to extend loans, rather than train loan recipients. As a result, training activities seem second in priority. The fact that current loan recipients are likely to be the best potential clients identified through the field research conducted may help explain this position. Additional planning regarding means to satisfy the anticipated training needs of BANCAHSA clients seems required.

4. Banco de Occidente

Banco de Occidente was created to support small investors whether in agriculture, industry or services. It has been argued that this is needed in Honduras in order to avoid the experience of other Latin American countries where banks have been nationalized partially to re-orient clientele priorities.

The bank relies mainly on "word-of-mouth" publicity to stimulate demand. Nevertheless, branch managers in the different cities where the bank operates are expected to identify potential clients in order to promote bank services.

For Banco de Occidente, the most important element in determining the credit worthiness of a client is his moral character and reputation, independently of whether he is or is not a small investor. According to the Chairman of the bank, and reported by Goldmark et. al., the bank takes "what it can" in the form of collateral once that credit worthiness has been established.

Despite its commitment to the development of small investors, in the case of small enterprise support the bank has extended loans using mainly the Central Bank's rediscount lines. In fact, Banco de Occidente claims to be the bank through which most FUNDEI loans have been extended. Data presented by Goldmark et. al. (1987) corroborate this claim as 30% of total loans discounted by the Central Bank have been discounted to Banco de Occidente. A total of fourteen banks participate in this program. There is a preference to use these rediscount lines as it is argued that it helps the bank keep a healthy liquidity level.

Loans are supervised regularly. The supervision may include basic instruction regarding how to keep accounts, particularly to help the bank follow-up loan expenditures. However, the way in which this is done seems to be less organized and systematic than in the case of BANCAHSA. Banco de Occidente believes, as does BANCAHSA, that its major function is to extend credit. Training of loan recipients needs to be handled by other institutions.

Formal and informal linkages between Banco de Occidente and other institutions providing assistance to the small business sector are

minimal.

5. Implications for the Project

FIA is responding to the concerns of one its major founders related to the extension of credit to micro-entrepreneurs. Following its tradition of developing a healthy portfolio, it is proceeding cautiously. Not only will it start a credit line for micro-entrepreneurs on a pilot basis, but funding for this line will not be put up entirely by FIA. Risk is minimized by asking ANMPI to participate in the creation of the fund. It is also minimized by ensuring that loan recipients would have received basic training in loan management. Cautiousness on the part of FIA is likely to be expected not only now, but also when the new project is implemented. This cautiousness should be respected. Nevertheless, FIA should be motivated to have a larger referral system, and not to depend solely on ANMPI for the identification of clients. ANDI/FYME could play a major role in increasing the referral base for FIA.

BANCAHSA is committed to expanding operations into a new area: micro- and small enterprise support. They have proceeded to grow in a rather technical fashion particularly basing decisions on research. Expansion of operations in this area is likely to take place given the results obtained through their new experience. The moral commitment of loan recipients to the bank and the impact of this commitment on loan repayment are encouraging for BANCAHSA. The same may be said about the fact that loan recipients are not only old bank clients. New clientele has been also attracted by the program. In addition, BANCAHSA is serving as a contact point between large and smaller clients. In the interest of insuring loan repayment from the small, in some cases BANCAHSA has identified large enterprises interested in purchasing commodities produced by their smaller counterparts. The field research conducted by BANCAHSA has allowed the bank to identify potential clients. This seems to be a rather large potential target population. Nevertheless, the client referral system should be extended to go beyond ASTRAL and FUNADEM. More attention needs to be paid to the mechanisms needed to provide BANCAHSA'S clients technical assistance and training in the management of the firms and loans that they may obtain from the bank. This is relevant as loans could be extended to clients not always at the top of the client identification list so far prepared.

Banco de Occidente seems to have a positive attitude about the project, particularly as it fits well with its basic philosophy. However, the possibility of the bank using its own resources to fund micro and small enterprises, even in the out years of the project, needs to be examined. A clearer definition of the target population that can be reached through Banco de Occidente needs to be established. Although the bank claims to work mainly with small entrepreneurs, most of the FUNDEI loans have been extended to firms which by any criteria may be either medium-sized or large. In fact,

bank representatives have indicated that loan delinquency in their industrial loans is as high as 20%, and that such delinquency is a result of loans extended to rather large clients. Stronger linkages with the existing small business assistance network should be strengthened. Training mechanisms to support bank clients need to be clearly defined.

F. Participation of Beneficiaries

1. Basic Rationale for the Approach Adopted in this Section

As suggested above, because of the small size of loans and lack of collateral characteristic of micro enterprises, FVUs and banks participating in the project are likely to work with different sub-populations of the small business sector. FVUs will probably work with the smaller firms of the spectrum. Many of the beneficiaries of services to be provided by FVUs through the project have not received assistance from formal sources of credit in the past. It is expected that the assistance to be provided by FVUs will help these smaller firms acquire the management and marketing experience leading to expansion. Once that that experience has been acquired and expansion is being observed, smaller firms are expected to graduate from the FVU assistance programs to the banking system. As a result of the institutional capacity that they have set up and developed, banks are more prepared to implement credit programs. The type of work to be carried out by FVUs is pedagogical in nature. As a result, the openness FVUs will show regarding suggestions made by program participants about services being provided will be very important in achieving the maturity needed to graduate from one financial assistance system to another. Receptivity to suggestions made by program participants should lead to higher satisfaction of the needs faced by smaller firms, permitting FVUs to tune up programs as required. It is based on this reasoning that we present below findings regarding the participation allowed by FVUs to their clients in the design of the programs that these organizations implement. The motivation of banking institutions is profit-oriented. As argued elsewhere in this report, in their case pedagogical concerns are second priority. To speak of the participation of clients in the design of credit programs implemented by banks would not make sense. In the best of cases, banks carry out market studies, as done by BANLAMSA, to determine the demand for the services that they offer and the extent to which profits may be assured.

2. Classification of Institutions

When evaluating the ANDI/PYME program, Flores (198/a) asked project beneficiaries to assess the openness of implementing agencies to accept the suggestions they make regarding existing training, technical assistance and credit programs. Beneficiaries assessed the openness of these agencies using a four-point scale. In this scale, 1 was equal to high openness; 2 was equal to average openness; 3 was

equal to low openness; and 4 was equal to indifference. We have utilized the information generated by Flores (198/a) to place PVUS into three categories: those considered to show (1) high, (2) intermediate, or (3) low receptivity to the needs and suggestions made by beneficiaries. The categorization was made following the approach to construct ordinal scales from qualitative data suggested by Guttman (1976). That is, the frequency with which more positive or less positive responses appear in a set of data is important to place institutions being judged in a hierarchical order from first to last, high to low, etc. We established cut-off points to define the categories mentioned. Agencies receiving 1's from more than 65% of respondents were categorized as showing high receptivity; those receiving 1's from 54% to 65% of the respondents were categorized as showing intermediate receptivity; and those receiving that assessment from less than 54% of the respondents were categorized as showing lower receptivity. Table No. 4 shows the results of applying this classification criteria per program assessed. The number of times a given institution was placed in each one of the categories created is shown. These numbers are related to the small business development services that a given institution may implement. The basis for preparing this table appear in Annex 2 of this report.

Table 4 - Categorization of Agencies

	Program			No. of Times in Category
	Training	IA	Credit	
High Receptivity	ANMPI	ANMPI	ANMPI	3
	UDEF	UDEF	UDEF	3
	APKUDIB	APKUDIB	APKUDIB	3
	IUH		IUH	2
	ANDEJUMUK			1
	ANAH	FENCIL		1
Intermediate Receptivity	FUNADEM		FUNADEM	2
		FUNADEMU	FUNADEMU	2
	FENCIL			1
		IUH		1
		ANDEJUMUK	1	
Lower Receptivity	ASEPADE	ASEPADE	ASEPADE	3
	FUNHDEMU			1
		FUNADEM		1
		ANAH		1

Beneficiaries seem to have influence on the programs implemented by some of the agencies of concern. Most respondents indicated that

102

the level of openness of these agencies is either high or average. Seldom low openness and indifference were mentioned. On the other hand, the level of openness of these agencies is not constant, independently of the program which is being assessed. Rather, variations per program are observed.

Higher receptivity seems to be more common in ANMPI, UDEF, AMKUDIB and IDH. Intermediate receptivity appears to be more common to FUNADEM, AHUEJUMUK, FUNMUEMU and FEHUIL. Lower receptivity is found in ASEPADE. The opinions regarding ANAM seem somewhat ambivalent.

Agencies estimated to allow higher participation from beneficiaries include two types of organizations. One, business associations representing the interests of small entrepreneurs such as ANMPI. And two, PVUS interested in providing support to small businesses such as UDEF and IDH. Higher participation in the case of institutions created to represent small entrepreneurs could have been anticipated. These are institutions where affiliated members elect the Board of Directors, who themselves are small entrepreneurs. Decisions regarding services to be provided by these institutions are made by elected representatives. On the other hand, PVUS considered to show higher levels of receptivity to suggestions made by beneficiaries are usually guided by a philosophical commitment to grass-roots development. Although beneficiaries may not hold seats in decision-making bodies such as Boards of Directors, general assemblies with the participation of beneficiaries may be held periodically. These assemblies become adequate fora where beneficiaries may express their opinions about the different programs sponsored. On the other hand, evaluation mechanisms instituted by these organizations also try to capture the opinions of program beneficiaries regarding the quality of services being provided. Such evaluations may be carried out every six or twelve months, providing adequate feedback to program designers and decision-makers about the concerns of target populations. Opinions expressed through any of these procedures, general assemblies and evaluations, tend to be respected and integrated into the planning of institutional activities.

Agencies at the other end of the scale may be PVUS characterized by different management styles where decision-making is more centralized and where a board of directors may not exist. These may be institutions strongly committed to the support of micro and small businesses, and they may have set the example for others after breaking through and showing that sub-populations considered to be relatively risky credit recipients may become subjects of credit and technical assistance programs. Nevertheless, in serving this clientele, a paternalistic approach may have been adopted. In so doing, beneficiary involvement has been limited. Some of these institutions have acknowledged the problem and are contemplating the adoption of mechanisms to solve them. One such mechanism is the constitution of advisory committees to central management. These advisory committees would be made up of program beneficiaries, and

would provide advise on credit, technical assistance and training related matters. The advantages to implementing agencies are obvious as members of these advisory committees may already know who loan applicants are, and may suggest to the agency whether they are creditworthy clients or not.

Between these two extremes may be institutions considered to have moderate levels of receptivity to the concerns of beneficiaries. Once again, they could be trade unions or business associations as well as PVUs. Their lower level of beneficiary participation may be explained by one of two reasons. On the one hand, they could be concerned so much about self-sufficiency that beneficiary participation is minimized for the sake of institutional survival. On the other, they could be dominated by politics and an assisted mentality among the member population. In these cases, decision-making by consensus may be difficult to reach.

3. Relating Openness and Efficiency

An effort has been made to determine whether receptivity shown by these institutions has any implications on institutional efficiency. This is a very difficult task for several reasons. One, it is necessary to determine what would be a good indicator of such efficiency. Or at best, what would be a good proxy for it. Two, the information used to calculate any efficiency measure may not always be reliable. This is true because institutions of concern may have less than optimal accounting records or they may conceal information from any evaluation or auditor trying to assess their performance. In fact, setting up appropriate accounting and financial management systems in participating PVUs is one of the activities to be implemented through this project. And third, if reliable information exists, it may not exist for all the institutions of interest for this exercise.

Despite these constraints, what we have done to study the relationship between the two variables, receptivity to suggestions from beneficiaries and institutional efficiency, is the following. Two efficiency indicators were chosen: operational costs per lempira invested, and delinquency rates. It is estimated that keeping costs down and recuperating loans would have implications both for self-sufficiency and program survival. The latter are considered important objectives in seeking institutional efficiency. The operational costs per lempira invested were calculated by Flores (1979a) and reported in the evaluation report where the receptivity judgements are presented. Thus, they refer to the same period of operation as the judgements on receptivity. The delinquency rates are historic rates. They were provided to us by ANDI/PYME.

We have calculated the average value of these indicators. Two categories have been created. That is, institutions where the operational costs/lempira invested and the historic delinquency rates are either below or above average. We have retained the same

168

breakdown for receptivity to suggestions from beneficiaries as that appearing in table 4. However, for the benefit of the doubt, institutions in more than one category (e.g., IDH, FEHCIL, FUNADEM) were included in the category of highest ordinal position. For example, in table No. 4 FEHCIL appears in the high and intermediate receptivity categories. Receptivity in FEHCIL, then, is not constant. It varies depending on the program implemented. For the purpose of our analysis, however, FEHCIL was included in the high receptivity category.

Results of our intent appear in tables 5 and 6. ASEPADE, AHDEJUMUK and ANAH are not included in table 5. No information on costs/lempira invested were available when Flores (198/a) carried out his study.

Table 5 - Relationship Between Receptivity and Efficiency when Operational Costs/Lempira Invested is Considered

Oper. Costs/Op. Inv	High Receptivity	Intermediate Receptivity	Lower Receptivity
Below average (more efficient)	APKUDI B IDH	FUNADEM	
Above average (less efficient)	ANMPI FEHCIL UDEP	FUNHDEMU	

Table 6 - Relationship Between Receptivity and Efficiency when Historic Delinquency Rates are Considered

Delinquency Rate	High Receptivity	Intermediate Receptivity	Lower Receptivity
Below average	APKUDI B ANMPI UDEP	FUNADEM AHDEJUMUK	
Above average	IDH FEHCIL	FUNHDEMU	ASEPADE

Results of this exercise indicate that any efficiency classification will depend on the efficiency criterion utilized. Institutions cannot be placed in the same institutional efficiency level, regardless of the efficiency indicator. As a result, it is hard to say that efficiency and receptivity are related. It is even

more difficult to say whether a causal relationship exists between these two variables, that is, if higher levels of openness lead to inefficiency or viceversa.

According to the results, three of five highly receptive institutions have above average costs/amount invested. Based on that criterion one could suppose that their level of receptivity may have led to higher costs and in turn to less efficiency. However, the situation is the opposite when we look at historic delinquency rates. Three out of five highly receptive institutions have below average delinquency rates. Thus, it would seem that highly receptive institutions recuperate their loans much easier and as a result are more efficient.

One conclusion is nevertheless certain. The data do indicate that in no case lower receptivity is associated with higher efficiency. This is true independently of the efficiency criterion utilized. As a result, some degree of openness to suggestions from the clientele would be required if any degree of efficiency will be achieved. Openness seems to be much more important in the case of high delinquency. Consultation with program beneficiaries regarding the reasons why loans are not being repaid is necessary, and perhaps even crucial, to keep delinquency down. The repayment capacity of loan recipients given the context in which they operate needs to be investigated.

3. Implications for the Project: Replications for the Future

The project needs to replicate the more positive experiences of already implemented interventions. The example set by institutions in the highly receptive category needs to be followed. Experiences that could be replicated include:

- (1) the institutionalization of participatory evaluation methodologies;
- (2) the institutionalization of mechanisms to enforce and follow-up the implementation of recommendations made by such evaluations;
- (3) the conduction of general assemblies where program beneficiaries may voice their opinions regarding services provided to them;
- (4) the constitution of advisory committees formed by program beneficiaries which may be consulted by management based on needs that may arise; and
- (5) power decentralization by the creation of Boards of Directors with beneficiary participation which establish institutional policies and guidelines.

G. Sustainability and Spread Effects

Project activities will outlive the project if banks find it advantageous to commit higher proportions of their own resources to

extend loans to the beneficiary population. PVUs providing both loans and technical assistance or training services must also create permanent funding sources to support their programs. Although they may never be expected to become fully self-sufficient, the road toward self-sufficiency must be initiated. This may require charging interest rates for loans higher than what banks charge, expanding the type of services offered and charging fees for them, and the mobilization of savings among target populations.

Increase of sales among small enterprises is crucial to either sustain or maintain employment. It is also crucial to maintain and improve loan repayment performance.

Working with banks already more organized and more committed to project goals may help set the example for the more conservative banking institutions, motivating them to replicate the experience.

H. Major Conclusions

- (1) From a socio-cultural feasibility standpoint, the project should face no implementation difficulties.
- (2) The available impact information on micro-enterprises indicates that in approximately 40% of the firms investigated, considerable changes in monthly sales and net income have occurred. These changes are attributable to the credit, technical assistance and training programs implemented in support of these enterprises. In addition, results suggest that the longer the duration of program involvement the higher the possibility of growth in these firms. Micro enterprises benefitting from the support of this program have been apparently able to keep their constant costs down, making a more efficient use of both available labor and capital.

An impact investigation of a program designed in support of small enterprises also showed impressive results, particularly with respect to production and employment.

Similar results are expected in the case of this project.

- (3) It is expected that approximately 40% of the micro and small enterprises to receive assistance through the project will be headed by women.
- (4) Available impact information in the case of micro enterprises also indicates that in 60% of the cases studied, stability was observed with respect to employment, sales and net income. The research was conducted with respect to only one program in support of micro enterprises implemented by a

given FVU. It can be argued that results obtained in this program may not be extrapolated to other FVUs. However, the proportion of cases where stability took place was such that the issue merits attention. Hypothetically, market elasticity would explain partially the performance of these micro enterprises. They may also be other factors causing this phenomenon. Further investigation of this issue is needed. The PMU should be charged with that responsibility.

- (5) The most common micro and small businesses are those dedicated to the manufacturing of foodstuffs, clothing, shoes and furniture. Because of the anticipated backward linkages with Honduran producers of some of the raw materials needed by these industries, support for these enterprises may create not only direct but also indirect employment.
- (6) Workers employed in small businesses who are family heads and with dependents belong to the lower echelons of urban Honduran society. They are earning monthly per capita incomes below the poverty line level. The information available regarding the current income levels of those employed by small businesses does not allow us to make any final conclusions regarding the socio-economic status of those workers who are still living with their parents and providing secondary incomes to their families. We can hypothesize, however, that in the Honduran context the need for younger family members to earn a living may be an indication of poverty.
- (7) In the past, employees hired by small businesses have fallen into three categories: (a) the new members of the labor force, many of whom are women often heading single parent families; (b) "scavengers" with little qualifications, mostly men, who move from job to job trying to earn a living the best they can; and (c) the career oriented strivers fighting for social mobility. This means that small business employment has not only created job opportunities for the unemployed, but also career opportunities for those already working. Furthermore, categories a and b together, represent 72% of workers interviewed in a given sample. Thus, despite the existence of category c, most jobs created are permanent. As a result of the jobs created through the small business support programs implemented previously, increases in income have been observed. Similar results may be expected in future small business assistance projects.
- (8) Through project activities, micro and small enterprises will receive assistance to solve major obstacles to growth which have been either expressed by entrepreneurs themselves or detected through different analyses of the small business sector that have been recently performed. That is, project

activities will facilitate access to credit, technical assistance and training, and market development services.

Project activities, nevertheless, need to address two additional constraints also detected through several studies. These are constraints related to: (a) the scarcity, poor quality and high variations in prices of raw materials; and (b) the absence of adequately qualified personnel.

The ANDI/PYME proposal includes sub-projects intended to help entrepreneurs solve the difficulties which they face in connection with raw materials. These projects need to be supported, and if possible need to become first priority.

Most, if not all, of the training conceived so far as part of this project is intended for the micro and small entrepreneur. Through its research activities, the PMU will need to establish the training needs of workers employed in micro- and small firms. The income of workers is related to their qualifications, and worker qualifications seems to be related to the volume of sales of firms. Plans to solve detected training needs by PMU studies may have to be defined and implemented.

INRUP may play a role in satisfying those needs. Nevertheless, since most of its present programs have been conceived for medium-sized and large enterprises, their more common clients, course contents may have to be adapted to the characteristics of small businesses, particularly their technological level. Incorporation of new training programs into INRUP's planning takes time. An option through which quicker responses may be obtained is CAUERH. Component II of the CAUERH II Project includes training needs assessments and training programs. Although these training programs have been conceived for new workers, project managers are open to the idea of also training workers already employed and who would need to improve their skill levels.

Providing skills to a group of unskilled workers has its risks. Once trained, these workers may be motivated to look for higher paying employment opportunities elsewhere. Contracts of services for periods of time yet to be established will have to be signed between the worker and the firm that has sponsored the training. This will have to be done in order to protect the firm from losing rather quickly recently trained personnel.

- (9) Owners of small enterprises are always responsible for managing the firm or for keeping the accounting for the firm. On the one hand, employees may be hired to manage the firm. On the other, the accounting for the firm may, and

usually is, contracted-out. This situation needs to be considered when planning training courses for small entrepreneurs. First because appropriate recipients of the training may not necessarily be the owners. And second, even if owners were trained, the content of training may not be necessarily the same as that which would be planned for managers and accountants.

(10) FIA, BANCAHSA and Banco de Occidente are interested in participating in the project. These institutions have expressed positive attitudes regarding future lending programs for micro and small enterprises. The more enthusiastic of these institutions about such programs is BANCAHSA. BANCAHSA has adopted a very technical approach in understanding the small business sector, in determining what the financial needs in that sector are, and in setting up a pilot credit program for small enterprises. FIA will soon start a similar pilot program for micro enterprises. Despite the interest manifested by FIA in these firms, its response is a more cautious one, and we should expect it to move more gradually in its implementation. Banco de Occidente will need to show higher commitment so similar types of activities. To the extent possible, bank resources should be committed to future small business sector credit programs.

(11) Banks and FIA need to receive assistance to conceptualize the training programs to be organized in support of the target population to be reached through their programs.

The client referral system of FIA will need to be expanded.

(12) To be able to reach entrepreneurs in most need of mentioned services, a working definition of the target population must be established. This definition should permit the accomplishment of various objectives.

(a) To allow banks and FIA to work with clientele which have been traditionally assisted by PVUS. This is particularly important as one of the intents of the project is to graduate micro-enterprises from lending programs implemented by PVUS to lending programs implemented by commercial banks.

(b) To avoid the destination of resources made available through the project to a small number of firms with higher financial demands. Thus, preventing wider spread of benefits.

(c) To ensure that employment will be generated.

An analysis of how lending institutions define micro- and small firms indicates that differences exist, independently of the criteria utilized to define them. Table No. 8 summarizes these definitions when fixed assets and number of

employees are utilized as the definition criteria. As it can be observed, FVUS such as FUNADEH and ASEPADE provide support to the smallest firms of the spectrum. BANCAHSA and FIA are providing financial assistance to firms of an intermediate size, larger than what FVUS may call small. Banco de Occidente seems to extend loans to firms which may be even larger.

Table 7 - Definition of Micro and Small Businesses by Lending Institutions when Fixed Assets and Number of Employees are Utilized as the Definition Criteria

	Micro-Enterprises	Small Enterprises
ASEPADE	< L10,000 Up to 10 workers	N/A
FUNADEH	< L20,000 Up to 6 workers	L20,000 to < L100,000 Up to 20 workers
BANCAHSA	< L50,000 A mean of 5 workers	L50,000 to < L200,000 A mean of 20 workers
FIA	< L50,000	L50,000 to < L200,000
Banco de Occidente	< L50,000	L50,000 to < L400,000

We have suggested that in the context of this project, micro-enterprises be defined as those having fixed assets under L20,000, an average of five permanent employees, and using labor intensive technology. We have also suggested that small enterprises be defined as those with fixed assets between L20,000 and L200,000, having an average of 20 permanent employees and preferably using labor-intensive technology in some of the stages of the manufacturing process. These definitions would meet the objectives mentioned earlier. In addition, it takes into account the fact that the number of employees may vary as micro- and small firms may increase their personnel on a seasonal basis as a response to market demands.

- (13) Policy issues regarding support for the micro and small business sector need to be raised with the government. The most significant policy issues in this respect are: (a) the

need to simplify the small firm registration and classification process; (b) the need to define and implement a strategy to fight contraband from neighboring countries; and (c) the need to identify means to provide higher spread to banks for small enterprise (on)-lending.

- (14) The level of openness PVUs to suggestions made by beneficiaries regarding the characteristics of implemented programs is generally considered to be either high or average. Seldom low openness and indifference have been mentioned in interviews carried out among beneficiaries.
- (15) With the type of data available, it is very hard to establish causal relationships between: (a) institutional openness to suggestions from the beneficiary population, and (b) institutional efficiency. However, without a doubt lower openness and high efficiency are not related. As a result, some degree of openness is necessary for efficiency to exist.

It seems that openness to suggestions regarding the terms of the loans may be related to lower delinquency. Lenders must understand the reasons behind loan delinquency, especially when delinquency rates are above the average performance that is common among PVUs in the Honduran setting. To obtain that understanding, consultations with loan recipients are necessary.

REFERENCES

- ANDI. Propuesta del Programa de la Pequeña y Microempresa. Período Junio 1985-Mayo 1986. Enero 1986.
- Bianey, K. and Heather Clark. Honduras: A Micro and Small Business Development Strategy. Robert K. Nathan Associates, Inc. 1987.
- Cruz Aceituno, Julian. Diagnostico Micro-Empresarial. ABEFADE, November 1987.
- Fajardo D. M., H. M. Fortin, M. Campos Buines and A. L. Meza. Necesidades de Capacitacion de la Pequeña Industria. Tesis de Licenciatura. Facultad de Ciencias Economicas. UNAH. 1985
- Fanconi, Wilfredo et. al. Analisis General de la Pequeña y Mediana Industria en Honduras. Tesis Grupal para Licenciaturas en Administracion de Empresas, Economia y Contaduria Publica. Facultad de Ciencias Economicas. UNAH. 1981.
- Flores, Luis. Evaluacion Nacional del Programa PYME. ANDI/PYME, Marzo 1987/a.
- Flores, Luis. Estrategia y Politicas para el Desarrollo de las Pequeñas y Micro-Empresas dentro del Programa PYME. ANDI/PYME, Julio 1987/b.
- Galindo Calderon, Hector. Problematica Juridica de la Pequeña y Mediana Empresa. Tesis Licenciatura en Derecho. UNAH. 1981.
- Goldmark, Susan, J.J. Deschamps, W. Glade, M. Willumsen, M.C. Lopez and A. C. Mejia. The Effect of Policy Upon Small Industry Development in Honduras. Development Alternatives, Inc. September 1987.
- Guttman, L. Base para elaborar escalas con datos cualitativos. In Gene Summers, Medicion de Actitudes. Mexico: Trillas, 1977, p. 213-261.
- Heinzen, Jim. Mid-term Evaluation of the National Development Foundation of Honduras. Pan-American Foundation, 1986.
- Reichmann, Rebecca. Evaluation of UKEME: A Micro-Business Assistance Project of ABEFADE. Inter-American Foundation, January 1988.
- Roeser, Kandy. The Locational Pattern of Small Rural Enterprise in Honduras. Washington: AID, 1982.
- Soto Baquero, Maria, Lesly C. Garces, Roger A. Usorto, Ramon E. Fuentes. Situacion actual de la micro-industria y necesidades de apoyo estatal. Boletin del Instituto de Investigaciones Economicas y Sociales de la UNAH. Nos. 152, 153 y 154. August-October 1985.

- 173

Zuniga, M. et. al. Ingreso, Gasto, Barrio y Familia. ABEFADE, 1983.

Persons Interviewed

Gladys de Henriquez, ANDI/PYME
Dorcas de Gonzalez, ANDI
Allan Inestroza, BANCAHSA
Enrique Acurcia, Banco de Occidente
Leonel Sosa, FIA
Guillermo Bolanos, PSP/AID
Munir Mahomar, Fabrica Carteras Catalina
Ned Van Steenwyk, AID/HKU

ANNEX 1

INTERVIEW GUIDE FOR PERSONS EMPLOYED IN COMPANIES
HAVING OBTAINED LUANS FROM FIA

1. Nombre
2. Edad
3. Sexo
4. Estado Civil
5. Numero de Dependientes (Escribir Cantidad)
6. Años de Escolaridad (Escribir Cantidad)
7. Ocupacion Principal
8. Tipo de Trabajo Anterior al Actual
9. Era un trabajo temporal o permanente? ..
10. Le pagaban a destajo o un salario fijo?
11. Salario semanal recibido al terminar de trabajar en ese lugar? ..
12. Incluye ese salario semanal horas extras? ..
13. Cuantas horas extras trabaja generalmente antes de que se saliera de ese trabajo?
14. Cuanto tiempo tiene de trabajar en esta empresa?
15. Que actividad desempeña aqui? ..
16. Es este un trabajo temporal o permanente?
17. Cual es su salario semanal actual? ..
18. Incluye ese salario horas extras? ..
19. Cuantas horas extras trabaja normalmente? ..
20. Cuales son las ventajas principales de este trabajo (frente al que tenía anteriormente)? ..

Table No.1 - Openness of Implementing Agencies
About Suggestions Made by Beneficiaries on Training Programs (%)

Agency	Level of Openness			
	High	Average	Low	Indifference
ANAH	100			
UDEF	100			
APKUDIB	100			
IDH	95		5	
AHDEJUMUKI	75	25		
ANMPI	70	27		3
FUNADEH	59	23	12	6
PERCIL	57	41	2	
FUNHEMU	33	42	25	
ASEPADE	20	55	22	3

Table No. 2 - Openness of Implementing Agencies
About Suggestions Made by Beneficiaries on IA Programs (%)

Agency	Level of Openness			
	High	Average	Low	Indifference
ANMPI	62	18		
FEHCIL	70	30		
APKUDIB	66	34		
IDH	50			50
FUNHDEMU	40	40	20	
FUNADEM	31	31	19	19
ASEPADE	59	23	12	6
ANAH		100		

Table No. 3 - Openness of Implementing Agencies
About Suggestions Made by Beneficiaries on Credit Programs (%)

Agency	Level of Openness			
	High	Average	Low	Indifference
UDEP	100			
APKUDIB	100			
IDH	30	10		
ANMPI	70	23	7	
FUNADEM	53	47		
AHDEJUMUK	50	50		
FUNHDEMU	41	53	6	
FEHCIL	40	60		
ASEPADE	29	59	12	

CRITERIA FOR PARTICIPATION

Target Group Institutions

PRIVATE SECTOR

1. Honduran PVO, NGO, non- and for-profit organization with major focus on providing assistance to small-scale enterprise. Assistance includes credit, technical assistance and/or training.
2. Previously established entity with a minimum of three years implementation experience with small business, preferably in the industrial rather than commercial or service sectors. Organizational objectives generally focused on employment generation/maintenance and creation of new businesses or social welfare objectives. Compatibility of objectives of organization with those of project.
3. Preferable national versus regional or local focus.
4. Preferable urban versus rural focus.
5. Major focus on off-farm activities.
6. Adequate administrative and financial management systems already in place. CONT/FARS will undertake rapid appraisal to ensure appropriateness of systems. Since Project efforts will be geared towards institutional strengthening, weaknesses noted will not eliminate entity from consideration.
7. Direct coverage to beneficiaries high or with potential to expand based on improved services.
8. Potential for growth in organization and impact on employment and income generation as evidenced by previous years performance.
9. If credit program ongoing, acceptable arrearage rates. (Mission will review arrearage rate problem to determine if rates can be brought down through minimal technical assistance or whether problem will require substantial assistance and time.) Subsidized interest will not be acceptable. Savings mobilization-optional.
10. Program is cost-effective with moderate administrative costs. As a marker, Mission will look at cost per job generated by institution.
11. Private sector orientation with strong possibility of self-sustainability in the short-term.

PUBLIC SECTOR

1. General consensus that entity suffers from minimal political interference.
2. Major focus on providing assistance to small-scale enterprise in both urban and rural areas. Assistance includes credit, technical assistance and/or training.
3. Previously established entity with a minimum of three years implementation experience with small business, preferably in the industrial rather than commercial or service sectors.
4. Major focus on off-farm activities.
5. Agreement on the part of GOH of independence of A.I.D.-funded program (e.g., PTR).
6. Potential for impact on employment and income generation as evidenced by previous years performance.
7. If credit program ongoing, acceptable arrearage rates. (Mission will review arrearage rate problem to determine if rates can be brought down through minimal technical assistance or whether problem will require substantial assistance and time.) Subsidized interest will not be acceptable.
8. Program is cost-effective with moderate administrative costs. As a marker, Mission will look at cost per job generated by institution.

FINANCIAL SECTOR

1. Privately owned institution.
2. Relatively strong economic and financial situation. Acceptable repayment record of Central Bank rediscounts/long term loans.
3. Good quality evaluation, processing and controlling system vis-a-vis their placement of funds. Profitability from lending operations.
4. Protracted interest on the part of senior management to participate in the Project.
5. Possibility of sustainability and expansion of the lending program from savings mobilization.

SUMMARY OF INDIVIDUAL NGO PROGRAMS

Provided below is a concise description of each program focusing particularly upon planned activities over the life of this Project. A more detailed description of each entity and its present and planned program is outlined in the institutional analyses (unattached Annex III, Exhibit C) and in their individual proposals (unattached Annex III, Exhibits E-G).

- (1.) FUNADEH (A. I. D. OPG \$2,000,000 in DA resources [Counterpart Contributions \$560,000 equivalent)

(a) Background

Founded in 1983, the Honduran Development Foundation (Fundacion Nacional de Desarrollo de Honduras - FUNADEH), is composed of approximately 175 prominent business persons with social interests in the development of SSEs. FUNADEH provides assistance to low income businesspeople, primarily small and micro-entrepreneurs, both in production and distribution. FUNADEH's main office and service area is in San Pedro Sula and the surrounding secondary cities of Progreso, Choloma, Tela and Siquatepeque.

FUNADEH's program to date consists of the provision of credit, training and technical assistance to the SSE sector. Under this Project, FUNADEH will continue the provision of this assistance with the overall goal of increasing coverage and service areas. Approximately three new secondary cities (La Ceiba, Santa Rosa and Santa Barbara) will be served through their program and employment generated will be in the range of 3,000 jobs. Following is a brief discussion of the planned FUNADEH program.

(b) Credit Program. FUNADEH will continue to support its two ongoing and distinct credit programs. The Production Credit Program will provide loans, at market rates (presently 17%) or above, to small and larger micro entrepreneurs. Credit will continue to be restricted to working and/or investment capital requirements. Terms of the loans will be normally six months to two years, payable monthly. Maximum loan amounts will be \$12,500 for individual SSEs and \$25,000 for groups.¹ Average loan size to individuals has been and will probably continue to be about \$3,500 for individual SSEs and \$16,000 for groups. FUNADEH requires a reputable guarantor and/or collateral at least equal to the value of the loan.

The Commercial Enterprise Credit Program, which was instituted by FUNADEH during 1987, will continue to provide financial assistance to small commercial businesses and distributors for the purchase of goods produced domestically by SSEs. Loans will be made with a minimum 17% interest rate and with a maximum limit of \$5,000 for individuals and \$25,000 for groups. The goal of this particular credit program will be to strengthen the ability of small producers to sell their products and compete in the marketplace.

¹ All figures through these sections are in dollar equivalent. Loans will, of course, be made in Lempiras at the current official rate of \$1 = L2.

190

By the end of the Project, it is estimated that FUNADEH's credit program will reach a volume (\$2 million) to permit it to achieve self-sufficiency, excluding the costs of TA and training.¹ Funds provided under this Project will more than assist FUNADEH to attain the \$2 million active loan portfolio. While FUNADEH will not be fully self-sufficient -- due to costs associated with the provision of TA and training -- they have begun and will continue to identify other sources of non-A.I.D. funding as well as institute fund-raising activities that will assist this organization to reach a high level of financial self-sufficiency.

As of March 1988, FUNADEH made 650 loans totaling L4.5 million with approximately one third of the total beneficiaries being women. The outstanding loan portfolio at the close of March was L2.6 million. FUNADEH estimates that 1,064 new jobs have been created, one for each L6,920 in credits made, or one for each L8,600 in credits made plus for operating expense, training, TA, and promotion expenditures. Under the new Project, approximately 2,550 loans will be made and, as stated above, 6,000 new jobs will be created.

(c) Training and Technical Assistance Program. FUNADEH will continue to stress the provision of training and TA to all of its clients, especially in the areas of financial management and marketing skills and practices. Training and TA will take two forms -- one is geared specifically to ensure that credit is used as planned, and the other towards the improvement of the operations of the business. Both one-on-one TA and formal training courses will be offered to the SSEs. One-on-one training will usually be industry or problem specific. Formal training courses will be conducted by such institutions as GEMAR, INFOP and Arthur D. Little. The number of training courses provided under the program will increase substantially from 110 provided to date to 300 during the life of the new Project. Nearly 2,400 people are expected to benefit from the provision of training and technical assistance.

(d) Institutional Support. Although management practices within this institution are sound, a new activity, Institutional Support and Training, will be introduced under the SB II Project. The activity will further improve the administrative and financial mechanisms of FUNADEH itself focusing on training activities for FUNADEH personnel.

(e) Inputs. Through an OPG financed with appropriated funds, A.I.D. will provide the following inputs to the FUNADEH program.

Credit	\$587,500
Training/TA for SSEs	\$430,750
Staff Training/Operating Expenses	\$691,750
Capitalization Fund	\$290,000
TOTAL	\$2,000,000

¹ See the 1987 evaluation of FUNADEH available in LAC/DR and USAID/H.

2. ASEPADE (A. I. D. OPG \$2,000,000 in DA resources (Counterpart Contributions \$1,000,000 equivalent))

(a) Background

Asesores para el Desarrollo (ASEPADE) was founded in 1977 as a private, nonprofit organization to provide consulting services to development agencies and to carry out development projects among low-income groups. Beneficiaries include both micro-producers and vendors located in or near the three major cities of Tegucigalpa, San Pedro Sula and Choluteca. A. I. D., as well as several other donors, currently support ASEPADE's three credit programs discussed below. A. I. D. is also financing a long-term advisor provided by Accion International/AITEC to ASEPADE. In addition, ASEPADE also supports a number of rural development projects through Honduras.

The SB II Project will provide financial resources to ASEPADE to continue and expand its present program of credit and technical assistance. Coverage in terms of both numbers of beneficiaries and geographic service areas will be expanded. Whereas ASEPADE presently provides services to eight cities throughout Honduras, a total of 15 cities will be reached during the five year life of project.

(b) Credit Program. ASEPADE will continue to operate three small-business credit programs. Using the model developed by Accion/AITEC in other countries in Latin America, the Credit through Solidarity Groups (CREDISOL) program will continue to provide credit to street vendors formed into fairly homogeneous groups, typically of three to six individuals. These groups will receive short-term working capital credit as well as training. Loans per group will range from \$150 to \$1,500 with an interest rate initially of 2% per month (24% per year).¹ Each group will also be required to participate in a savings program. The Credit for Micro-Entrepreneurs (CREME) program will continue to provide loans and TA to micro-industries - firms averaging fewer than three employees and covering such industries as shoemaking, tailoring and dressmaking and furniture-making. Loans will be normally for working capital in amounts of \$200 to \$1,000 with a four to sixteen weekly payback period. Interest rates are the same as for the CREDISOL program, i.e., 2% per month. The savings program for CREME is a standard twenty percent. The third program, which will receive limited support under SB II, is the Credit for Market Vendors (CREVEM) program which provides credit and other services to women market vendors through cooperatives. Each cooperative runs a self-sustaining credit program and ASEPADE provides the necessary leadership and financial training for the cooperative to run on its own.

¹ ASEPADE is currently revising this interest rate which may be increased in the near term to compensate for the higher costs of administering credit to this target group.

182

Under the new Project, approximately 15,000 micro- and small-scale enterprises will receive credit for a total of over \$11,000,000 lent. The CREDISOL and CREME programs, which are at present just over 50% self-sufficient will be fully self-sufficient at the project end.

(c) Technical Assistance and Training Program. Training will continue to be an important part of all three credit programs and will be additional to individual technical assistance provided by ASEPADE's promoters. Typically, CREME credit recipients will be offered optional twenty hour courses in topics such as basic accounting, basic micro-business administration, marketing and production. CREDISOL beneficiaries will participate in one-hour training sessions upon receipt of credit. Training will emphasize simple business concepts. CREVEM training will continue to stress cooperativism with five day courses provided every several months. Under SB II, training programs will be expanded to include 70% of all micro-producers who receive credit from ASEPADE. The goals will be to improve the quality of production, introduce marketing concepts and improve overall use of accounting and other controls within the SSEs.

(d) Institutional Support. Similar to FUNADEH, institutional strengthening will be a major focus of the ASEPADE program in order to eliminate basic program inefficiencies. Support to ASEPADE will assist them to achieve self-sufficiency within their credit program, to open an additional regional office, to improve its monitoring and evaluation systems (especially gathering and analysis of impact evaluation data), to achieve total integration of its financial and accounting systems through automation of the accounting and financial aspects of the program throughout all offices, and on-going training of key staff operations of ASEPADE. Technical assistance from the PTU will focus specifically on the upgrading and expansion of ASEPADE's accounting system.

In addition, a full-time advisor to provide continual TA to ASEPADE will be made available under the PTU. Given the inherent difficulty in working with ASEPADE's tremendous client group -- microenterprises -- which requires more monitoring and overall management to ensure an efficient and cost-effective program, the Mission and ASEPADE believe the presence of a full-time advisor will be beneficial to the institution as it strengthens and expands its programs.

(e) Inputs. Through the DA-funded OPG, A. I. D. will provide the following inputs to the ASEPADE program.

Credit	\$ 985,000
Training/TA	\$ 322,000
Equipment	\$ 46,000
Support for Operational Costs	\$ 647,000
TOTAL	\$2,000,000

183-

3. ANDI/PYME (A. I. D. OPG \$4,600,000 in DA resources [Counterpart Contributions \$1,273,000 equivalent)

(a) Background

The National Association of Industrialists (ANDI) was founded in 1958, by a group of well-established Honduran businesspersons to support medium to large industries. In the early 1980's, ANDI established a division called the Small and Micro Enterprise Program (PYME) to oversee a Business Assistance System (BAS). The BAS was seen as a way to provide funding to entities to carry out specific training and TA activities with SSEs, to increase the institutional capabilities of the entities and to effect coordination where appropriate. When the Small Business Project (522-0205) was authorized by the Mission in June, 1984, ANDI was selected as a co-implementor (along with FIA) of the Project.

ANDI/PYME is, therefore, a second-story organization -- whereby it provides technical assistance and financial support, but not credit, to a series of small business support entities (such as ASEPARE and FUNADEH), which, in turn, direct their assistance to the small-scale entrepreneurs. ANDI/PYME's clients are other Honduran organizations, typically NGOs, cooperatives and trade associations, that work to provide assistance (credit, technical assistance and training) to SSEs located throughout Honduras. Since its inception, the ANDI/PYME program, which is located in Tegucigalpa, has provided financial assistance to over twenty entities throughout Honduras. In addition, as of March 1988, ANDI/PYME calculates that approximately 3,776 SSEs were assisted and 5,716 new jobs were created, as a result of PYME's financing of 62 subprojects for a total of L2.2 million.

Under the SB II Project, ANDI/PYME will continue to focus on a series of already established programs (such as provision of assistance for institutional support and training for clientele personnel) as well as institute a series of new activities. Under the new Project, ANDI expects that approximately 9,000 jobs will be created and value-added to production will amount to nearly \$27 million in local currency equivalent.

(b) Training and Technical Assistance. ANDI will continue to arrange training courses for administrative, management and field personnel of the SSE assistance entities. Courses such as credit portfolio management and impact evaluation methodologies will be generally provided under contract by public or private training institutions in Honduras. ANDI will also continue to use the services of volunteers from the International Executive Service Corps (IESC). Courses will be frequently intensive [for example, two day courses in management by objectives will be provided to management level personnel of selected NGOs that work with SSEs.

124

As part of this activity, ANDI/PYME will continue to provide funds to the entities for specific projects. Each entity will present a proposal detailing expected outputs and achievements. Many of these projects will provide training and technical assistance to SSE's as well as fund the necessary administrative costs for the organizations to run their outreach programs. PYME funds will not be used for credit, although funds can be provided for administrative costs for credit programs.

(c) Business Assistance Network. ANDI/PYME has organized a network of the entities involved in providing direct services to SSEs. It has held five inter-institutional meetings, at which representatives of the various entities have discussed issues of mutual concern, published a newsletter which is reprinted in the newspaper and has initiated a dialogue between the BAS and private banks. Under the SB II Project, ANDI intends to continue publication of its newsletter and continue holding the successful inter-institutional meetings, both on a more frequent basis.

(d) Institutional Support. Limited financing will also be provided to strengthen ANDI/PYME in such areas as financial management and internal controls, automation of its financial and data records.

In addition, ANDI/PYME will expand its current program as well as introduce several new activities, inter alia, marketing, promotion (involving studies of the SSE sector, lobbying the GOH and local governments on behalf of the sector, promotion of the services provided by the participating entities), industrial profiles of several industries where SSEs predominate, to better understand the problems and potential of each, and a data bank which will computerize price information on products produced by SSEs and on certain raw materials, technical information on technologies of interest to SSEs, and statistical information related to assistance entities and their activities.

(e) Inputs. Through the DA-funded OPG, A. I. D. will provide the following inputs to the ANDI/PYME program.

Support for Coordination Expenses	\$749,100
Assistance to Organizations	\$3,714,000
Training	\$16,000
Information Network	\$48,400
Evaluations	\$72,500
Total	<u>\$4,600,000</u>

125

OTHER POSSIBLE PARTICIPANTS

1. Institute for Honduran Development (IDH). Using a matching grant from A. I. D., the Institute for International Development, Inc. established the Instituto para el Desarrollo Hondureño (IDH) in 1979 as a non-profit organization. IDH has three objectives: (1) to reduce unemployment through the development of small enterprises; (2) to provide an alternative credit source to those businesses unable to obtain it through existing formal credit lines and; (3) to provide its clients with technical and managerial assistance.

IDH was one of the early participants in the A. I. D. centrally-funded PISCES Project and as an early leader helped to establish the viability of micro-enterprise development programs in Honduras.¹ IDH works directly with the SSE sector providing credit, technical assistance and training through four regional offices. Their beneficiaries cover both urban and rural SSEs. More recently, they have received funds from both ANDI/PYME and FOPRIDEH for institutional strengthening as well as training and credit programs for its beneficiaries.

Despite their considerable experience in serving the needs of SSEs, IDH has not grown significantly as an institution. According to a evaluation conducted in 1987, management deficiencies exist in the organization. With the exception of the director, top management staff require training. This need for training is shown in the high arrearage rates of their portfolio and their inability to meet programmed goals and objectives. Finally, despite the national character of the organization, its actual impact in the field (numbers of loan recipients) is small.

IDH is considered a candidate for future participation given their experience to date and potential for expansion. Under the SB II Project, technical assistance provided to IDH could strengthen it as an institution and make it a valuable player in the field of small business assistance entities.

2. The Federation of Private Honduran Development Organizations (FOPRIDEH). The Federacion de Organizaciones Privadas de Desarrollo de Honduras (FOPRIDEH) was established in 1985 as an umbrella group for NGOs in Honduras. It received a five-year OPG from A. I. D. to provide grants to NGOs for training management and technical assistance. The members of the organization include: small business development organizations, rural cooperatives, and social welfare organizations.

¹ PISCES (Program for Investment in the Small Capital Enterprise Sector), funded by S&T's Office of Rural and Institutional Development began in 1978 as a pilot project whose purpose was to explore the feasibility of direct assistance to informal sector small and microenterprises.

186-

FOPRIDEH has defined two priority groups for its program grants:

- 1) programs for employment generation, credit and savings, and marketing and services for small agriculture and small businesses; and 2) programs in health, education, population and human resources. To date, FOPRIDEH has approved and financed 28 small projects. In the small business area, it has provided funds for NGOs to run programs in credit, training and technical assistance. Many of these organizations have also received grants from ANDI/PYME for their administrative and staff training costs.

Similar to many newly created organizations, FOPRIDEH suffers from inherent weaknesses in its administrative and management structure. A young staff requires further training and administrative procedures must be reduced in order to make the project approval process more timely. In addition, the institution needs assistance to strengthen its monitoring and evaluation capabilities.

As a second-story organization and because of FOPRIDEH's valuable role in providing credit funds to NGOs, the organization received serious consideration as a member of the initial core group. However, given the Mission's desire to work initially with NGOs whose programs are strong and capable of rapid yet careful expansion, the Mission determined that FOPRIDEH would be best considered under the expansion group.

3. Honduran Association of Managers and Entrepreneurs (GEMAH). Gerentes and Empresarios Asociados de Honduras is a non-profit organization begun in 1984 by a group of San Pedro Sula business people to provide high quality business training to Honduran businesses. GEMAH received an OPG from USAID/Honduras which terminates June 1988. GEMAH provides courses to mid and upper management in larger private and public enterprises. In the development of its program, it has received technical assistance from the American Management Associations.

GEMAH has recently begun a new training program for small businesses. This program is based on the model of the Fundacion Carvajal of Cali, Colombia. It provides twelve weeks of continuous training to small and micro-entrepreneurs, with six modules which cover various facets of business management (e.g., accounting, marketing, financial analysis, cost analysis, etc.). The Mission has provided financial assistance for GEMAH's pilot project to test the viability of such a training course in Honduras. A member of the GEMAH staff was trained in Colombia and will manage the initial pilot program. Under a tripartite agreement which includes AMNPIH and FIA, AMNPIH which will provide the initial participants to the GEMAH program and FIA will provide credit to eligible graduates of the training course.

The Mission is looking with great interest at this pilot project and believes GEMAH and its pilot program would be an excellent candidate for the expanded core group. If the pilot is successful, GEMAH will be able to contract with core group institutions to provide training services under SB II.

187