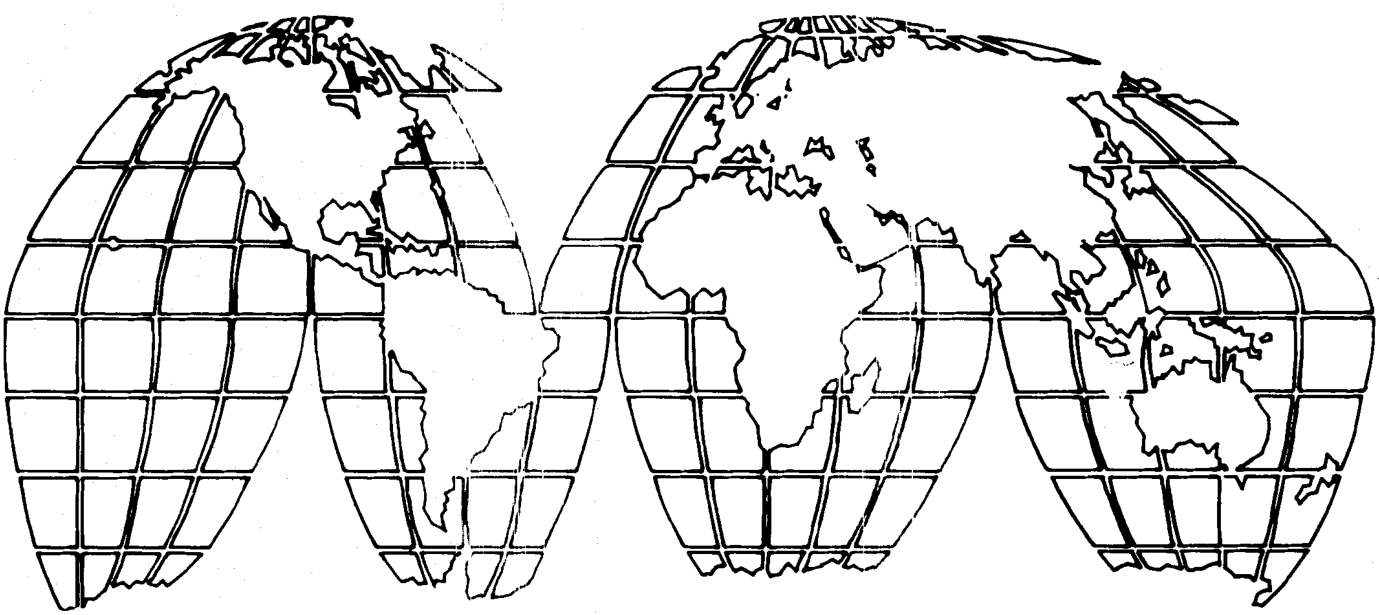
A.I.D. Evaluation Special Study No. 12

Ventures in the Informal Sector, and How They Worked Out in Brazil



March 1983
U.S. Agency for International Development (AID)

PN-AAL-009

VENTURES IN THE INFORMAL SECTOR, AND HOW THEY WORKED OUT IN BRAZIL

by

Judith Tendler

A.I.D. Evaluation Special Study No. 12

Office of Private and Voluntary Cooperation
Bureau for Food for Peace and Voluntary Assistance
U.S. Agency for International Development

March 1983

This report, prepared under AID Contract No. PDC-0100-S-00-2019-00, was submitted in August 1982; some additional material was added in September and October 1982. The views and interpretations expressed in the report are those of the author and should not be attributed to the Agency for International Development or to any individual acting in its behalf.

A.I.D. EVALUATION PUBLICATIONS

A complete list of reports issued in the A.I.D. Evaluation Publication series is included in the back of this document, together with information for ordering reports.

Table of contents

Tables

References

Appendixes

Comments of Jeffrey Ashe of AITEC on the Draft Report

Comments of Mauricio Camurca, Director of UNO, on the Draft Report

List of acronyms

AID	-	U.S. Agency for International Development
AITEC	-	Accion International/AITEC
ATI	-	Appropriate Technology International
BANDEPE	-	Development Bank of the State of Pernambuco
CEBRAE	-	Brazilian Center for Managerial Assistance to Small and Medium Businesses
Cr$	-	The Brazilian monetary unit, the cruzeiro. Most dollar values in the report are the result of converting 1981 constant cruzeiros to dollars at the average rate for 1981--Cr$91.265 to the dollar. In April 1982, the rate was Cr$165 to the dollar.
FIDEM	-	Foundation for the Development of Metropolitan Recife
IDB	-	Inter-American Development Bank
NAI	-	Nucleus for Management Assistance to Manufacturing Firms
PISCES	-	Program for Investment in the Small Capital Enterprise Sector
PVOs	-	Private voluntary organizations
SPC	-	Serviço de Proteção do Crédito (Credit Protection Service)
SUDENE	-	Regional Development Authority for the Northeast
UNO	-	Northeast Union of Assistance to Small Businesses (pronounced OO-nō)

Preface and acknowledgments

In late 1981, AID's Office of Private and Voluntary Cooperation (PVC) asked me to evaluate the UNO program of credit to small businesses in Northeast Brazil. UNO, a Brazilian voluntary organization located in the city of Recife, was founded 10 years ago by the U.S. voluntary organization, Accion International/AITEC.

The PVC office felt that UNO would be particularly interesting for evaluation because: (1) UNO is considered a model of success, not only in delivering credit to small businesses without access to formal credit, but as a voluntary organization that started out from nothing and has now been included in three World Bank projects; (2) the UNO evaluation fit into a series of five evaluations of small-business assistance programs in other countries now being completed by AID; (3) an evaluation of UNO would also be relevant to a two-year research effort of AID (PISCES) to explore ways of assisting informal-sector businesses; and (4) the UNO evaluation was meant as a second step in an exercise carried out by the PVC office to understand better what the special contribution of private voluntary organizations can be to development assistance, and how one can go about evaluating that contribution.

I spent four weeks with UNO in the city of Recife during the months of January and February, about half of which was dedicated to interviewing 25 small businesses that had received credit from UNO.[1] In addition, I interviewed 10 members of UNO's management and staff, accompanied four student workers on routine selection or monitoring visits to clients, attended a training session for UNO's student workers, and sat in on a meeting to organize a group of food-store owners who were UNO clients. I also interviewed five members of Recife's business community (some of whom also hold public-sector positions), who had been involved in UNO's founding and belonged to its board of directors; four economists at the Federal University of Pernambuco who were doing contract research on UNO or Recife's informal sector; two members of Recife's urban development agency, one of the state entities with which UNO works on contract; and the chief of credit to small businesses at the state development bank. Before going to Brazil, I spent a day with AITEC in Cambridge, where I had highly informative discussions with William Burrus, AITEC's director, and Bruce Tippett, formerly of AITEC, who was closely involved with UNO's beginnings.

[1]Ten small retail operations (mainly food stores and novelty and clothing shops), ten manufacturing firms, and five service establishments.

My work in Brazil was made possible and delightful by the extensive help and generosity of Dr. Maurício Camurça, UNO's director. I learned a great deal from him and his highly intelligent staff. I also thank Alexandre da Costa e Silva and Antônio Ivo Mendes de Albuquerque for accompanying me on my interviews of UNO clients and for helping me gather data from UNO's loan files.

While I was writing, I benefited very much from conversations with Lorene Yap, Pasquale Scandizzo, Anna Luiza Ozorio de Almeida, Ricardo Moran, Lovell Jarvis, Henry Jackelen, Albert Fishlow, Ruth Dixon, Andrea Calabi, Neal Boyle, and Dennis Anderson. A meeting in Washington with AID staff and other project evaluators, to discuss a first draft of this paper, was extremely useful. I am particularly grateful to Ross Bigelow and Judith Gilmore for comments on the first draft.

Jeffrey Ashe, Associate Director of AITEC, took out several hours of his time to discuss his reactions to the draft report with me and to provide excellent written comments, which helped me very much for revisions. Because certain differences in interpretation between us still remain, I thought it would be useful and interesting to the reader to append Ashe's comments to my work. They appear at the end of the report, following the bibliography.

I am most appreciative of the written comments on the draft summary and conclusions sent to me by Maurício Camurça, director of UNO, and have taken the liberty of translating and appending them to my report. I am particularly sorry that funds did not permit our providing UNO with a Portuguese translation of the report in draft form, and that I was therefore not able to benefit from the reactions of Dr. Camurça and his staff to the full draft report. Fortunately, at least, the final report will be translated to the Portuguese.

All translations from the Portuguese in this report are my own.

Summary and conclusions

Everyone's eyes are on UNO in the Brazilian city of Recife. Considered a model of how to provide credit to small businesses, UNO seems to have achieved what many similar programs have not. Its repayment rates, at about 95%, are unusually high. Its management is dedicated and talented, with a continuity that is impressive for an organization paying salaries that are lower than in the public sector. It has succeeded in lending to firms with no previous access to bank credit, and has not allowed political pressures to influence its lending decisions--a remarkable achievement, given the lure of its highly subsidized interest rates. UNO has not succumbed to the temptation to lend larger amounts and to better-off firms, in order to achieve the economies of scale inherent in making fewer and larger loans. By lending to small firms without access to credit, UNO has been a pioneer in Brazil, working where no other agency has, showing that it could be done, and opening a path for the public sector.

UNO was created in 1973 by the U.S. private voluntary organization Accion International/AITEC, with support from Recife's business community, other foreign donors, and the Brazilian public sector. After becoming successfully rooted, UNO did not grow for its first six years; on the average, it made 175 loans per year, at U.S.$2,000 each, with an annual operating budget of U.S.$275,000. Starting with its seventh year, UNO's achievements started to pay off: between 1978 and 1982, it received a resounding vote of confidence from the World Bank and the Brazilian public sector in the form of a manyfold increase in its funding. By the end of 1982, it will have made 2,000 loans in a new program outside Recife, and was projected to be making another 2,000 loans a year in Recife by 1985. Despite this massive increase in its public-sector support, it was allowed to continue being an autonomous voluntary organization, working under annually funded government contracts--now the sole source of its income.

For a model, UNO has surprising flaws. Unit costs of lending are very high and productivity is very low. The program has not yielded the kinds of benefits, in turn, that might justify such high costs. Mainly, (1) the number of firms receiving credit has been small, (2) the assisted firms have not increased output or created new jobs, (3) managerial extension has had little impact on the assisted firms, (4) the credit experience with UNO has not provided the majority of firms with direct access to formal credit institutions, and (5) UNO's learning about how to distinguish good microfirm credit risks from bad has not spilled over to formal lending institutions or translated into greater willingness to lend to microfirms. Some of these paltry results can be traced to UNO's way of operating. Others relate more to the characteristics of the small enterprise sector--and certain mistaken assumptions about it--and to the political-economic environment in which UNO and many similar programs operate.

With respect to costs, an average UNO loan of U.S.$2,000 cost U.S.$1,700 until 1979, amounting to 82% of loan value. In 1981, costs seemed to start downward, with 1981 costs at roughly half the previous level: a loan of U.S.$1,600 cost U.S.$733 in 1981, representing 46% of loan value. Reflecting these high costs, the number of loans made per field worker is low, at 24 per year.

UNO's high costs come as a surprise to anyone who has heard of UNO as a "low-cost" approach to informal-sector businesses--with its low overheads (10%), its cheap student workers (half the cost of a permanent employee), and its meager facilities and equipment. Though one might not be bothered by these costs and their productivity implications in a tiny program like UNO, which made only 387 loans in Recife in 1981, one certainly would not want to expand such a "model" to public-sector dimensions.

UNO justifies its work by pointing to the employment and income its loans provide to small-firm owners who, it says, are poised at the brink of urban unemployment. UNO's clients, however, turn out to be in the top 30% of the distribution of earnings, household incomes, and perhaps even microfirms--and live comfortably above absolute poverty. Most of them voluntarily left formal-sector jobs to start their own businesses. Their place in the distribution, in other words, is not where poverty and unemployment problems are concentrated, though they are truly outside the pale in terms of institutional credit and other benefits of belonging to the formal sector.

One does not need to justify lending to small firms, of course, on the grounds of alleviating their poverty. After all, they have the potential to increase output and contribute to the creation of new jobs--given that they are among the better-off small firms and use labor-intensive technologies. The average UNO client, however, does not expand his output as a result of his experience with UNO--and hence does not create new jobs. UNO's clients, in sum, are too well off to justify lending to them on income or employment (of firm owners) grounds. And their lack of growth precludes a justification on the grounds of increased output and new jobs.

UNO firms do not expand for various reasons. One set of reasons has to do with UNO's way of operating--namely, it does not believe in selecting firms for their expansion or employment potential. The largest share of loans (42%) goes to retail firms with an average number of 1.2 workers--as compared to manufacturing and service firms with an average of 3.5 and 2.0 workers, respectively. UNO is content, moreover, merely to help firms survive; it is not interested, it says, in "creating mini-capitalists." Contributing to the same result, UNO is not aggressive about "graduating" its clients to direct bank credit, nor does it encourage its clandestine clients (half of the total) to become legal. The ongoing costs of being legal, it says, would bankrupt most of its clandestine firms.

A more important set of reasons for the lack of expansion and job-creating among UNO clients--including the successful ones--has to do with the nature of the small-firm sector itself. Many small firms perceive expansion as "unnatural" and even imprudent--mainly because of the management problems involved in taking on new employees. New jobs may look good for benefit-cost ratios, in other words, but they are considered a headache by small-firm owners. Other factors causing growth to be difficult are (1) the problems of seasonal peaks and troughs in demand, (2) the difficulties of acquiring raw materials, and, most important because it is often forgotten, (3) the strong preference among owners of family firms for not complicating their lives. The lack of credit, of course, is supposed to be among the impediments that keep small firms from growing. But when the credit constraint was removed in the UNO case, the other impediments continued dominant. Even if firms do not grow, finally, they will often use their credit to bring about small increases in productivity--the purchase of a vehicle for transport, the buying of raw materials on better terms, a modification of the premises. These changes, though economically desirable, will not necessarily involve the expansion and the new jobs upon which the justifications of small-business programs are predicated.

Our expectation that small firms will grow when they are well-assisted has been nourished by the reports on job-creation from small-business programs. My analysis of the jobs created by UNO and some other programs suggests, however, that many of the "new jobs" last only for the duration of the credit. Visiting its client firms soon after the credit was disbursed, for example, UNO reported approximately 230 new jobs per year and 1.6 new jobs per client firm over a period during which a longer-term analysis of the client firms showed an absolute decrease in jobs of 5% (one to three years after the loan was disbursed). Since the same study showed that assisted firms tended to fail less often than non-assisted firms (though the latter results were not statistically significant), a "job-saving" justification might be more realistic, even though it is less impressive.

Though the above-cited barriers to expansion are familiar to us, they tend to be forgotten when we justify programs to assist small firms. If stability is the rule rather than growth, then we must look for other ways of justifying such programs. The saving of jobs, mentioned above, is one possible alternative, though we do not have carefully enough collected data on such programs to know if job-saving is indeed one of their outcomes. The productivity increases cited above are another possibility, though they will not necessarily create jobs and may sometimes even destroy them.

Critics of UNO point to its disinterest in choosing firms for their job-creating and output-expanding potential. The origins of this "flaw," however, are the same as for some of UNO's strengths. UNO has shown a cautiousness in its lending that has contributed to its enviously high repayment rates and to its neglect of the expansion and employment potential. Its caution takes the following form: (1) it lends mainly for working capital (75%) instead of investment; (2) it is loathe to lend to new firms or for the new activities of old firms; (3) in its investment credit, it is cautious about lending for equipment that is over-dimensioned; (4) it shaves loan amounts in relation to the firm's needs; and (5) it lends more to retail firms than to the riskier manufacturing and service sectors. All these behaviors are financially commendable because high delinquency rates in business credit programs tend to be associated with (1) too much investment credit in relation to working-capital credit, (2) overinvestment in equipment that is beyond the firm's marketing or production possibilities, (3) too much credit in relation to firm size, and (4) the financing of new firms, new activities, and large expansions.

UNO's financial prudence may also result in the passing up of firms, or their projects, that are particularly capable of expanding and hiring new workers per unit of credit lent. More aggressive lending, of course, does not necessarily have to lead to higher delinquency rates, as long as one is skilled at screening out the problems. But the ability to screen wisely requires considerable experience, specialized personnel, and resources for research on the characteristics of defaulting borrowers and on the sectors with comparative advantages--all of which UNO has not had. UNO's financial prudence, then, has been quite fitting to its size, though resulting in a loan portfolio that shows little results in terms of expansion of output and creation of jobs. The goals of organizational survival and economic impact, in other words, were partially conflicting.

Had UNO wanted to select clients who truly needed income and employment--the hawkers and vendors, for example, as opposed to the makers of furniture and shoes--it would have had to operate quite differently. Group lending rather than loans to individuals, and loan sizes of U.S.$100 rather than U.S.$1,500, would have been called for. Similarly, if UNO had wanted to strive for significant economic and employment-creating impacts, it would also have had to take on additional activities such as technical assistance, the organizing of producers for group purchasing and selling, research to identify sectors with growth potential, and selection procedures that would identify the particular firms in possession of this potential. In choosing particular sectors, moreover, UNO would have also run the risk of causing market-saturating expansion, perhaps leading to the demise of its expanding clients--an argument that UNO itself makes against choosing clients this way.

That UNO did not carry out several such activities contributed to its survival and its good reputation. UNO stuck singlemindedly to providing only credit to individual firms, despite criticisms from various quarters. To attempt more would be foolish, it felt, because of the limits and tenuousness of its funding. The pursuit of this one task for almost 10 years, and the neglect of additional activities that might have increased the program's impact, provided UNO with the time and the experience to mature into a competent and dedicated operation--the only one of its kind to become prominent in Brazil.

UNO's high costs can also be traced, in part, to its achievements in other areas. UNO's stubborn insistence on excluding better-off firms and lending in small amounts accounts for its success at avoiding the drift upward in the size of client firms and their loans--a drift that happens in many subsidized credit programs for the poor. At the same time, this insistence meant that UNO gave up the possibility of reaping the cost reductions to be had by making at least a small number of large loans. The objectives of wise financial management and serving only the intended beneficiaries, in other words, were in conflict. For the same reason, the goals of reaching small beneficiaries were also in conflict with the indicators commonly used to judge the performance of credit projects and branch-bank managers--respectively, the volume of lending per time period, and the profits made on it.

UNO's modest budget, typical of many small voluntary organizations, also turns out to be an unexpected culprit in the failure to lend at reasonable costs--while at the same time contributing to UNO's achievements. On the one hand, the small and uncertain annual budget (U.S.$275,000) kept UNO from taking on more than it could handle and forced it to be a lean organization. This went along with a remarkably "democratic" office environment, in contrast to the more typical hierarchy of larger bureaucratic organizations. The lean and democratic environment, in turn, contributed to UNO's success at identifying with its clients, and in not feeling squeamish about spending time at their businesses and in their neighborhoods.

Though UNO was admirably constrained in its expenditures on overhead, vehicles, facilities, and personnel, it was nevertheless extravagant in the use of time. This canceled out the cost advantage of its pinched expenditures. The role of the small budget in this extravagance was that it gave UNO the freedom to not worry about reaching a significant number of firms. Not having to worry about impact--the luxury of many small organizations--translates easily into not worrying about how to reach the most borrowers for a given amount of funding, which can be done only by reducing unit costs and increasing productivity. (Other concerns and goals, moreover, took precedence over unit costs and productivity: the voluntary organization's view of its task as "good works," and the more pressing need to survive and gain recognition as a "reputable" organization.) That UNO's small budget and correspondingly limited horizons exempted it from the pressure to develop a low-cost model is an important finding, applicable to many small organizations. The stern financial discipline of small budgets, after all, is usually thought of as forging low-cost ways of doing things.

Is my concern for whether the model can be used to achieve public-sector impacts misplaced? Many small voluntary organizations, after all, cannot even aspire to delusions of impact, unless they are dealing with a circumscribed problem or a very small client group, like lepers. That UNO became a competent and respected organization, one might argue, was good enough; unit costs and productivity are pressing matters more for large organizations with greater aspirations. Similarly, that high economic and social benefits were beyond the reach of the model could be looked at as less important than that UNO represented a job well done, carried out with relatively modest total expenditures and free of the "vices" of large bureaucracies. Although this view is perfectly compatible with the priorities of many voluntary organizations, it is nevertheless not sufficient as a guide for deciding how to spend scarce public-sector funds for development assistance.

What is it, then, that UNO is a model of? How does one reconcile UNO's success as an organization with its failure to develop a replicable or economically and socially significant way of providing credit to the informal sector? The reconciliation becomes easier if we first give up our idea that UNO is a model of how to carry out a certain task, and instead see it as a lesson about how to build a certain kind of institution. The features of this redefined model, taken from UNO's history and elaborated in the text, might include the following: (1) grounding of the new organization in the local elite community; (2) "premature" withdrawal of the outside funding organization; (3) the taking on of only one task rather than many; (4) relatively scant outside funding in non-growing annual increments; (5) a long "quiescent" period during which expansion and diversification of activities do not take place; and (6) an operating style, a type of task, and a support group that all help protect the organization from political interference and from other organizations.

Other aspects of the redefined UNO model are surprising, showing that UNO behaved in some ways less like a "better" alternative to the public sector than we have been led to believe. Although prizing private-sector independence, UNO and its founders never concerned themselves with giving UNO the opportunity to become financially self-sufficient or to have self-maintaining credit funds. Even though the opportunities to charge for services were greater for credit than for many other services provided by voluntary organizations--and even though UNO's clients had already proved themselves willing to pay a lot for credit--UNO and its creators opted for a highly subsidized interest rate and a low commission that guaranteed that the public would always be dependent on the good will of public-sector benefactors. Today, therefore, UNO has virtually no source of funds outside the public sector, a state of affairs that has compromised the autonomy it prizes so highly. UNO's founders, in sum, behaved very much like our image of the public sector--by ignoring opportunities to become financially self-maintaining, and by endorsing an unnecessarily highly subsidized approach to providing a service.

That the UNO experience produced a good organization and not a good technique is perhaps not that disappointing. Building an organization that is suited to an UNO-type task may be more difficult than devising the best way to provide the service. Once the organization is solidly in place, the task of discovering the best technique may be much easier. Perhaps that is why UNO is only now exploring some new ways of doing things, ten years after its founding, and starting on a path leading toward cost reductions. If building the organization requires more effort than finding the right technique, moreover, then perhaps we should alter our concept of the purpose of providing "pilot" projects. We may not need a project to discover the right way of doing things, that is, if we first build a good organization that then has the competence and the character to find the technique itself.

That UNO evolved in the course of using an unsatisfactory technique did not seem to impede its survival or its recognition by the public sector. The life-threatening problems it faced had nothing to do with its high unit costs, or the low social and economic value of its lending. Whether UNO will now move on to the right technique will be apparent soon--after completion in 1985 of the major expansion and diversification of its activities under the three World Bank projects. The UNO that emerges from this expansion, whether successful or not, will be very different from the existing one. The continuity will be found in the organization, and not in its way of assisting small enterprises.

An organization that has been so successful at surviving, like UNO, may be particularly loathe to modify the way it does things because it considers the whole package to have been responsible for its success. UNO's extension program--and its high investment in a loan-application procedure that probably does not increase the likelihood of repayment--are examples of such hallowed yet inefficient ways, which also are followed by other small-business programs. Sometimes, an organization may be spurred to give up such ways when a totally new constraint appears, as has happened with the high lending targets UNO must now keep up with, for the first time, under the World Bank projects. In order for UNO to attain this speeded-up pace of lending, something will have to give that causes its high unit costs to come down. It will also have to show that it is striving toward more impact in order to sustain these higher financial commitments from the public sector.

Because of the difficulty organizations have in giving up some of their ways, outsiders will sometimes be the only ones to understand clearly how the technique can be improved upon, even though the organization is at the stage where it is more than competent to do so itself. The need for a newcomer's vision may explain why a recent program in Ecuador, created in UNO's image by a private bank, has succeeded in lending at a fraction of UNO's costs while still obtaining high repayment rates. It has abandoned UNO's cherished courses for microfirms, which account for 30% of its costs, and has streamlined the selection process; it has even given up evaluation and some other internal control mechanisms, also in the name of reducing costs.

The importance of a cost-minimizing or impact-maximizing constraint in helping an organization shed its inefficient ways cannot be exaggerated. For a large public-sector program, as UNO's is becoming, the constraint is partly a political one: if a large subsidized program does not touch many people, it will be in political trouble. For a private-sector program, as in the case of the Ecuadorian copy of UNO, the constraint is a profit-maximizing one: the bank was forced by law to lend a certain percentage of its deposits to small firms at a low interest rate, or face the alternative of having to purchase government bonds at an even lower interest return. It chose the higher-return alternative (lending to small firms), but wanted to do so in a way that minimized its losses and maximized its returns.

UNO, like many small voluntary organizations, was exposed to neither of these disciplines. Because it is now becoming subject to the public-sector discipline of breadth, it may be impelled to develop a way of operating that deserves imitation. The greater closeness to the public sector, of course, will also threaten some of the very qualities that made UNO successful. Now that it is ten years old, it may be better able to survive these dangers than it was before.

I - Introduction*

Many consider the Northeast Union of Assistance to Small Businesses (UNO) to be a model of how to provide credit to microfirms. After spending a month with UNO in Recife, I found it easy to see UNO as a success story, though not always in the terms I had expected. At the same time, it was easy to see UNO as not very successful at all--particularly with respect to the characteristics we usually attribute to model projects. At one point, I thought the best way to represent the UNO story would be to write it first as a success, and then as a failure. I decided against such a presentation because I suspected that my own concepts of success and failure--plus the received wisdom about UNO--might be making it difficult to see the UNO story in an integrated way. The way the story is told here, then, grew out of my resistance to telling two separate stories about UNO.

In the following section, I present an introductory pic- [illegible] d a suggestion of my findings in the form of a [illegible] engths and weaknesses. The rest of the paper [illegible] in three ways: (1) its history, (2) its operations, and (3) its beneficiaries.

The Facts About UNO

UNO was founded in 1972 in Recife, one of the major coastal capital cities of Northeast Brazil, by a U.S. private voluntary organization, Accion International/AITEC. UNO, chartered as a Brazilian private voluntary organization with funding from AITEC and donations from private firms, was set up to provide credit to small businesses without access to banks. AITEC's objectives, as in its similar projects in other countries, were twofold: (1) to contribute to increased employment, production, and income among the poor by assisting

---

*All dollar values in this report are presented with the original cruzeiro values in parentheses. The dollars are sometimes rounded off when precise magnitudes are not important. Before converting cruzeiros to dollars, the cruzeiros were recalculated into constant values using the general price index as a deflator and 1981 as the base; cruzeiros were then converted to dollars at the average exchange rate for 1981 (Cr$91.265), so that dollar values are constant 1981 dollars. In a few cases where it was more appropriate, I converted cruzeiros to dollars at other rates, all these exceptions being specified in the text. A table of exchange rates from 1973 to the present is presented in Table 9.

businesses that had no access to formal credit and government subsidies, and that tended to use "appropriate" labor-intensive technologies; and (2) to create a private voluntary institution that, after an initial period of AITEC tutelage, would become completely Brazilian and be able to stand on its own. AID, in financing AITEC's small business programs in other countries later on, subscribed to these same objectives. More generally, AID hoped that U.S. voluntary organizations like AITEC could contribute to the development process of third world countries by tapping the institutional potential lying outside their public sectors.

At its start, UNO was provided with credit resources by two private banks and later the development bank of the state of Pernambuco. Together the three banks contributed U.S.$490,000 (Cr$44.8 million) in loans to UNO clients in the first full year of the program's operation (see Table 1). During its first six years, UNO received U.S.$314,300 in donations from six private voluntary organizations (plus the Canadian Embassy), of which AITEC was by no means the largest contributor.[1] This outside funding accounted for 60% of UNO's operating funds in its first year, a percentage that fell to 45% for the next three years, and then dropped to almost nothing thereafter. The Brazilian public sector, an important contributor to UNO from the start, made up the difference: whereas the public sector had contributed 32% of UNO's funds in the first year of operations, it was contributing 73% by UNO's seventh year (see Table 3). By 1981, the public-sector contribution had risen to 85% of UNO's budget, and was projected to reach 93% by 1982. Much of this increase had to do with UNO's being included in three World Bank projects, as discussed below.

UNO history falls into two distinct periods: the modest early years of consolidation and little growth until 1979, followed by a substantial and rapid increase in funding,

---

[1]See Table 3. Contributors, in descending order of the size of the contributions, were Oxfam (U.S.$96,300), PACT (U.S.$92,000), Catholic Relief Services (U.S.$34,200), the Inter-American Foundation (U.S.$32,200), the Canadian Embassy (U.S.$24,800), AITEC (U.S.$23,600), and the Merrill Trust (U.S.$11,200). In 1980, Appropriate Technology International (ATI) contributed a further U.S.$72,000, making for a total of U.S.$362,800 in outside funding. These figures may be in error because they were taken from UNO's yearly cruzeiro data on the sources of the funds it spends. I converted the figures to dollars at the exchange rates of the year in which the funds were spent; the total figure is therefore not corrected for inflation of the U.S. dollar.

personnel, and lending resulting from the "discovery" of UNO by the World Bank. Until recently, UNO had been a small and non-growing operation. From its inception through 1981, it had made a total of 2,552 loans--1,680 in Recife and 872 in the interior (refer to Tables 1 and 2). Between 1974 and 1978, it granted an average of 165 loans in Recife per year, with an average loan size of U.S.$2,000 (Cr$190,700). By 1981, average loan size had decreased to U.S.$1,600 (Cr$146,000). After the no-growth years of 1974 to 1978, UNO suddenly became the beneficiary of greatly increased funding, after being included in a World-Bank rural development project located in an interior area of the state, the Agreste Setentrional. The interior project resulted in a quadrupling of total UNO loans between 1979 and 1981, and a quintupling of their value. By 1981, the interior program had surpassed that of Recife, with the number of loans at one-and-a half times the number in Recife (617 vs. 387).[1]

By the end of 1981, UNO's Recife program was projecting a fourfold increase in annual lending by 1985, as part of another World Bank-financed project for urban development in the city of Recife, to commence in late 1982 (7,300 loans to be made over the 1982-1985 period). Also in 1982, UNO was included in yet another World Bank project for assistance to middle-sized cities, though with a budget considerably smaller than the other two projects. Under these three projects, credit to clients would be channeled only through the state development bank, the private banks having dropped out in 1977.

UNO lends to its clients at 25% interest.[2] Interest earnings accrue to the bank and institutions supplying the credit funds, and not to UNO. With Brazilian inflation rising from 30% in UNO's first years to 100% by 1980, the UNO rate of interest has always been negative in real terms, and increasingly so. These highly subsidized interest rates are not unique to UNO, and indeed have been a feature of Brazilian Government credit policy in industry and agriculture for at

---

[1]This evaluation covers only the older Recife program of UNO, and not the interior projects, though I refer to the latter project at various points. Loan and personnel data were available for Recife as distinct from the total program, but budget data were available only for the whole program.

[2]UNO earns an additional 3% (previously 2%) of the value of the loan as a commission, which represents an insignificant contribution to its costs. The commission is discounted from the loan in advance along with a 2% commission to the bank, a 2% insurance premium, and a banking tax--making the real interest rate somewhat higher than 25%.

least a decade. Though the UNO interest rate had been about the same as the controlled Brazilian rate for commercial credit until 1976 (also negative in real terms), it has now fallen considerably below the rates on special government lines of credit for small and medium industries (40% to 80%)--not to mention commercial rates of 130% to 230%. UNO's decision to charge negative real interest rates, then, meant that credit funds could never be self-maintaining.

Most of UNO's credit is for working capital loans (75% of the value) repayable in 12-15 months with a grace period of three months; loans for investment are repayable in up to 36 months, with a grace of six months. Retail establishments account for the largest share of UNO loans (42%), followed by services (34%) and manufacturing (24%); small retail food markets are the largest single lending category (21%). Borrowers may obtain additional loans as long as previous loans are repaid and firms have not become so successful as to qualify for direct bank credit, but most repeating borrowers do not obtain more than one additional loan. Loans to repeaters have accounted for as much as 40% of total loans in Recife in any one year, a share that declined to 25% by 1981 (Table 2).

In order to qualify for an UNO loan in early 1982, firm owners had to have less than 5 employees (10 for manufacturing); an annual family income of less than U.S.$8,900 (Cr$1.2 million); annual sales of less than U.S.$62,000 (Cr$8.4 million) for manufacturing firms, and U.S.$45,000 (Cr$6 million) for retail and service establishments; and fixed investment of less than U.S.$52,000 (Cr$7 million) for manufacturing firms, and U.S.$37,000 (Cr$5 million) for retail and services. (Exchange rate for this paragraph is Cr$135.)

Until the initiation of the World Bank interior project in 1978, most of UNO's field work was done by half-time university students, contracted annually by UNO at half the cost of a permanent employee with normal-school training. In 1978, UNO had a permanent staff of 20, including 10 professionals, plus 26 half-time university students. By 1980, the second year of the interior project, the number of permanent staff for the first time surpassed that of university students, with 48 permanent staff to 36 students. (This change is partly a result of the use of permanent staff rather than students in the larger interior program.) UNO's students are responsible for the bulk of the fieldwork--canvassing small businesses, filling out questionnaires on possible borrowers, preparing the loan application for the bank, and monitoring loan recipients.

The state development bank plays no role in screening UNO applicants, and accepts UNO's recommendations in almost all cases. Loan collection is the official responsibility of the bank, in terms of notifying borrowers of delinquency and initiating collection procedures. UNO nevertheless takes upon itself the task of tracking down delinquent borrowers, finding out what the problem is, and recommending appropriate action to the bank. Delinquency in the UNO program has never been more than 8%, depending on the measure used--a remarkable achievement for a program of this nature. Loans are backed by a guaranty fund, originally set up with donations from the private sector but now financed from a 2% surcharge on the value of the loans, as part of a Brazil-wide government guaranty fund for all small-firm credit. Of the 2,552 loans made by UNO since its creation in 1972, only 98 or 4% had to be paid out of the guaranty fund.

UNO spends most of its time with microfirms during the selection and loan-application stage, rather than after a client receives a loan. Of a total of 32 students in the Recife program in 1981, only 5 worked on loan monitoring. Until 1980, only 20% of the firms canvassed in any year received loans (Table 8). The percentage increased to 48% in 1981, partly as a result of UNO's streamlining of its selection procedures, and the resolution of a longstanding problem of delays in bank processing.

UNO provides no extension or technical assistance except for a series of courses offered to clients and other interested parties in simple bookkeeping and other matters such as sales promotion and learning how to write checks. UNO estimates that roughly 30% of its operating costs are for the training courses, which borrowers are not required to attend. The student workers also offer advice during their visits to clients. UNO files and my interviews with borrowers suggested that few borrowers attended the courses or considered them valuable, a not infrequent finding for this type of technical assistance. In the interior program, technical (as opposed to managerial) assistance is available to UNO through a contract with a state agency, ITEP.

Strengths and Weaknesses

I close this section with a list of UNO's most salient strengths and weaknesses, leaving the discussion of them for later. The achievements are the following:

1. UNO succeeded in reaching businesses that, in most part, would have had no access to institutional credit. Given the attraction of the highly subsidized interest rate to better-off borrowers, this is a significant achievement.

2. UNO attracted and built a staff that is highly dedicated to the organization's goals of getting credit to

poor firms, and is highly sympathetic to the needs and problems of its client group.

3. UNO succeeded in becoming independent of its creator, AITEC, at a relatively early stage. The technical-assistance relationship was ended only three years after UNO's creation, and AITEC funding terminated five years after creation, never having represented more than 3% of UNO funding in anything but the first year (when it was 19%). UNO entered its second decade of existence, moreover, with large, unprecedented increases in its public-sector funding.

4. UNO has earned an excellent reputation as a dedicated, competent organization from persons in both the private and public sectors.

5. Though UNO is a private voluntary organization, it succeeded in obtaining a substantial share of its budget from the public sector from the start (33% in the first year). After eight years, moreover, UNO's good work and reputation resulted in its being noticed by the World Bank and included in three of its projects, bringing a major increase in its funding from the Brazilian public sector.

6. The creation of UNO was achieved with a fairly small commitment of funds from outside donors during the first four years--U.S.$23,600 from AITEC, and a total of U.S.$290,800 from others. After that point, large government contributions took over under the World Bank projects (Table 3).

7. In addition to receiving public-sector funding, UNO has succeeded in warding off the political intervention that often afflicts government programs of subsidized credit.

8. UNO is a lean organization, with overhead costs of only 10%, only one vehicle (unusual for an entity that does so much field work), and much less of the hierarchy and rigidity that characterizes many public-sector entities in the credit and extension field.

9. Repayment rates on UNO lending, at 92% to 98%, are remarkably high.

10. UNO succeeded in avoiding various practices that have been associated with high delinquency in similar programs. Namely, (a) UNO has lent mainly for working capital instead of for investment; (b) it has stayed away from financing new firms; (c) it has financed only modest increments to a firm's fixed investment.

Along with its strengths, UNO has the following weaknesses:

1. UNO's operating costs have been quite high as a percentage of loan value--ranging from 50% to more than 100%, though falling to 46% in 1981; cost per loan is also high at U.S.$733 (Cr$66,900), though it has fallen from twice that level in the last few years (Table 1).

2. Productivity is low, with loans made per student worker (full-time equivalent) in Recife at about 24 per year; if supervisory staff were included in the ratio, the productivity figure would be even lower.

3. UNO's Recife program hardly grew during its first nine years of operation, and reached only 0.3% of Recife's microfirms in 1981 (387 loans out of 120,000 firms). Even over the whole nine-year period, the total number of firms receiving UNO loans (1,219) was only 1% of the client population.[1]

4. Though private banks and the state bank contributed some funding for UNO credit in the early years, the banks did not sustain their financial commitment. Commitment of the state bank was never great enough until recently to resolve overwhelming problems of delay and requirements for documents, adding to average loan costs because of the number of discouraged borrowers who gave up after UNO prepared their loan applications.

5. UNO itself rejected the private banks' participation when interest-rate ceilings were removed in 1977, even though their processing of loan applications was smooth and rapid.

6. Financial support from the private sector, expected to be a mainstay of the program, never reached more than 29% of funding, and diminished to nothing after the first five years (Table 3).

7. UNO has never been able to generate its own income, or to be as financially independent of the public sector as it was meant to be.

---

[1]The 1,219 figure is obtained by subtracting 461 repeat loans from the total number of loans, 1,680, to obtain the total number of firms lent to in Recife.

8. UNO spends 30% of its operating budget on courses for small-firm owners, courses that are of questionable value.

9. Only a minority of UNO borrowers seem to "graduate" from UNO credit to the formal banking system, meaning that the rest must be permanently dependent on UNO for credit or revert back to their previous creditless state.

10. Though UNO has established itself as a reputable organization, its style of operating does not seem worth copying because of the high costs per loan, the low productivity, and the insignificant portion of the target group reached. As evidence for this, many of the features of the "model" are changing, it seems, as UNO rapidly grows to a more significant size under the World Bank project.

The above juxtaposition of UNO's strengths and weaknesses brings us back to the quandary posed at the beginning of this introduction--many of the weaknesses seem to be inextricably bound with the strengths. Does this mean that UNO's successes at surviving and becoming a praiseworthy organization were in any way a function of its weaknesses? Did the success require that UNO be a small, insignificant organization, with high costs and low productivity? Can the weaknesses be eliminated without undermining the strengths? These are the questions behind the discussion that follows.

II - The History

What explains the success of AITEC in creating a lasting institution in the form of UNO? What explains UNO's limited and rapidly diminishing support from the private banks and the rest of the private sector? What is the meaning of UNO's inability to grow during its first several years? How would one describe what AITEC created institutionally, given that UNO was not the independent institution envisioned at the beginning? What was the significance of UNO's "loss" of independence? What was AITEC contribution as outsider?

The Local Connection

UNO's successful rooting and long existence had much to do with AITEC's hard work at promoting UNO in the business community of Recife. The promotion effort resulted in an UNO board of directors chaired by a leading local industrialist and other prominent members of Recife's business and banking community. Most of these elite backers of UNO belonged to the local federation of industry and commerce, a very active organization. The federation was always looking for business-related programs it could sponsor, and was constantly on guard against "incursions" of the public sector on its territory. In approaching the local business community for support for UNO, then, AITEC was indirectly linking the UNO effort to a well-established and influential local institution.

To its local grounding of UNO, AITEC added a few important connections to nationally important persons. AITEC's Rio de Janeiro affiliate, founded in 1971, was headed by an influential banker from southern Brazil, Ari Burger, who vigorously supported UNO and who had been a director of the Central Bank in the late 1960s. AITEC also garnered the public support of another prominent Brazilian personage, Roberto Campos--an ex-planning minister, Brazilian ambassador, and writer on Brazilian economic policy. The early support of these prestigious Brazilians, outsiders to Recife and the Northeast, impressed Recife businessmen and banks and helped elicit their support.

Bringing in the banks

Local political considerations played an important role in the success of AITEC and UNO at getting three banks to participate in the program. Of the two participating private banks, one was very much a Recife institution. The Banco Nacional do Norte operated only in Northeast Brazil and was owned by a

Pernambuco industrialist living in Recife. The Banco Econômico, the other private bank, also had a Northeast base; it was led by an industrialist from the Northeast state of Bahia, who also had been recruited to the cause of UNO by AITEC.

The third participating bank was in the public sector and was also a local institution--the development bank of the state of Pernambuco (BANDEPE). The better-funded and more powerful public-sector banks--the Bank of Brazil and the Northeast Development Bank--did not participate, despite AITEC's expectations that they would. The Bank of Brazil, though one of the largest banks in the world and frequently responsive to social directives in its lending, is a Brazil-wide network, headquartered in Brasilia. It would have had less interest than BANDEPE in a program just for Recife, and its centralized lending policies would have made such an exception difficult. Though the Northeast Development Bank was closer to home, and AITEC also sought its participation, it was still Northeast-wide and headquartered in another city, Fortaleza. BANDEPE, in contrast, was created by the state of Pernambuco and operated only in that state, with headquarters in Recife. It was therefore more sensitive to Pernambuco politics, in which the opinions of UNO's business-elite backers were important. BANDEPE, then, was partly beholden to the same business leadership that was backing UNO. There was no such vital connection with the two other official banks.

Five years after UNO's creation, BANDEPE was the only bank, state or otherwise, participating in the UNO project. UNO withdrew the program from the two private banks in 1977, because the Brazilian monetary authorities terminated the ceilings on interest rates for commercial credit, which would have brought an increase in UNO rates from 25% to 35%. UNO thought that these new commercial rates were too high to charge to its clients--even though they were negative in real terms--and the private banks would not accept such a discrepancy between UNO's rate and the others. At present, commercial rates are between 130% and 230% and UNO rates are 25%. The current rate is now the same as that fixed by the Brazilian public sector for all subsidized credit to microfirms. BANDEPE, as a state bank with various subsidized lines of credit, had no problem with the low UNO rate.

The emergence of a state bank like BANDEPE as UNO's savior is an interesting turn of history. The termination of participation by the two private banks was a result of the insistence by UNO on a policy that was incompatible with private-sector banking. Yet UNO was set up as a "better" private-sector alternative to the public sector's way of doing things. Also, whereas UNO was considered an "apolitical" organization, notably devoid of political meddling in the allocation of credit, the state bank had the opposite reputation. Along with other state development banks in the Northeast, BANDEPE had been bypassed in large World-Bank projects as a mechanism for channeling subsidized credit to agriculture, and the Bank of Brazil had been chosen instead. The Bank of Brazil was more reputable, more established, and more "above local politics" than the state banks, which were considered too politicized in their credit decisions, too responsive to state politics. Yet this "responsiveness" was precisely what drew BANDEPE to UNO's cause. BANDEPE's position in the midst of local politics, in other words, was exactly what UNO needed.

UNO's strength, then, was not only a matter of its private-sector support, but also of its ties to influential persons at the local level, as opposed to regional and national levels. A small-business program for Recife would not have had the political appeal at regional and national levels that it did locally. By mobilizing local elite support, then, AITEC was endowing UNO with the most effective political ties it could.

The limits of local support

A few qualifying comments about UNO's local connections are in order. That UNO was locally well connected is not to say that it was "political," or that it had the direct support of local politicians. UNO was among the most apolitical of credit-granting entities in the Northeast. Its local connection was not a direct line to the politicians but, rather, an indirect tie through an "apolitical" business elite whose opinions were taken seriously in the way state funds got allocated. Similarly, the strength of UNO's local connections should not be exaggerated. AITEC, after all, assumed that official development banks would contribute approximately 40% of the funds for UNO lending, but they hardly participated at the start.[1] The credit resources made available to UNO by local banks, moreover, were minuscule. UNO loans never exceeded more than U.S.$550,000 (Cr$49 million) per year until 1980, increasing to U.S.$696,000 (Cr$63.5 million) in that year and more than doubling in 1981 to U.S.$1.6 million (Cr$147 million). Even at these higher levels, UNO loans in 1980 amounted to less

---

[1] The expectation was expressed in the minutes of UNO's first meetings of its board of directors. The official banks expected to participate were the Banco do Brasil, the Banco do Nordeste Brasileiro (BNB), and the Banco de Desenvolvimento do Estado de Pernambuco (BANDEPE)--the latter bank being the only one to participate.

than 1% of only the subsidized credit for small and medium firms granted by the state development bank in Recife.[1]

UNO's business support was not enough to sustain the participation of the two private banks, as seen above, which dropped out in the fifth year of the program. Though the state bank remained, moreover, its bureaucratic demands and delays increased the costs of the program and decreased its effectiveness markedly. These problems have started to be resolved only in the ninth year of UNO's operation, coincident with the World Bank project. Stronger political commitment by the state bank would no doubt have resolved the problems much earlier.

Despite UNO's support in the business community, donations from private firms never exceeded the budget support provided by the public sector--even at the height of these donations in UNO's first years, when 35 firms were contributing. The private share, at the most, was never more than 29%,[2] whereas public-sector funding accounted for about 30% of UNO's budget during its first four years, including the first (Table 3). Brazilian private donations, moreover, never exceeded the contributions of foreign donors. Foreign donations were the major single share of UNO's budget in its first four years, starting at 60% in the first year and varying between 40% and 47% in the subsequent three years. Though AITEC and UNO worked hard to raise donations from the local business community, then, significant and lasting funding did not come from that source. Local-elite support of UNO, one might say, turned out to be more moral than financial, and sometimes half-hearted rather than robust. This does not mean that it was not important. It got the organization started and kept it moving, albeit at a slow pace.

UNO's local grounding was also limited in that it was in no way participatory. AITEC and UNO never encouraged formal participation by the beneficiary group, nor did they consult

---

[1]The corresponding percentage in 1981 was 2%. In 1980, that is, current Cr$24.4 million of UNO loans represented 1% of Cr$5.6 billion of BANDEPE loans; in 1981, current Cr$166.2 million of UNO loans represented 2% of Cr$9.2 billion of BANDEPE loans. Data are from BANDEPE headquarters in Recife.

[2]This share is difficult to determine because the category including private-sector donations is a residual category for "local institutions," including miscellaneous funds from various sources.

the intended beneficiaries when designing the program.[1] UNO still does not consult client groups when it makes changes in its programs, though it is interested in their opinions. UNO's non-participatory origins and style, of course, worked in important ways to its advantage: its business-elite supporters had more influence and organization than a group of UNO clients ever would have, in terms of eliciting funds and other forms of support from entities in the private sector, the public sector, and from foreign donors. Participation, however, might have helped UNO to overcome the inadequacy of its training program for firm owners, as had been the case in other programs. (This matter is discussed at length in the section on training below.)

The private sector loses interest

Recife businessmen who had participated on UNO's board of directors offered various reasons for their limited and declining financial support of UNO. Most important, strangely enough, was their expectation that large contributions would be made by the public sector--international as well as domestic. Since AITEC vigorously campaigned for finance from international donors and kept UNO's business backers apprised of these efforts, this expectation was understandable; indeed, one reason for loss of interest in UNO by an important contributor was disappointment with AITEC over the fact that it did not bring in the level of international funding that it said it could. AITEC did come through with enough foreign donations over a four-year period (U.S.$291,000) to keep alive the hope that they would dispense with the need for local private ones. Similar hopes about the Brazilian public sector's contributions to UNO, Recife's backers said, partly explained the ease with which UNO terminated its relationship with the two private banks in 1977: since the state bank was starting to participate more, there really was no more need for the private banks.[2]

Though UNO's private-sector backers saw public-sector funding (including foreign) as highly desirable, they also took any signs of such support as permission for them to withdraw their financial backing. It was not that the business community was against public-sector financing, but rather that they

---

[1]The lack of participation was also noted in DGAP (1978:41).

[2]The interest-rate problem, as described above, was probably a more immediate and significant reason for UNO's withdrawal from the private banks.

felt their responsibility to the program was relieved as soon as the public sector appeared on the scene. Thus one form of success, or the expectation of it, brought another form of failure.

Private-sector support for UNO waned also because of changes in the power of UNO's nationally prestigious supporters. As noted above, UNO received a strong initial endorsement from a major industrialist of Brazil's developed south, who had been a director of the Central Bank. The Central Bank's regional representative in the Northeast, therefore, was also a member of UNO's board of directors and, following the line of the Bank's director, was also a strong supporter of UNO. The Central Bank endorsement, in turn, was said to be influential in convincing the two private banks to participate; anything they could do to please the Central Bank, which held great power over them, made their relationship to that institution easier. A few years after UNO was created, the industrialist-director lost his influence at the Central Bank, and nobody else influential took interest in UNO; the new Central-Bank representative in Recife became equally lukewarm. At this point, it was said, the two private banks no longer saw anything to be gained from the Central Bank by being good to UNO.

In explaining their meager financial support of UNO, Recife's business leaders also pointed to themselves as running family-held and inward-looking enterprises, without a tradition of public giving. The needs of poor firms, they felt, should really be met by the public sector, which had been charging the private sector ever-higher taxes and making credit tighter and more expensive. They could ill afford the luxury of contributing to a program of subsidized credit for the poor, they felt, whose responsibility was at any rate that of the state. Given these attitudes, it is remarkable that AITEC succeeded in obtaining any private-sector funding at all! Nevertheless, the expectation that private-sector participation could be sufficient enough to endow UNO with autonomy seemed to be an unrealistic one.

AITEC's efforts to raise Brazilian private-sector funds, it should be noted, were more successful in the state of Bahia, where the only other Brazilian UNO program was created in 1976. But by 1982, UNO/Recife was much better off than UNO/Bahia. While UNO/Recife had succeeded in maintaining its independent organizational status, contracted by the public sector on an annual basis, UNO/Bahia was being absorbed by the state government--an outcome discussed later. Thus the greater early financial support by the private sector of the Bahian UNO did not guarantee a better outcome in terms of organizational survival. The significance of private-sector donations to UNO, then, should not be exaggerated as a measure of the quality of private-sector commitment, or as determining UNO's destiny.

Good works and self-sufficiency

The attitude of Recife's business leaders toward financing an UNO-type program was understandable. As owners of successful firms, they had nothing in particular to gain from a program that would assist microfirms to grow. They never envisioned UNO as becoming capable of having a significant impact on the microfirm sector. Rather, they saw the organization as a charity, as "good works" and good public relations. UNO and its management, in their eyes, were something to be proud of--a job well done. A small and nongrowing UNO, with little impact and low productivity, would give no particular cause for concern. In addition, UNO's business backers saw their creation as inherently limited. The assisted microfirms would not be fit to work directly with the banking system; they would continue to be pathetically poor, and unable to meet a bank's requirements for documents, guarantees, and minimum balances. Only the public sector, they felt, would have the resources to expand UNO's clientele significantly, and make UNO into an organization with an impact. If this act of public-sector benevolence were to take place, they knew that it would take UNO out from under their tutelage.

The "good works" view of UNO by its business-leader benefactors is also reflected in their emphasis on employment of firm owners, as opposed to hired workers, as the main employment benefit of the program. UNO's loans, that is, are said to give employment to microfirm owners who might otherwise swell the ranks of the urban unemployed. The stress on employment for firm owners as opposed to hired workers makes it more understandable that the largest single share of UNO loans (42%) goes to retail firms, where job-creating potential (for hired workers) is the least.[1] The emphasis on employment for owers, however, misses a large part of the employment potential inherent in such a program--the jobs offered to new employees by the owners of expanding small businesses, which typically use more labor-intensive techniques than larger, formal-sector

---

[1]A survey of 500 client firms of UNO showed the average number of employees (unpaid as well as paid) to be only 1.4 for retail firms, in contrast to 3.5 for manufacturing, and 2.0 for services; for the firms combining two activities, average number of employees were the following: 2.5 for services/manufacturing, 4.5 for manufacturing/retail, and 1.9 for retail/services. (UNO 1980:105, T.57.)

firms.[1] (UNO's job-creating performance is discussed in a separate section on employment below.)

UNO's creators and business supporters also seemed little interested in the production impacts of giving credit to micro-firms. UNO credit would not be directed to any particular sector in which small firms were thought to have a comparative advantage, or to particular firms or sectors identified as having potential for growth. Though there were some good reasons for this lack of specialization or focus, as discussed later, it was also consistent with the "good-works" view of what UNO was doing.

Today, some of the Brazilian government and World Bank professionals who deal with UNO characterize it as "welfarist" or "socialist" in philosophy--because of its lack of interest, until now, in choosing firms according to growth and employment criteria. In their view, UNO proceeds as if any firm deserves credit as long as it can pay back, and seems to have no concern for maximizing the employment or output impact of its actions.[2] The lack of concern for impact, however, seems to reflect more the "good-works" vision of its business supporters--that is, more a paternalistic vision than a welfarist or socialist one.

In contrast to the technocrats, the liberal left has criticized UNO (and AITEC) for doing exactly what I say it is <u>not</u> doing: by working with firms individually, UNO and AITEC <u>are</u>, according to these critics, simply turning a few poor persons into successful capitalist firms, a privileged few who leave the rest behind. Instead, they say, UNO should be organizing poor producers to engage in group actions, like buying and selling, that will increase their market power.[3] It is true that UNO has not promoted such collective efforts until recently; but its lack of interest in choosing firms with good growth or employment potential shows it also to be relatively

---

[1]AITEC says that its employment objectives, for UNO and other such programs, have always focused on jobs for hired workers rather than firm owners.

[2]An economist of FIDEM, the metropolitan Recife agency with which UNO contracts under the World Bank loan, criticizes the project for not taking a more impact-maximizing approach to the selection of project beneficiaries. (Osório 1981:34-39.)

[3]An example of this type of critique can be found in the DGAP evaluation of UNO, which points to the "overemphasis on the purely economic aspects of enterprise development and the lack of activity in the area of community development" (DGAP 1978:40).

uninterested in creating capitalists--or, at least, not very good at it. If one wants to be critical, then, it seems more accurate to describe UNO as doing charity, and as not choosing firms with a potential for growth.

There is another side to the "good works" vision. UNO's founders never conceived of their creation as generating its own income, even though it was providing a service for which people are accustomed to paying. UNO and AITEC focused their attention mainly on how they could mobilize gifts from others--businesses, foreign donors, the Brazilian public sector. A 1978 evaluation reported on UNO and AITEC as considering six measures that would increase UNO's funding--five of which involved donations and only one of which addressed itself to charging the clients.[1] None of these hoped-for measures were obtained, and UNO's funding (though not self-sufficiency) problems were soon resolved from a totally unexpected source--the World Bank and Brazilian government counterpart funding under three World Bank projects. Strangely enough, moreover, though UNO and others recognized and worried about the increasing dependence on the public sector, they presented the referred-to measures (and others)[2] as a way of becoming independent of the public sector. The seeming contradiction lies in the fact that UNO was actually concerned with its dependence on one particular public-sector entity, CEBRAE--as discussed further below--and saw the proposed measures as freeing it from CEBRAE. The independence to be gained from the proposed measures, then, related less to financial self-sufficiency than to being free of one public-sector entity by obtaining funding from others.

---

[1]The donations suggested were (1) a grant from the Inter-American Development Bank, (2) fund-raising among private donors, (3) contributions from city government to training costs, (4) partial subsidy from a government agency, and (5) bank donations of a percentage of their profits to training courses. It was suggested that the interest rates be raised--but only by two percentage points to a still negative level in real terms (20%)--and with reservations about whether borrowers "could afford" to pay more. Along with this proposed increase, it was hoped that rediscounting facilities could be offered to the bank to lower its cost to 5% (another form of donation), and that this would leave UNO with a 15%, instead of a 2%, commission (DGAP 1978:51-53).

[2]UNO hoped for (1) a direct transfer of funds from the Federal Government, perhaps out of an existing 1% tax on all financial transactions (ISOF); and (2) a bank decision to absorb part of the costs of the program (DGAP 1978:14-15). Neither hope was realized.

It is ironic that UNO's founders, so proud of having created a fine organization like UNO without the "vices" of the public sector, would not have concerned themselves with its financial independence. The precedent for income-earning, after all, was already set in the 2% commission (now 3%) UNO charged. But the low volume of lending and the high unit costs guaranteed that the commission would never generate significant operating funds. UNO's negative real interest rate was also of no concern to UNO and its backers, even though it guaranteed that any credit funds would be rapidly decapitalized by inflation, thereby removing the possibility of creating a self-sustaining fund out of UNO's initial donations. (Both these issues are discussed in greater detail later.)

Finally, there was a certain feeling by UNO and its backers that charging for services, and becoming financially healthy thereby, was not the proper behavior for a voluntary organization helping the poor. When UNO was recently encouraged by the World Bank to raise its commission to higher than 3%, it felt that such a move would make it look "greedy"--as if it were interested only in padding its coffers and promoting its growth, rather than in "helping the poor."

Though proudly claimed by the Recife private sector as independent and unlike a public agency, in sum, UNO's potential for earning its own income was hardly explored. Instead, UNO was looked at as a work of charity, always to be sustained by donations from the outside, just like its clients. Seeing UNO this way probably made it easier to ignore the issue of financial self-sufficiency, as well as the existence of high unit costs and low productivity. In general, then, the half-heartedness of UNO's private-sector support meant that its chance for survival and growth as an independent entity were remote. In addition to the meagerness of their donations, UNO's business benefactors did not apply their acumen and their power to increasing UNO's chances for financial strength, or to generating more participation from the banks, or to pressuring the state bank to streamline its procedures for attending to UNO clients. At the same time, the private-sector support that UNO did receive was important in getting it started and endowing it with legitimacy.

Cutting loose

That UNO's backers had such high hopes for public-sector support showed that they viewed UNO as a very Brazilian institution. This was AITEC's payoff for firmly grounding UNO in the Recife business establishment. UNO's founders felt strong enough, moreover, to reject a continuation of the technical assistance agreement with AITEC only three years after UNO's creation. The main reason for this action, decided upon by the UNO board, was a growing dissatisfaction with the technical assistance of AITEC. The board felt that most of AITEC's financial support to UNO was being eaten up by technical assistance services that had to be purchased from AITEC as part of the agreement. In return, the board felt, AITEC was not providing very much of value to UNO and was really not equipped to do so. At the same time, UNO's board felt that AITEC had been a vigorous and dedicated promoter of UNO--first, in generating support for the idea of an UNO in the Recife business community, and then in raising funds from other foreign donors.

Another sign of AITEC's success at getting UNO grounded locally was a growing feeling of the UNO board and management that the association with the U.S.-based AITEC was becoming a political liability--in terms of UNO's hopes of obtaining funding from the Brazilian public sector, as well as from the better-endowed Brazilian firms of the south. AITEC's Brazilian affiliate in Rio, moreover, was seen by UNO and some others as not really "Brazilian"--because of the influence of AITEC in AITEC/Rio, because more than half the 13-member board of directors represented multi-national corporations, and because the executive director was American. AITEC and AITEC/Rio were proud of their success in creating UNO, of course, and conveyed their pride to others in Brazil; UNO's well-thought-of management was often portrayed as one with AITEC, even after the relationship became distant.[1] UNO grew increasingly embarrassed by AITEC claims of closeness, which made UNO feel as if it looked to others like "the Brazilian subsidiary of a multinational corporation"--rather than the truly Brazilian operation that UNO considered itself to have become. AITEC's claims, UNO worried, made it difficult to be taken seriously by the central government as a candidate for funding. This partly nationalistic reaction to AITEC and AITEC/Rio, it is interesting to note, emerged not out of a reformist group but out of the politically conservative and established business elite of Recife.

---

[1]AITEC's Summer-1980 bulletin, for example, describes UNO quite inaccurately, as almost a dependency of AITEC until 1980. "[The AITEC representative in Brazil] has been the force behind AITEC's effort to establish the successful mechanism known as UNO... [The representative] is confident that the mechanisms for assisting the micro-business sector are in place and he feels committed to leaving the remaining work entirely in Brazilian hands... Needless to say... [the AITEC representative] will be greatly missed." The statement appears four or five years after the formal relationship of AITEC to UNO had ended.

Regardless of the accuracy of UNO's and AITEC's perceptions, the importance of this story is that UNO's rejection of AITEC reflected AITEC's success at creating a truly local institution. Precisely because UNO felt it belonged to the Recife business community, and was strong enough to stand without AITEC, it came to see AITEC as a burden rather than a support. Given the history of many institution-building projects, it is remarkable that UNO felt able to stand on its own, and so fiercely local, only three or four years after its creation.

Like many private voluntary organizations, AITEC's purpose in creating UNO and AITEC/Rio was to build an independent local institution. The story suggests that AITEC was more successful in achieving this goal with UNO than it was with AITEC/Rio. Perhaps this was in part due to the fact that UNO was built around one particular city and its business elite, whereas AITEC/Rio had a more geographically and functionally diffuse mandate. UNO's more limited task and geographical mandate, then, may have helped it to take root more easily. UNO's board of directors, moreover, was never burdened with the large non-Brazilian representation that AITEC was in Rio.

Another important point about the above story is that though a U.S. organization like AITEC was able to generate support from a local elite like Recife's--and to work side by side with that elite for some time--the tolerance for a close association with a U.S. entity lasted only so long. The same AITEC that gained acceptance in the Recife business community was, a few years after its success at getting UNO started, looked at as sullying that success. UNO's change of heart, then, was partly a function of its becoming rooted locally and of the fact that the public sector was its only hope for significant funding.

UNO's embarrassment at being promoted by a "gringo" organization in the halls of the central government did not, it should be noted, extend to the World Bank. It was the Bank, after all, that had brought UNO to the central government's attention; the Bank, UNO and its backers felt, had put UNO "on the map" in Brasilia. Being promoted by the World Bank was felt to be prestigious, something to be proud of rather than embarrassed by. Clearly, this was because the World Bank was seen by Brazilians as a serious judge of project-executing agencies in Brazil, in the role as a major financier of Brazilian development projects. The Bank, moreover, was seen in Brazil as an international rather than a U.S. entity, a significant distinction for Brazilians, regardless of its accuracy in this case. Finally, the Bank was not involved in UNO's creation and early years, and thus could not lay claim to responsibility for its good qualities.

In the case of the World Bank, then, the promotion of UNO by an "outsider" came after UNO was formed and rooted. The Bank's relationship to UNO, moreover, was at greater distance than AITEC's, given that the Bank often dealt with UNO indirectly through the project hierarchy of the Brazilian public sector.[1] UNO's association with AITEC and AITEC/Rio, in sum, gradually became incompatible with UNO's becoming a local institution. The less-involved support of the World Bank and UNO's other foreign donors did not create this dilemma.

The role of sentiment against the two AITECs as U.S. organizations should not obscure the other important reasons for UNO's dissatisfaction with the AITEC relationship. Even before the AITEC connection became embarrassing, UNO felt that it was not getting adequate technical assistance from AITEC. AITEC simply had little to offer in the realm of technical assistance, UNO felt, in sharp contrast to AITEC's fine contribution in the area of promotion--in getting UNO started, grounding it in the local community, and raising money from international donors. AITEC's main contribution, in other words, seems to have been promotion around start-up activities, followed by "early" retreat from the scene. AITEC admits that it was short on technical expertise at the time of UNO's founding, since it had had no experience with credit programs until then, having worked exclusively in the area of community development. Now, AITEC says, it not only has 10 years of experience with UNO-like programs, but it hires staff members with training in business administration.

AITEC's better performance in promotion, as opposed to technical assistance, bears on two general points. First, the contribution of U.S. private voluntary organizations in the field of small-business projects is often portrayed as being one of providing technical assistance--as distinct from the emphasis on the promotional strengths of PVOs with religious origins. In this case, however, the U.S. voluntary organization was weak on technical assistance, but made an important contribution in promotion. A second general point is that UNO was not the only entity to judge its PVO creator weak on technical assistance and strong on promotion. The evaluation literature on PVOs has frequently made the same judgment. Might this mean that the qualities making for good promoters do not mix well with those making for good expertise and its

---

[1]In the interior project, through the regional development agency (SUDENE) and its office for integrated rural development projects in the Northeast (POLONORDESTE); in the Recife urban project, through the urban development agency (FIDEM) and the two municipal government agencies (URB and URJ) through which the project will be operating.

transfer? Whatever the answer, it is important to remember that even though UNO was "under-nourished" on technical assistance, it did very well as an organization. Promotion, in other words, may have been the more indispensable ingredient.

Finally and most unusual, UNO's termination of its close relationship with AITEC was achieved without rancor. Premature dissolutions of relationships between organizations and their creators usually end less smoothly. AITEC continued to contribute to UNO after the ending of the technical-assistance agreement, and a friendly informal relationship of consultation and exchange of information exists to this day.

Private Survival in the Public Sector

The Brazilian public sector supported UNO from the start, when it contributed 33% of UNO's first-year budget. That share never fell to less that 29% and, by 1981, had risen to 85% (Table 3). By 1977, moreover, only the public-sector bank of the state of Pernambuco was processing UNO loans, the two private banks having dropped out in that year. Finally, the support of UNO by the World Bank, starting in 1978, was crucial to UNO's survival and to its emergence from insignificance. By the end of 1982, UNO would be responsible for a small component in three large integrated projects negotiated by the Bank and the Brazilian government, and in which all the other executing entities were public: the integrated rural development project of the Pernambuco Agreste Setentrional (1979), the Recife urban development project (1982), and the Brazil-wide medium-sized cities project (1982). The funds supplied to UNO by the central government just for these three projects accounted for 26% of UNO's budget in 1979, 55% in 1981, and a projected 76% by the end of 1982.

I was surprised to learn that the public-sector share of UNO's budget was so important and had been from the start. UNO is usually described as an independent entity, growing out of U.S. and Brazilian private-sector support. UNO and its evaluators, moreover, always conveyed a sense of the organization's differentness from the public sector, and its independence from public-sector interventions. In certain ways, this impression was an accurate one: UNO is an independent entity, using public-sector funds on contract to certain government entities, and is unusual in the strong commitment of its staff and the leanness of its operations. But UNO's substantial public-sector financing, combined with its ability to maintain a considerable distance from the public sector, makes this story of "independence" much more interesting. How this all happened is the subject of this chapter.

The state and the private voluntary sector

UNO was founded at a time when the Brazilian government was creating, coincidentally, a national entity to provide technical and managerial assistance to small and medium firms. CEBRAE, the Brazilian Center for Managerial Assistance to Small and Medium Businesses, was founded in 1972 as a central-government agency that would create or link up to entities at the local level. Though CEBRAE offered mainly managerial and technical assistance--to small firms larger than UNO's clients--a credit operation like UNO still fell within the purview of CEBRAE's mandate. In contrast to UNO and some local public agencies dedicated to business assistance in several Brazilian state capitals, CEBRAE was very much a "top-down" entity, with a central office in Rio (and then Brasilia) that attempted to direct the various state-level entities to carry out standardized programs and procedures.

In making arrangements for its operations in Recife, CEBRAE did not devote much attention to UNO, which was working mainly with credit rather than technical assistance, and with firms considerably smaller than those to be assisted by CEBRAE. Instead, CEBRAE made its Recife contacts with an already existing public entity, NAI (Nucleus for Managerial Assistance to Manufacturing Firms). The existence of NAI in Recife, and CEBRAE's attempts to link up to NAI, affected UNO's evolution in important ways, as will be seen momentarily.

The public sector will often tolerate the independence of privately funded agencies like UNO when the state has no political interest in aiding that agency's particular client group. Sometimes, the state will even give its official blessing to the private agency's activities, so that it can take some of the credit for looking after the needs of that group.[1] In this sense, the public sector's funding of UNO (at low levels), together with its tolerance of UNO's autonomy, are perfectly understandable. Sometimes the state becomes intolerant of a private agency--meddling in its operations, or even swallowing it up, as occurred with UNO in Bahia. This change usually takes place as a result of the state's starting to take an interest in the hitherto neglected sector.

When the state starts to take interest, the causes for the meddlings and the takeovers are twofold. First, the state wants to gain more political returns from its investment in the agency by rewarding the politically faithful with its

---

[1]I discuss this at greater length, and give examples, in Tendler (1982a:76-104).

subsidized services; this usually violates the agency's technical criteria for allocation. Second, when the state takes new interest in a client group, it creates new entities like CEBRAE and NAI, which are its own; or it empowers old entities to move into the new area. The newly involved state entities will often not tolerate the presence of a private entity already operating in "their" area. When the private entity has public funding, like UNO, it is quite easy for the state entity to emasculate the private agency, simply by making the case that public funding for this activity should really be more closely within the state's control. CEBRAE, extending its power over the small-business sector throughout UNO's history, fit this image of the new and rapidly expanding state entity.

In light of the dynamic described above, how did UNO maintain its public funding, let alone increase that funding markedly, during a period when the state was moving into the microbusiness sector? Why was UNO's autonomy and private status tolerated when there were two public entities--CEBRAE at the national level and NAI at the state level--operating in the field of small-business assistance even before UNO came onto the scene? Why was a private entity like UNO chosen as the instrument for major expansion of the state's assistance to small firms in Pernambuco, through the three World Bank projects? If the state wanted to take advantage of the experience of UNO, why did it not simply absorb UNO, as occurred in Bahia? After all, UNO was so dependent on public funding by that time, that it would have had to shut down if its annual contracts with CEBRAE and the public entities financing the World Bank projects were not renewed.

The link and the buffer

Part of the answer to the above questions can be found in UNO's grounding in Recife's business community, and its support by an even better grounded NAI, which helped it to resist CEBRAE's attempts to take more control. NAI was created in 1969, along with similar units in other Northeast state capitals, within the Pernambuco state department of industry and commerce, with funding from the Northeast regional development authority, SUDENE (and some AID monies for training). Funded by contracts with SUDENE, the various state NAIs were meant to strengthen local industry in the Northeast; the same concern gave rise to the AID-financed RITA-Asimov project, which planned to create small "industrial parks" in the Northeast, starting in the state of Ceará. (The Asimov project turned out to be a failure.) Each NAI was a local undertaking, not related to any regionwide or nationwide program, and the contracting state entity might be a university, state company, state bank, or federation of industry--as well as a state agency, as in the Pernambuco.

A few years after the Recife NAI was created, the local business leadership of the state federation of industry and commerce petitioned to gain more control over the program by taking it out of the state government. This was done, and NAI started to charge for its technical and managerial assistance so as to have some independent source of income in addition to its public-sector funding. (Income from its charges now accounts for 40% of the NAI budget.) As a result of this move, NAI came to be considered very much the "property" of the Recife business community--more so than UNO--partly because NAI's client firms were more "respectable" than UNO's, and partly because of the independence provided to NAI by its charges for services.

Just as important in attracting Recife's business leadership to the cause of NAI was CEBRAE's attempt to impose its policies and standards on NAI. In Recife, CEBRAE was not starting from scratch in establishing an affiliated state office. The office already existed in the form of NAI, with strong involvement of a local business leadership that had its own ideas about how such a program should operate. CEBRAE, coming from outside with other ideas, was not able to overcome this local opposition, and had to compromise on the way in which NAI, and ultimately UNO, were brought into the CEBRAE system.[1] This did not mean that NAI and UNO felt they had gotten their way; both of them had little good to say about CEBRAE, complaining of the standardized procedures it attempted to impose, and the low priority CEBRAE gave to NAI and UNO when the annual budget squeeze occurred.[2]

NAI brought UNO to the attention of CEBRAE, telling CEBRAE that UNO's work would be worthy of CEBRAE funding. Why would

---

[1]The main disagreement between NAI and CEBRAE involved the latter's belief that NAI should become a consulting service to individual firms, whereas NAI emphasized its course-giving function.

[2]Critics of CEBRAE felt that the agency had made the political mistake of proceeding in a too highly centralized fashion, and thus did not build up the political support it would need as a new agency among the local businesses that would be its client groups. To the contrary, CEBRAE's actions were said to arouse opposition in Recife as well as some other state capitals. In its zeal to build a nationwide system, in other words, CEBRAE may have demonstrated a certain insensitivity to existing local activities in this sector, which operated with political support from local sponsoring and client groups. In this sense, UNO _did_ do better than a public-sector agency, grounded as it was in Recife's local business leadership.

NAI have concerned itself about support for UNO, which might well have developed into a competitor in the area of assistance to small businesses? The answer is simple: AITEC had grounded UNO in the same Recife business leadership that built up NAI. The president of NAI, during those early years of UNO, was also an important personage on UNO's board of directors. In addition, UNO's links to NAI had grown out of its having been set up to work in association with NAI in the early years. NAI handled the training to be given to the firms receiving UNO credit, and UNO did most of the work related to the choice of clients, preparation of credit proposals, and monitoring of repayment. (In the beginning, NAI actually contributed to these latter activities as well.) The NAI-UNO collaboration lasted until 1977, when UNO took over the training function, in addition to all loan processing activities. The early UNO link with NAI had given legitimacy to UNO in the eyes of contributing businesses and banks. Without the NAI connection, as one bank manager said, the banks would not have participated. AITEC agreed to the NAI-UNO association--though it was not particularly happy about encumbering the new organization this way--because of the support that it knew this would bring from both the public and the private sector.

UNO's association with NAI, in sum, determined its relation to its public-sector benefactor, CEBRAE, in various ways. First, UNO started out not only with public-sector funding, but it was set up to work in conjunction with an existing entity, NAI, which was public and at the same time had strong ties to the local business community. Second, NAI served as a lightning rod for CEBRAE's attempts to impose its own form of assistance to small enterprises at the local level. The struggles of NAI to defend its local prerogatives against the expansion of the central government into small-business assistance could not help but also benefit UNO. Third, the legitimacy that the NAI association gave to UNO in the local business community made it easier for UNO to resist the attempts of CEBRAE to push it around. NAI, in sum, brought UNO to the coffers of the public sector and, at the same time, served as a buffer between UNO and its most important public-sector funder.

The case of the wrong dichotomy

The story of UNO, NAI, and CEBRAE suggest that the dichotomy of public vs. private sector may not be the best way to interpret UNO's history--or that of the projects of many voluntary organizations. This dichotomy, so characteristic of the way people talk about the achievements of UNO and other voluntary organizations, obscures an important aspect of what helped keep UNO alive. If there were opposites in the UNO story, they might better be described as local vs. central-government interests--an opposition that provided UNO with substantial protection from its central-government funder. UNO support, that is, was forged out of a coming together of the private <u>and</u> public sector at the local level--a union that fed on opposition to a common "enemy," the central government.

The history of regional growth and politics in Brazil made the local-national dichotomy in the UNO case even sharper. Brazil's Northeast, somewhat like the United States' South, is the country's poorest region, and has always looked at the central government as unfairly representing only the more developed and powerful south-central region. The Northeasterners see themselves as victims of the "internal colonialism" of the Center-south, which is said to have exploited the Northeast through unequal terms of trade between the Northeast's primary products, mainly agricultural, and the Center-south's manufactured goods. The Northeast has felt that, in compensation for this inequity, it should have received more of the central government's expenditures than it has. At the same time, Northeasterners have often viewed with distrust the expansion of central-government programs into their area, since the central government and its agencies are seen as outsiders. Whereas the Northeast was continually demanding more funds, then, it was at the same time resisting the increased presence of central-government agencies that such expanded funding brought.

The struggle of NAI vs. CEBRAE, in sum, was not just the typical battle of local vs. central-government interests, but was also infused with Northeast "patriotism." Carrying out the struggle was a worthy deed for any local leader, regardless of the matter at hand. Because UNO was rooted in the Recife business community, and because central-government intrusions into local territory through CEBRAE happened to be taking place at the time of UNO's creation, the cause of UNO was transformed into a noble one.

The blurring of the public-private distinction in the history of UNO also arose out of the nature of UNO's (and NAI's) work. UNO and NAI were assisting small businesses, an activity in which the private sector could claim expertise and interest. The influence of business leadership is not uncommon in such programs, more so than in areas like public health or community organizing. That UNO's business was to assist small firms rather than do community organizing, in other words, made the combination of private-sector control with public funding less unusual than would have been the case with some other activities. What UNO evolved into, then, might be better described as a special kind of publicly financed entity with a special kind of independence from the public sector--rather than as a private entity that happened to obtain some public funding. Finally, the UNO (and AITEC) style of assisting businesses individually--rather than organizing them to gain more market power (as UNO's critics would prefer)--may also have been influenced by this admixture of public with private; Recife's business leadership might have been considerably less interested in an UNO that sought to organize firms for collective action to increase their market power.

Keeping away the competition

By the time of the new World Bank projects, UNO and NAI no longer worked in tandem, though they maintained good relations and cooperated on various matters. NAI, moreover, was now the official Pernambuco state representative of the CEBRAE system. Why would NAI have not wanted the large funding increases of the World Bank projects to go to itself rather than UNO? Why did NAI not use its influence to gain the upper hand?

The obvious division of labor between what NAI (and CEBRAE) and UNO were doing was an important reason for NAI's allowing UNO to step into the limelight. NAI was engaged in technical assistance and not credit, while UNO was almost exclusively a credit operation. (NAI leadership said that it had not wanted to go into credit initially because the state would have had to supply the credit and that would have invited too much "intervention.") Even though NAI might have wanted to move into credit--and indeed started to do so in late 1981 with about 30 microbusiness loans--it was clear that UNO was the only agency with a history of providing credit to microbusinesses. In addition, UNO's client firms were smaller than those of NAI and CEBRAE, which worked with "small" as opposed to "micro" businesses. Even when NAI opened a "microbusiness" line in 1981, its definition of a "microfirm" was twice as ample as UNO's: no more than 10 employees for service and retail establishments instead of UNO's 5, 20 employees for manufacturing establishments instead of UNO's 10, a maximum annual sales value for manufacturing establishments of 5,000 MVR in contrast to UNO's 1,465 MVR--and 2,000 MVR for retail and service firms in contrast to UNO's 1,047 MVR.[1]

More than half of UNO's clients were clandestine firms. They did not pay taxes, observe city codes, register with the city, or respect the labor legislation. This also defined a

[1]The MVR (Maior Valor de Referência) is a standard unit used for calculating various indicators. It is tied to the minimum wage, representing a little more than half its value. In 1981-1982 (May to April) the MVR was U.S.$46 (Cr$5,733). (Exchange rate is Cr$125.)

division of labor with NAI (and CEBRAE), which assisted only registered firms, even in their microfirm programs. This distinction may be important in explaining NAI's disinterest in UNO's clients. The state, after all, was looking the other way by providing funding through UNO to firms that evaded its taxes and codes. To instead fund these "illegal" firms through an entity of the public sector, like NAI, might have been politically less comfortable than doing so through a "private" agency like UNO.

UNO's clients were not only clandestine but they were also "low-class," compared to NAI's clients, and looked at as illiterate, traditional, and hard to work with. Visiting these firms could be quite unpleasant, set as they were in places of difficult access, amidst open sewers, with unpaved streets that were either dusty or muddy, and beset with pesky mosquitoes and unfriendly dogs. Even if NAI's clients were only a cut better off than UNO's, moreover, NAI had the comfort of dealing with them only at its office rather than at their place of business. UNO, in contrast, insisted on dealing with its clients at their place of business, which also may have kept the program from being coveted by others. UNO's clients, in other words, were stigmatized--and this helped to keep other agencies away.[1] The small-business field was broadly enough defined, in turn, that there were plenty of firms at the upper end of the range that were easier and more pleasant to work with.

UNO's philosophy and operating style, in sum, gave it a certain natural protection against intrusion by the public sector. It insisted on clients being visited and monitored in their place of business, no matter how long the trip might be or how difficult the access. It insisted on working with clandestine firms, and even discouraged these firms at times from becoming legal (as discussed later). And unlike many credit programs for poor producers, UNO stood vigilant against the drift toward larger clients and larger loans that characterizes many subsidized credit programs for poor producers. All these qualities defined a place for UNO in the small-business field that did not compete with what the expanding public-sector agencies were doing. That UNO was interested in "outcast" firms, then, contributed to the autonomy it desired in the public-sector world.

---

[1]The stigmatization of a client group is one of several possible ways of keeping poor beneficiaries of a project and their service agency protected from incursions by better-off pretenders to the project's subsidized services. I have discussed the effectiveness of this and other ways of separating the rich from the poor in Tendler (1982b).

UNO From Within

Until now, I have emphasized UNO's links to its environment in explaining how that organization evolved. In this section, I would like to discuss certain qualities of UNO that are common to many private voluntary organizations--smallness, insularity, insignificance, and the limited nature of the task. These qualities were at least as important in UNO's formation as the links to the public and private sectors.

UNO the plodder

In the eyes of some of UNO's sympathetic critics, the recent events leading it into a web of relationships with public agencies augur well for the organization, rather than poorly. According to this view, UNO has been a somewhat plodding, parochial, and isolated entity--not willing to listen to others, loathe to share data on the results of its lending, stubbornly insistent on doing things its own way, and uninterested in establishing contact or sharing ideas with public agencies doing innovative things in the informal sector. The characterization is a fairly accurate one,[1] though I would not put these qualities in a purely negative light; while they were indeed responsible for some of UNO's shortcomings, they also contributed to its success.

The vision of UNO as a plodding agency has something to do with its caution. It engaged in only one "limited" activity--loans to individual firms. It does not organize producer groups, through which credit might be channeled. (It started to do so in its interior program only under pressure from the World Bank and the Brazilian coordinating agencies.) It lends conservatively, mainly for working capital rather than investment (75% vs. 25%). Manufacturing firms, with their greater risk and potential for employment and output growth, are subordinate to retail firms in the distribution of loans (24% vs. 42%). UNO does not give technical assistance to its manufacturing and service borrowers, even with respect to equipment purchases. Finally, UNO's style of operating today is almost exactly the same as it has always been, at least in Recife. Aside from some streamlining of the loan application process, it has not added new things or dropped old ones.

---

[1]With the caveat that I found UNO staff and management to be extremely cooperative in sharing their data, their experiences, and their opinions with me.

In defense of UNO's singlemindedness, it should first be said that providing "only" subsidized credit to individual businesses is not an easy thing to do. Subsidized interest rates and easy terms attract credit applicants who are usually able to borrow directly from the bank, and many credit programs have not done as well as UNO in resisting the pressures to make larger loans to larger borrowers. The high repayment rate achieved by UNO, moreover, is also not an easy accomplishment.

Programs that attempt to open up access of the poor to institutional credit always have difficulty with the banks. Though the banks may agree to participate in an UNO-type program, they often do not put much effort into resolving the major problems of delay and excessive demands for documentation and guaranties. Thus only in late 1981, almost 10 years after UNO's founding, was credit being released by the state development bank with less than several weeks' or even months' delay. That it took this long to get the cooperation of the state bank, of course, was a sign of the political weakness of UNO and its client group; this is in sharp contrast to the relatively short period it took to resolve the problem in the interior program (one year), when UNO had a powerful backer behind it, the World Bank. Until this kind of very serious problem was resolved, it might have been unwise for UNO to expand into other activities. UNO could have more easily diminished its problems with the bank, as other programs do, simply by moving up to a somewhat higher class of borrowers. But UNO stood firm in its allegiance to the unattended microfirms. That the problem of delay was ultimately resolved represents an achievement--a certain political recognition by the state banking system of UNO and its client group.

Some of UNO's singleminded behavior puts it in good standing with the recent evaluation literature on small-business programs. With respect to UNO's shying away from investment credit, some recent studies have suggested that credit programs often overemphasize investment to the neglect of working capital (e.g., Anderson and Khambata 1981). The shortage of working capital has been seen by these studies as a more significant constraint to firm growth than long-term capital for investment; bad loans have often been concentrated among firms borrowing for investments that they were not able to sustain for lack of working capital. UNO's lending to retail establishments, which account for about half its loans, is also conservative and has no doubt contributed to its high repayment rates--despite criticism from those who felt that credit to retail firms, as opposed to manufacturing and service, did not maximize employment and output impacts. The retail and working-capital emphases of UNO, and the evaluation literature referred to above, are discussed later in the section on repayment.

UNO's dogged pursuit of "just one thing" may also have contributed to its survival. The task of integrating more than one activity in an organization makes its work much more complex than if it has only one thing to do. UNO of Bahia, for example, is said to have failed to resist absorption by the state government partly because it was too innovative, too interested in taking on new things, trying too hard to fill all the gaps. Soon after the founding of UNO/Bahia, which was more successful than UNO/Recife in terms of private-sector donations, AITEC/Rio decided to launch an affiliate in Bahia that would offer venture capital to expanding microfirms (MICROPAR). This was in direct conflict with the preferences of UNO/Bahia, which felt that such an operation would deal only with the better-off clients of UNO and thus dilute the program's emphasis on working with firms beyond the reach of public-sector programs. MICROPAR not only created dissension and confusion in the UNO/Bahia program, but it failed. UNO/ Bahia embarked on new programs in the suburbs of the Bahian capital and the interior--after fewer years in existence than UNO/Recife, which still had not ventured out of its metropolitan area. These new programs were soon absorbed by the state department of labor and social welfare, and were ultimately doomed by the lack of public-sector credit funds. These different histories of UNO in Bahia and Recife are consistent with a recent finding in the evaluation literature that projects which modestly supply a single "missing" ingredient fare better than those "calling for simultaneous actions on several fronts" (Kilby and Bangasser 1978:352; also DAI 1979, and Tendler 1976).

UNO's singlemindedness also helped it to remain independent. Taking on additional activities often requires coordination with other entities. Since UNO did not have the resources to provide technical assistance to its clients, for example, it would have had to contract for those services with another agency. (This is what UNO is now doing in its interior program, where funding is more abundant and a contract has been made with the state technical-assistance agency, ITEP.) UNO's performance, of course, was already extremely dependent on another agency outside its control--the state development bank. That single link, as explained above, created severe impediments to UNO's successful functioning. Thus if UNO had been more dynamic, more related to others, and more experimental, this would probably have involved links to other agencies, and more opportunities for them to exercise control.

UNO's parochialism and isolation from other agencies contained still another advantage. A study of 11 technical assistance projects in Africa, most involving small industries, viewed isolation of project organizations from the rest of the public sector as desirable, rather than undesirable (Kilby 1979:319). This study emphasized the isolation provided by geography; the most successful projects were geographically remote from the rest of the public sector and hence less vulnerable to intervention. UNO's "geography," in contrast, put it right at the hub of the public sector--at the center of a city that was a state capital and the home of the Northeast regional development authority. UNO's insular style, however, may have compensated for this excessive geographical closeness, serving as a proxy for physical isolation.

Though UNO was all the bad things noted above, in sum, those same things played an important role in its success--achieving high repayments, retaining considerable independence, reaching firms with no previous access to credit, and gaining a reputation as serious and honest.

Virtue and small budgets

Much of UNO's mode of operation, as described above, has been less deliberate policy than it has been financial prudence in the face of a budget that hardly increased (in real terms) during UNO's first five years. This is partly behind the emphasis on retail firms, the feared risk of lending too much to manufacturing and service firms, the lack of technical assistance, the disinterest in forming producer groups, and the lack of selectivity with respect to firms and sectors with potential for growth and employment. UNO's budget was not only constant during this period, but there was often uncertainty as to whether the annual contract with the public sector would be renewed and for how much. With respect to CEBRAE funding, which accounted for 30% to 50% of the budget from the start, UNO was never sure until well into the fiscal year how much it would actually receive of the budgeted funds. The only certainty about CEBRAE funds, UNO felt, was that they would always be significantly less than programmed for.

UNO was not unique in suffering the problem of cuts and delays in its public funding. Partly because of the high rates of inflation in Brazil, most public programs are subject to these delays and last-minute reductions; budgeted monies will often be released to the program only several months after they are due, with the result that agencies frequently cannot meet their payrolls. These shortfalls in central government revenues bring about an extra stage in the political process of allocating public resources between programs and agencies. Policymakers do not simply make uniform cuts or delays across programs, but use the occasion of shortfalls to impose their ideas about which programs are less or more important. Programs with less political support than others will therefore be cut relatively more--something that has happened various times, for example, to the Northeast rural development projects.

CEBRAE funded many other activities in Brazil besides UNO, even in the state of Pernambuco; UNO, in turn, did not "belong to" CEBRAE and was therefore not as responsive to CEBRAE as many of its other affiliated local bodies. There was good reason, then, for CEBRAE to subject UNO to greater relative cuts than its other activities.[1] In some ways, then, UNO was plodding because it perceived itself as having no choice. Given its tight and uncertain budget, more ambitious or innovative behavior could have jeopardized its survival. In face of the greater dynamism of UNO in Bahia, coupled with its ultimate demise, one suspects that UNO may have been wise in proceeding as snail-like as it did.

As with many voluntary organizations, UNO and its supporters have been proud of their tight budget. They have talked about the budget constraint almost like a welcome deprivation, which helped form strong organizational character. They have looked at public-sector agencies, in contrast, as dens of excess job security, overfunding, slothfulness, gigantism, and political meddling. (UNO salaries are as much as 50% less than public-sector salaries, and UNO employees do not enjoy the job tenure of public-sector employees.) UNO, as a member of its board of directors said, was not one of "those megalomanic projects." UNO's smallness and inability to grow, in sum, were depicted as virtues.

Extolling the virtues of smallness and rueing the size of public-sector bodies are common ways of talking among private voluntary organizations and their workers.[2] UNO is no different. But because of this talk, UNO's high cost of lending and low productivity came as a surprise to me, particularly given the conspicuous leanness of the organization. Its administrative overhead costs are only 10% of its total budget, as UNO likes to tell, and it is considerably less endowed than many public agencies--fewer vehicles, less reproduction and calculating equipment, fewer telephones, less support staff. It does not have the large spaces and barriers that typically divide the director from his staff. How could such a lean organization have such high costs? Does it make no difference

---

[1] I was not able to verify, independently of UNO's contentions, whether UNO actually suffered greater relative cuts.

[2] Thus many PVOs tend to be critical of largeness _per se_, whether in the public or private sector. Lissner (1977) has an interesting discussion of this set of attitudes toward the public sector, explaining it in part as a result of feelings of inferiority and powerlessness by voluntary organizations with respect to the public sector.

in efficiency to take away the slackness of better endowed programs?

Part of the answer to these questions is that when UNO and other PVOs talk about doing things "cheaply," they actually mean small total expenditures rather than low unit costs or high productivity. Or, they mean low expenditures for certain conspicuous items. The "cheapness" of using part-time temporary students is an example: because expenditure on them is significantly less than for permanent workers,[1] their "low cost" is assumed to signify a low-cost service. The assumption would be accurate enough, given the high share of personnel costs in total costs (85% in UNO's case), if productivity were also high--a matter I return to later. "Low overheads" are also pointed to by voluntary organizations like UNO as a sign of efficiency, partly because high overheads are associated in people's minds with extravagance and slackness. Alone, however, overhead levels say nothing about the relative cost of providing the service. Cheap students, low overheads, and small budgets, in sum, get mistakenly identified as indicators of unit costs or productivity. Only these latter concepts, however, allow one to determine that one way of doing things is less costly than another.

The mistaken identity of low absolute expenditures with efficiency is enhanced by a certain moral virtue that is attributed to an organization working under a tight budget. UNO is proud of its pinched funding and considers its virtues to be a result of that privation. The financial constraint, in other words, is looked at as a hard taskmaster in forming committed staffs and inducing careful selection of clients. The virtuousness of low expenditures, however, can easily coexist with extravagance in the use of time, as will be seen in the section on UNO's costs. If the pinched budgets of voluntary organizations have favorable effects, then, they may lie more in the important area of dedication and commitment, than in that of unit costs and productivity. The one set of accomplishments should not be confused with the other.

It is puzzling, at least to an economist, that severe budget constraints would not lead to greater concern for productivity in an organization--that lean organizations would not show low unit costs. The question of impact helps resolve this contradiction: because small organizations are often not asked to demonstrate impact or significance, they are not forced to worry about how to reach the maximum number of persons with a

---

[1]For UNO, a temporary student worker costs half what one would have to pay for a permanent employee, including the latter's fringe benefits, which add 50% to wage costs.

given level of funding. Indeed, smallness seems to get used as an excuse for not thinking about these things; one is too little to have any delusions of impact. Thus it is that UNO considers itself too small to even presume to reach a significant number of microfirms--even as little as 10%. Yet the concern for significance, or the necessity to show it to benefactors, may do more than low budgets to force organizations to look at their unit costs--because the lowering of these costs will be the only way to reach for impact.

The lack of concern for matters like cost-effectiveness and impact can also be explained in terms of the way voluntary organizations perceive their work. Helping the poor is seen as not only improving the lot of the poor, but as also ennobling the helper. Doing a worthy deed is an accomplishment in itself, that is, just so long as total costs are not out of hand; if the program remains small, the latter condition is easy to meet. From this point of view--a variation on the "good works" theme mentioned earlier--the goal of assisting the largest number of people possible within a given budget may not be that relevant. Small voluntary organizations like UNO, finally, keep very busy just struggling to stay afloat, always scrambling for next year's funding. What helps most in such tenuous times, as the UNO story shows, is political connections and conspicuous goodness as an organization, rather than efficiency. Perhaps it is for this reason that almost none of the evaluations of UNO to date, curiously, have noted its low productivity and high unit costs.[1]

Worrying about productivity, strangely enough, may be a luxury reserved for larger, more secure, and better funded organizations. They are under pressure to attend to large numbers of people, their high unit costs turn into more conspicuous total amounts when they are larger, and it will take a certain amount of slack and money to discover that productivity is low and to experiment with ways to improve it.[2] Whereas the

---

[1]Partial exceptions are DGAP (1978) and a PACT-sponsored evaluation, which showed concern over UNO's high unit costs, but did not look into the reasons for its low productivity. The DGAP evaluators said in 1978 that "costs are falling" (p. 43), which Table 1 shows to be inaccurate. They projected costs to decrease to 50% of loan value by 1978 (they were actually 125%, as Table 1 shows), and to 30% in 1979 (when they were 131%). AITEC felt that the costs could be reduced to as low as 15%-25% (costs were 46% in 1981, and projected by UNO to fall to 38% in 1982). DGAP and AITEC projections from Ibid., pp. 11-12, 20.

[2]A small UNO-like program in Ecuador, run by a private bank, decided to dispense with evaluations of results and other internal control mechanisms in order to "reduce costs" (PISCES 1981:223).

large public-sector organizations may not experience the discipline of a small budget, then, they are subjected to another discipline that the small organization is not--that of having to please a significant enough number of clients to justify what they do and receive continued political support. At the same time, these larger and more politicized organizations operate with more slack, more expenditure on certain items, and less commitment.

I am not saying that either smallness or the impact constraint produces a better or more efficient organization, or that the public sector in Brazil has been able to reach UNO-type borrowers at all, let alone at a more attractive cost. Rather, I am arguing that PVO leanness is not incompatible with high costs and low productivity, and that the discovery of UNO's high costs and low productivity should therefore not come as a surprise. It _is_ a surprise only in light of the oft-heard claims that UNO and similar programs do things "more cheaply" than the public sector. The superiority of UNO and other PVOs to the public sector, then, may hold only if they remain small--that is, if they never reach the scale and attempt the impact that public-sector undertakings do. An UNO blown-up to public-sector size--with its low number of loans per worker and its high costs per loan--would be unviable.[1] In this sense, the comparison with the public sector may be of limited value, giving little guidance about how to go about tasks with public-sector breadths.

With UNO's rapidly increasing funding over the last and next three years, it is now moving into that better funded stage where it can afford to, and will be made to, worry about productivity and unit costs. That unit costs have already decreased over the last three years as the result of a conscious effort in that direction, as discussed below, may be a portent of such change.

UNO at the Crossroads

The question of whether UNO's virtues would be relevant to a similar program of public-sector breadth is anything but

---

[1]This finding is not peculiar to UNO or small-business programs. A study of special or experimental health, nutrition, and family planning projects in India--many of them carried out by voluntary organizations--drew similar conclusions: even among the successful projects, per capita expenditures were four times those of the public sector, and the population reached was minuscule (Faruqee and Johnson 1982:v, ix.).

academic. With the three World Bank projects, UNO is now undergoing the acid test. Between 1978 and 1985, its number of offices will have expanded from 1 to 13, the number of loans per year from 150 to 3,000, and size of its staff from 46 to 288. Just as significant, UNO is starting to do things it has not done before--offering technical assistance to clients, working with groups of producers, and providing an expanded training program for firm owners. These activities take UNO beyond the simplicity of "the UNO model" and bring in new bureaucratic actors with whom it must now, for the first time, coordinate its work--the state technical assistance agency (ITEP), the state agencies for apprenticeship training in commerce and industry (SENAC and SENAI), and the state program for employee training (PIPMO).

Being part of the three large projects also introduces UNO to the new control of the coordinating agencies--POLONORDESTE in SUDENE, FIDEM in the Pernambuco state government, and two city governments (Recife and Jaboatão), the mayors of which are running for governor, vice-governor, or federal deputy in the elections of late 1982. UNO's subordination to CEBRAE will also continue, with 70% of UNO credit funds being channeled to the state development bank through CEBRAE, in addition to the 18% CEBRAE contribution to UNO's operating budget in 1982. The local office of CEBRAE, moreover, is a part of the Pernambuco state department of industry and commerce, the director of which is also running for election in 1982, as a candidate for deputy. Thus UNO has suddenly been drawn closer to the center stage of politics and the public sector in Pernambuco. This development is a result of its success at getting noticed by the World Bank and incorporated into the Bank's projects.

Agencies participating in World Bank projects are not always drawn into a web of new bureaucratic relationships and subjected to new political pressures, as in UNO's case. The Bank's presence often has the contrary effect; the project agency finds a powerful ally in the Bank when it tries to fend off politicians and other agencies. UNO is different because it is a minor agency in a large project, and hence its relation with the Bank tends to be filtered through the Brazilian agencies that coordinate the wider project. Since these coordinating agencies represent some of the forces that UNO wants to stay away from, the lines are not clearly drawn between the "bad" agencies or political actors intervening from outside the project, and the "good" agencies needing protection inside the project. For the Bank to be a faithful ally of UNO, then, would be difficult--in that it might require protecting UNO from another, more important agency <u>inside</u> the project.

The increased relatedness of UNO to other agencies and the heightened vulnerability to political pressure do not necessarily bode poorly for UNO's future. These factors may result in an UNO that is more responsive to questions of impact, more innovative, or more concerned about raising its productivity. But to the extent that independence and simplicity accounted for some of UNO's good qualities, those qualities are bound to undergo some change.

Politics, magnetism, and protection

Though UNO has remained relatively independent until now, it has always suffered some pressure from politicians or public agencies regarding its credit allocation and other operational decisions. Most subsidized credit programs like UNO are sitting ducks for political interference in decisions about who gets credit. The interest rates and the repayment terms are so subsidized that they act as a magnet to those with the power to wrest favors from the government, or those with whom politicians want to curry favor. Real interest rates are so low that it is a worthwhile investment for the borrower to take out a subsidized loan and reinvest the money elsewhere--a well-known activity for borrowers of subsidized agricultural credit in Brazil, many of whom invested their loan monies in urban real estate. With interest on common savings accounts in Brazil now at more than 100% per annum, the UNO borrower would not need much sophistication to comprehend that he could earn a substantial "return" on his 25% UNO loan, simply by investing it in a savings account. A little more than half the UNO borrowers I talked to had savings accounts, and some freely admitted that they "put away a little" of their loan proceeds in the savings account; an UNO survey found the same.[1]

Applicants for credit who have enough influence to get the rules bent are usually better-off than the intended clients of subsidized credit for neglected groups. As a result, these programs tend to drift upward in the income distribution; loans get larger, and clients are less poor than was intended. UNO, like all such programs, experienced pressures to divert its credit to applicants who did not fit the lending criteria--for example, in requests from the state governor to give special attention to certain applicants. But UNO succeeded in deflecting most of these requests, patiently referring the solicitant or his political benefactor to UNO's long list of exclusive lending criteria. That UNO was able to resist most of these

[1]UNO 1980-1981. I do not suspect that this "reinvestment" of UNO loans in savings accounts occurred to a significant degree. Of course, to the extent that borrowers used UNO money instead of savings, the UNO credit simply substituted for their own money.

requests, and still receive public-sector funding, is remarkable.

Until the advent of the World Bank projects, UNO's low levels of lending, its lack of growth, and its reluctance to take on other activities besides credit, protected it from other kinds of political pressures--namely, those associated with the provision of physical goods or equipment, or the inauguration of new physical structures, like new branch offices or equipment-rental centers. The conspicuousness of these structures and equipment, especially in concentrated urban neighborhoods, makes them highly desirable politically. UNO's expansion under the three World Bank projects has suddenly made it vulnerable, for the first time, to the political pressures associated with physical structures. Under the interior project starting in 1979, for example, UNO had planned to open various new branch offices over a three-year period, having previously had only one office in Recife. A state legislator, up for re-election in one of the interior counties scheduled for a new UNO office, put pressure on UNO to open the office immediately, so as to coincide with his election campaign. This would have meant initiating the program in that county three years earlier than planned. UNO succeeded in freeing itself of the deputy's entreaties only by appealing to a higher political authority--the governor of the state. The governor, a friend of UNO, insisted that the project's timetable be observed; the office would open only in the third year, as planned.

Political pressures were also significant in determining the organizational design of UNO's major expansion in metropolitan Recife under the World Bank project, to start in 1982. The project provides for the opening of six new UNO offices (to be rented) in Recife's metropolitan area. Originally, UNO was to be contracted under the project by FIDEM, a Pernambuco state urban planning agency for metropolitan Recife. (Until now, UNO has worked only under contract to CEBRAE in its Recife program.) FIDEM is considered to be a "technocratic" and fairly apolitical agency, or at least willing to defer to UNO's judgment on technical matters. The elected city governments of two of the cities in metropolitan Recife (Recife and Jaboatão), however, wanted UNO to relate directly to them, rather than to FIDEM. (The mayors of the other cities, not as politically strong or aggressive as the other two, were content to allow FIDEM to manage the UNO contract.) The final outcome of these political concerns was that UNO would work under <u>three</u> contracts, instead of the one originally envisioned with FIDEM: two contracts would be with the urbanization agencies of the two cities with the politically vigorous mayors, and a third contract for the three remaining cities would be made with FIDEM. Under the FIDEM contract, UNO would choose its own new office space; under the Recife and Jaboatão contract, it would rent office space in the urbanization agencies of those two cities. For obvious reasons, UNO felt more comfortable about its independence under the FIDEM contract than under the other two.

A final example of the increased political vulnerability brought by UNO's expansion and diversification relates to a plan to build neighborhood equipment centers. Under the Recife project, the two city governments contracting with UNO will build neighborhood equipment centers where microfirms can use equipment at a rental fee. After a time, it is expected, groups of microfirms organized by UNO will acquire and run the centers themselves. Though UNO is skeptical about the viability of such a program, the city governments are enthusiastic. The inclusion of the centers in the project against UNO's better judgment is probably a manifestation of the greater political desirability of neighborhood equipment centers, and their inauguration opportunities, than of a program dispensing only credit.[1]

UNO's inclusion in the World Bank project, as noted above, increased the number of contact points between UNO and public-sector agencies. This gave the latter, as coordinating agencies for the complete project, some control over UNO. Under the rural development project, for example, UNO became linked with one of the major public institutions in the Northeast--the regional development agency, SUDENE--and the department in charge of all Northeast integrated rural development projects, POLONORDESTE. The much greater size and power of this institution meant that it was going to take the prerogative in determining how UNO would do some things, which indeed it has done. UNO sees its new place in these project hierarchies as making it vulnerable to other more powerful agencies. In contrast to its own caution about taking on too many new things, UNO feels that these agencies want to add new programs and make

---

[1]UNO's skepticism about the equipment rental centers is not without good reason, since many such projects have been unsuccessful in Brazil as well as in other countries. See Kilby (1979:316) for one report on these projects and the reasons for their poor performance. Kilby also comments on the political appeal of production centers, as "photogenic" and "highly visible," making "a good impression on evaluation missions and visiting dignitaries." He also found that one of the four characteristics of the projects with low benefit-cost ratios was the use of "extensive resources in constructing physical facilities" (p. 321). (The other three characteristics were a low number of clients assisted, delays in project implementation, and excessive administrative overheads.)

other changes out of a desire to build their own political strengths and increase their own staffs.

Regardless of whether the new ideas and directives will make UNO better, UNO is clearly less independent and more politically exposed than it was before. Although it is pleased about its expanded funding under the new projects, it at the same time yearns for its earlier days of insignificance, when independence and integrity could be greater. The smallness and insignificance of UNO's early years, in sum, were partly responsible for its freedom from outside interference.[1]

UNO's increasing closeness to the public sector has also had its desirable side. It has brought badly needed political support and protection from political meddling, not just from intervention. The same state governor who protected UNO from the campaigning state legislator also threw his political weight behind UNO on another occasion. On that latter occasion, UNO was not suffering from political pressure, but from the apathy of the state development bank in resolving problems of delays in credit contracting and disbursement in the new interior program. After months of trying to work out the problem with the state bank, UNO finally made progress only by going directly to the governor, who intervened on UNO's behalf. The delay problem was immediately resolved.

This helpful political intervention was no doubt the result of UNO's reputation for competence, which had helped bring politically prestigious outside funds to the state for a microfirm component in the World Bank project. Politically, in other words, UNO had proved itself worthy of protection. The case of the campaigning legislator cited above, and the protection from him provided UNO by the governor, is a similar example. Thus UNO's proven seriousness, its backing in the business community, and its coexistence with other public entities helped increase the incidence of "desirable meddlings"--those that protected UNO from the public sector, rather than engulfing it.

---

[1]Kilby (1979) and Kilby and Bangasser (1978:352) come to similar conclusions about the desirable features of smallness. With large-scale, "multi-expert" projects, they say, their "prominence alone attracts a great deal of outside interference." They list another undesirable feature of such projects that is consistent with the discussion of the equipment centers above--namely, that large projects tend to build new capacity rather than increase the utilization of existing capacity.

UNO as a model

Perhaps the lesson to be learned from UNO's history is that in order for an organization to be successful at what UNO will do under the World Bank projects, it will, like UNO itself, first have to become strong. To do this it will first have to become fit through independence, a simple task, constrained funding, and a highly committed staff. If UNO succeeds in its expanded form, according to this interpretation, this will be a result of its having first had several years to become strong, and not because it was using a good model for providing credit. The high unit costs and low productivity of the model made it unsuitable for providing credit, but its simplicity helped the organization to become strong. UNO may have needed a long, plodding, and insular period in order to consolidate and build its sense of self, and then open up to the outside world. It may now have the strength and the knowledge to withstand the dangers inherent in its new, expanded role--qualities it would not have had if it had started doing things that way from the beginning. UNO's success, if it turns out that way, will therefore have been partly the result of its "failure" to receive additional funding and to grow during its first six years--a success based on enforced smallness. Smallness will have turned out to be good for character formation, then, though not necessarily for creating efficient and economically significant ways of providing credit to microfirms.

If UNO emerges successful from its transition, then, what will have been demonstrated will not be the effectiveness of "the UNO model," but of the organization itself. A much larger UNO, that is, will not be able to operate with such low productivity, high unit costs, and inattention to socio-economic significance--as reflected in changes in UNO's operating style that are already being brought about under the Bank projects. Thus the value of the UNO model will not be that of showing how to provide credit to the microfirm sector but, rather, of suggesting how one creates a "good" organization--or, at least, an organization with the good qualities described here.

If my representation of the UNO story and transition is accurate, then our concept of the pilot project also needs modification. A pilot project may not really be a test of how to carry out an activity--which is how we usually conceive of it--but rather of how an organization gets built. This view would certainly help explain why the evaluation literature has sometimes shown that the successful projects among a set of pilot projects share no common characteristics. An evaluation of small projects in Latin America--many involving small business credit or assistance--found that the only thing shared by the successful projects was that they were carried out by the "stronger organizations."[1] The successes of a very different set of pilot projects--in the field of health, nutrition, and family planning in India--were also found to have no characteristics in common (Faruqee and Johnson, 1982:44).

Building and testing an organization, then, may sometimes be done better with techniques of operating that are not necessarily the best suited to the task at hand. If the pilot project works, according to this interpretation, the result will be an organization that will know how to feel its way toward techniques that are appropriate to a full-scale stage. The most desirable technique may be too complex for a new organization, too exposed to the influence of others, too dependent on intimate experience with the beneficiary group. Thus if one tests the desired technique from the start, the organization may not be able to handle it. The resulting failure of the pilot project will then be mistakenly identified as a failure of the technique--when it may actually signify a failure of the organization resulting from premature adoption of the technique.

Building an effective organization, in sum, may be more difficult in some instances than finding the best way for it to carry out a certain task. Succeeding in a first task--any task--can set the wheels in motion for success at the second. In these cases, the "genuine" pilot project would therefore assign an organization some simple tasks suitable to the development of the organization, but not necessarily the best way to conduct that particular activity. Once the good organization was built, one might not need a pilot project just to test the technique. The competence, wisdom, and strength acquired by the organization in its pilot stage would assure its intelligent choice of workable techniques for its full-blown stage. In this view, it would be only natural that the operating style of the "pilot project" would be undesirable, as in the case of UNO, for expansion. This is one way to reconcile the seeming contradiction of UNO's success as an organization and failure as a model.

---

[1] Inter-American Development Bank files.

III - The Program

I have organized the findings on UNO's operations into five subjects: (1) the high costs, the low productivity, and their causes; (2) the high repayment rate and its explanation; (3) the "graduation" of UNO borrowers to direct bank credit; (4) UNO's success at keeping out large borrowers; and (5) the training program for microfirms. Though the facts and interpretations could easily be presented in other ways, I chose to organize the material around these subjects because of their importance to general discussions about small-enterprise projects and about private voluntary organizations as development agencies.

Why Does It Cost So Much?

From 1974 through 1979, the average value of an UNO loan was U.S.$2,000 (Cr$190,700) and its average cost was U.S.$1,700 (Cr$155,500).[1] This amounted to an average cost of 85% of loan

---

[1] See Table 1. Data on processing costs of the bank for UNO loans were not available and therefore are not included in this figure. I have used UNO's total budget expenditures to estimate cost per loan for the following reasons. UNO engages in little other activity than the making of loans. The only exception is the courses provided intermittently to microfirms by its permanent staff. Though UNO estimates that these courses represent 30% of its expenditures, it has made no direct calculation of that cost. (UNO does not have a separate teaching staff, but draws on the same permanent staff that supervises borrower selection and approval.) Because part of UNO's public-sector revenues are earmarked for these courses, and based on my own observations, I suspect that the share of the budget spent on training is considerably less than 30%. I also chose not to exclude the cost of the courses so as to roughly compensate for the lack of information on the bank costs involved in making UNO loans. Though these costs would be small compared to UNO's--since UNO does all the field work and much of the paperwork--I was not able to determine what they were. Even if one were to subtract the full 30% for training from the cost figures, the results ($513 per loan and 32% of loan value) are still substantially higher than the examples from other programs cited in the following paragraphs. Finally, and most important, I preferred to use UNO's total expenditures because this was more consistent with the data available to me for comparison to other programs (see following paragraph in text). These data also did not allow for identification and exclusion of costs not directly related to lending. Other information of use to those who may want to recalculate the costs is the following: (1) personnel costs (including 50% charges in salaries for fringe benefits, and per diem for fieldwork) amount to 85% of total expenditures, and (2) overhead is estimated at 10%.

value, having risen above 100% for three of the six years (not the first three). Throughout the period, moreover, these costs showed no tendency to decrease, and fluctuated around the average. To UNO's credit, costs seemed to begin a downward trend in 1980, with 1981 unit costs at half their 1974-1979 levels. Though still high, average cost per loan had fallen to U.S.$733 (Cr$66,900) by the end of 1981, amounting to 46% of average loan value. Costs were projected to fall further in 1982 to U.S.$587 per loan, 38% of loan value.

Costs of this magnitude are high. Though cost data on other small-business credit programs are fragmentary and not consistently calculated, they suggest that costs tend to range up to 20% of loan value--with some significantly higher exceptions. Administrative costs for eight banks involved in lending to small businesses in Colombia, India, and Korea averaged 2% of average total assets and varied from 0.4% to 6.3% (WB 1978:41, T-2). (The banks were state banks except for a few private banks in the Colombian case.) In the Philippines, administrative costs for the small-scale loans of two lending institutions were 3% of loan value (Chuta and Liedholm 1979:70). (For large loans, the corresponding percentage was 0.5%.) A World-Bank study of programs to assist small enterprises reported that, though costs vary widely, 5% of loan value is not atypical (Anderson 1981:75). Research on lending costs of a private development foundation in the Dominican Republic, which specializes in small loans, showed administrative and capital costs to be 10% of loan value (Adams and Romero 1981:221). The administrative costs of a small enterprise program in Mauritius were 13% of loan value (Timberg and Raghavan 1982:169). Finally, the costs of a program in Ecuador that was modeled after UNO are a fraction of UNO's--13% of loan value and U.S.$138 per firm receiving credit, in contrast to UNO's costs of 46% of loan value and U.S.$855 per firm in 1981.[1] A similar program in Colombia (DESAP), set up with the assistance of AITEC, also shows lower costs. In 1981, DESAP's costs were projected for the next few years to be U.S.$400 per

---

[1]The Ecuador program is of the private Banco del Pacífico. Cost figures are based on loans of U.S.$1 million over a three-year period to 900 firms at an operating cost of U.S.$125,000, as reported in PISCES (1981, p. 22). The U.S.$733 UNO cost figure of the previous paragraph is cost per loan, whereas this figure is cost per firm. UNO made 1,004 loans in 1981 to 860 firms. The lower costs of this UNO replica were said to be achieved by (1) eliminating the training program, (2) streamlining the selection procedure to a reduced number of visits, (3) dispensing with evaluation and other internal control mechanisms, and (4) collecting repayments only twice yearly, rather than once monthly (PISCES 1981:216-223).

firm receiving credit--lower not only than UNO's U.S.$855 per firm in 1981, but also than its U.S.$676 per firm projected for 1982.[1]

UNO is not completely alone in showing high costs. Small-enterprise lending in India (for loans less than U.S.$1,250) is done at administrative costs of 30% to 40% of loan value--not as high as UNO's, but beyond the 20% level (Timberg and Raghavan 1982:169). A small enterprise development corporation in Jamaica (SEDCO) lent at costs that were 160% of loan value, averaging U.S.$1,300 for a U.S.$500 loan (Kilby, Liedholm and Meyer 1981:19). A small enterprise lending program in Honduras, sponsored by another U.S. private voluntary organization (IIDI), was lending at costs of U.S.$1,800 per loan--exclusive of the support costs of the U.S. organization.[2]

Costs as high as UNO's are not totally unjustifiable, if the resulting benefits of such lending are high--which will require benefits that extend beyond the duration of the loan period. Though data on borrowers were not sufficient to calculate benefit-cost ratios, it is possible to identify the types of benefits that would have given a satisfactory benefit-cost ratio: (1) expanding sales of assisted firms, (2) a large number of firms assisted, (3) increases in managerial or technical productivity resulting from technical assistance, and (4) the eventual establishment of permanent and direct borrowing relationships between assisted firms and the banks.[3] UNO showed quite limited results in all four of these areas, as will be seen in the following discussion.

UNO's high costs can be related to four aspects of its operating style: (1) low productivity in terms of numbers of loan proposals approved per worker per year; (2) the large investment of choosing candidates for loans; (3) the reliance on outside institutions, the banks, to manage the credit; and (4) the diseconomies of making small loans. I will take up each of these aspects in order.

---

[1]DESAP figures (PISCES 1981:222) are based on projections of U.S.$80,000 in operating costs and 200 firms lent to per year.

[2]Fraser (1982:14). Data provided were not sufficient to calculate average loan size, or costs as a share of loan value.

[3]This list is based on unpublished World Bank documents on how to calculate benefit-cost ratios for small-business credit programs.

The student as cheap worker

UNO's corps of half-time student workers has always been larger than its professional staff. In 1981, UNO worked in Recife with 32 half-time students and 18 professionals, excluding the director and administrative support staff. The students did most of the loan preparation work in the field, trained and supervised by the permanent staff. The average number of loans made per half-time student in 1981 was 12 (or 24 for a full-time equivalent), up from 9 (or 18 full-time) in the previous year (Table 7). This level of productivity seems remarkably low, especially when one considers that the number of loans has been divided only by the number of students, and excludes the input of the supervisory staff.[1] That the employment of part-time and temporary student workers would be associated with low productivity and high unit costs is a surprising finding--given that UNO, AITEC, and other commentators consider the use of students to be a virtue.[2] Because student workers cost so much less than permanent workers, they are considered the sine qua non of keeping such programs inexpensive, particularly in relation to the public sector, which must pay fringe benefits (50% over wages) and provide tenure to its employees. Since personnel costs are the major share of the costs of an UNO-type program (85% of UNO's operating budget), the savings involved in using students would seem to be significant.

If one watches the way UNO's students go about their work, the low productivity figures do not come as a surprise. During the four-hour half shift, it is unusual for a student to contact and interview more than one prospective client. UNO has no vehicles for its field work; one vehicle, assigned to the director, is at the students' disposal for visits to inaccessible places, but most students do not have driver's licenses. The student spends roughly one hour each way going to and from

---

[1] I have not used this latter figure because the professionals spend part of their time in non-loan-related work--mainly in conducting courses for microfirms and training of student workers. Part of the time of the students and their supervisors, moreover, is spent on supervising loans. Of the 32 students working for UNO in 1981, however, only 5 or 15% worked on supervision only. Given these considerations, and the lack of adequate data to make a more accurate cost accounting, I assume that the calculation of loans per worker based on only students' time is biased, if at all, in the direction of overestimating productivity.

[2] See, for example, PISCES (1981:171).

the microfirm's place of business. This leaves only two hours for seeking out and interviewing the prospective client. Since the interviews require from 45 minutes to an hour and a half, there is no time left for a further interview during that half shift, if one includes the time necessary to take the bus back to UNO or home. Most prospective UNO clients do not have telephones, so it is not uncommon for the student to arrive and find the firm owner absent. Even for students who work a full shift, the possibility of doing more than one interview per half day is not increased, given that the work day is always broken with a two-hour lunch period not taken in the field. (Working otherwise is not without precedent; some offices work straight through the day, taking a small break for lunch on the job and leaving work two hours earlier than the normal working day. UNO itself sometimes keeps its students in the field for a full day when neighborhood censuses are being carried out, but this requires the payment of a per diem.)

The necessity of getting to and from the field by bus within a four-hour work period is only half the story of the low number of loans per worker. Students spend another half-day, after interviewing a prospective borrower, writing up the results of the interview--i.e., completing the work necessary to present a set of accounts for a loan application. The students do this work sitting at one of two long tables in a large room; much time seems to be spent socializing rather than working. The student workers also seem to be casual about spending time away from work to do other things, often involving other income-earning activities. In the public sector in Brazil, this is not unusual, particularly when salaries are low.[1] Finally, low productivity is surely contributed to by the fact that UNO's students work only temporarily (about one or two years) and only part-time. This decreases the returns to the investment that UNO makes in formal and on-the-job training of its student workers.

Because the students earn low wages and work in a somewhat casual environment, it does not necessarily follow that productivity would be significantly higher if they were replaced with full-time permanent workers. A large part of the problem, as noted above, seems to lie in the organization of the work day. Furthermore, a comparison of productivity in Recife to that of the interior program, where permanent workers rather

---

[1]Students earn about U.S.$5 (Cr$625) per half day, and do not receive any fringe benefits (because they are contracted rather than employed). This is roughly equivalent to 2 1/2 times the minimum wage (Cr$10,200 as of November 1981), or 70% of the salary of a permanent employee of normal-school level. (Exchange rate is Cr$125 to the dollar.)

than students are used, does not seem to show much difference. Loans per field worker in the interior program were 27 in 1981, in comparison to the full-time equivalent of 24 for the student workers in Recife.

Cheapness is not the only reason that student workers are valued for microfirm-credit programs. UNO also likes to use students because of the learned bias it encounters in better-trained professionals against the rustic production and management techniques of its client firms. Business-administration graduates, UNO feels, are particularly "handicapped" by their training, having only inappropriate advice or contempt for UNO's client firms; or, according to the PISCES evaluators, "they become easily bored with the day-to-day problems of the informal sector" (PISCES 1981:171). "The last thing we need," UNO says, "is a Master's in Business Administration!" Students, in contrast, are felt to be still young enough to be socialized to another norm. And UNO screens its students carefully for commitment and ability to feel at ease in poor urban neighborhoods, as well as for skill and intelligence. A selected group of applicants is given three weeks of training, and only after the first week is the final screening made. Self-selection, in UNO's eyes, also makes the student workers more suitable. University students who work are said to be among the poorer of the student body; it is not unusual for some of the student workers to have grown up in the neighborhoods where UNO lends, which makes them comfortable and more knowledgeable about working there.

According to UNO, investment in training the student workers is not completely lost when the student leaves after one or two years of work. UNO's current professional staff is almost completely made up of ex-student workers, meaning that the work-study program has served as an excellent means for UNO to recruit and train permanent staff. A strong recruitment mechanism like this is important for UNO, given that it is at a disadvantage with the public sector in competing for professionals. Its salaries range from 50% to 75% of those paid in the public sector, and it cannot offer the job security that public-sector jobs do, since it is a private organization funded by annual contracts.

UNO believes that its work-study program, finally, leads to a better understanding of the informal sector and the needs of microfirms by Recife's future public servants. Many of the student workers who do not join UNO permanently, that is, are likely to hold positions in Recife's large public sector. Public-sector professionals with more understanding of UNO's way of operating and more sympathy for its client group, it is felt, can only be of benefit to UNO. For UNO, then, the work-study program represents the socialization of a new generation the repeated investment in training for temporary workers, and the time during which their productivity, through lack of time on the job, is low. At the same time, student workers may not be the cause of high costs at all, since they occur not only in the high-cost UNO program, but also in its low-cost replica by the Banco del Pacífico in Ecuador. Finally, the comparative cost advantage of using student workers lies in the ability of the hiring organization to legally avoid the labor legislation. The use of unprotected labor is perhaps not the best model for building a replicable program to service the poor.

As UNO moves into better-funded times, the questions of low productivity and high unit costs will become more important. Since a case can perhaps be made for using students on the grounds of commitment and socialization alone, any proposal to substitute permanent staff for students would have to deal with these same issues. UNO's interior program, which uses permanent staff instead of students, would be a good place to start finding out what difference the absence of students makes.

The banking bottleneck

UNO's dependence on the state development bank to complete the loan procedure has contributed to its high costs in two ways. First is the additional work that UNO must do so that the loan application will satisfy the bank's requirements, some of which UNO would dispense with if the credit process were completely in its hands. Second is the cost to UNO caused by bank delays in processing loan applications.

Until 1980, the number of loans made to UNO borrowers averaged only 65% of the number of loan applications prepared by UNO (Table 5). Most of this difference was not due, as one would expect, to rejection of loan applicants by the bank, which has almost always accepted UNO's recommendations. The difference was caused mainly by delays of several weeks in the bank's processing of applications, which resulted in a loss of interest by many applicants and their withdrawal from the final stages of the loan-contracting process. This occurred particularly among applicants who wanted the loan for an immediate purpose, such as the purchase of a particular piece of second-hand equipment. Applicants also lost interest because delays of several weeks, at annual inflation rates of 100%, resulted in reduced value of the funds when they were finally released. In these cases of applicant withdrawal, UNO was losing the amount of time invested in the preparation of an otherwise acceptable loan application. The time invested by UNO in the withdrawn applications, of course, enters into the average cost per loan actually made.

of professionals for a public-sector environment in which UNO will have to operate increasingly.[1]

For anyone familiar with programs that attempt to extend credit and technical assistance to poor producers, UNO's claims about the results of using students cannot be taken lightly. Most of these programs have significant problems in extending their services to poorer clients. Low interest rates and other subsidies attract larger and more powerful claimants, and extension workers often feel more comfortable working with the larger clients, from whom they also may receive income in kind. UNO is unusual for the absence of these problems, and for the commitment of its staff. If the work-study program indeed contributes to this particular achievement, then this is a serious argument in its favor.

The explanation of UNO and others for their preference for student workers has interesting implications. UNO is saying, in essence, that less-educated workers are better than more-educated ones--that education, and its corresponding elite professional status, socializes people to the "wrong" norm. As a result, UNO has to provide its own "alternative" education, catching the students before they pass through the established system. That less-educated workers would be viewed as more desirable than better-educated ones is sad testimony to the fact that the world of informal-sector business is excluded not only from subsidized credit programs, but from what educational institutions teach about the world. For UNO, providing an alternative education is one way out of this dilemma--though at the cost of gaining permanent workers from among only a few of those it trains.

Student workers, in sum, are seen as endowing UNO-type programs with both high commitment and low cost--particularly in comparison to public-sector programs. The student workers can be considered low-cost, however, only in terms of the relative cost of a student worker to a permanent worker. The unit costs for delivering loans, as seen above, are anything but low. The "cheapness" of hiring students instead of permanent workers, in other words, says nothing about the cheapness of delivering credit in this way. The use of students may actually contribute to the program's high costs--mainly because of

---

[1]Another advantage to such programs of contracting temporary student workers rather than hiring permanent staff is that the number of student workers budgeted for in any particular year can be finely tuned to expected demand for credit. Permanent employees cannot be brought on as quickly as students to meet an increase in credit operations, nor can they be reduced in times of reduced demand.

In 1980 and 1981, loan applications increased markedly as a percentage of approvals, from a previous average of 65% to almost 100%. This probably reflects the sudden breaking of the bank-delay bottleneck in the interior program in 1980, and in the Recife program in August 1981. This increase in the approval rate must also have contributed, along with other facts discussed elsewhere, to the marked decrease in UNO's unit costs in 1980 and 1981--from an average of U.S.$1,700 (Cr$155,500) in the 1974-1979 period to U.S.$733 (Cr$66,900) in 1981.

UNO's problems with the bank are typical of programs that attempt to extend bank credit to the poor.[1] Yet the evaluation literature tends to emphasize the costs to the borrower of bank delays and red tape--that is, the various trips to the bank, the payments for food and lodging when problems are not settled immediately, fees for documentation and notaries, and the cost of not having the funds in time for the projected expenditure, a cost that is particularly high for farmers. We have seen, however, that the costs to the executing agency can also be significant. Part of the problem results from the credit-disbursing function being placed in a separate entity (the bank), a matter that is discussed further in a later section.

Balance sheets as ritual

UNO's costs are also high because of a time-consuming loan application exercise, the intrinsic value of which is not clear. What takes the UNO student interviewers so long for each case (one full working day) is the tortuous construction of a set of complete accounts for a firm which, in most cases, keeps no records. The result is a presentation to,the bank of a set of balance sheets that a larger firm would maintain on its own and be required to present to the bank if it wanted a business loan. The student workers become quite adept at asking the questions and doing the calculations to construct these accounts, using various proxies for getting at difficult data, and becoming wise at discovering inconsistencies resulting from exaggeration and underestimation.[2]

---

[1]AITEC reports that it even has these same problems with U.S. banks, in a small-business credit program in the state of Maine.

[2]The students know, for example, that loan applicants usually exaggerate the estimated value of their real property, thinking erroneously that it will serve as a guarantee for the loan; food-store owners are said to consistently understate the value of their credit to customers, because they think that banks disapprove of their selling on credit.

UNO's account-building exercise is not solely a result of bank requirements. The accounts are used by UNO to calculate certain indices--liquidity, debt-equity ratio, etc.--that help determine whether the borrower can service the loan and whether the requested loan amount should be adjusted. (As a result of these calculations, UNO has often adjusted the loan amount downwards.) Thus the accounting information on each firm has helped UNO to lend conservatively. At the same time, the exercise does not seem to have helped weed out undesirable applicants or identify the good ones. If applicants did not receive loans, it was usually for reasons beyond UNO's control--borrower loss of interest, failure to qualify as a small firm, inability to find a co-signer, failure to provide documentation--rather than UNO decisions based on the analysis of the firm. It is difficult to know whether those who did not receive loans for the former reasons would have been better or worse repayers, and thus the selection process has had a highly random content--at least until recently.

Most of UNO's weeding out of applicants takes place at an early stage in its contacts with prospective borrowers, before the complicated account-building interviews take place. These criteria--financing mostly working capital, not funding new firms or new activities, and financing repeat loans only after previous loans are repaid--are probably much more important than the financial analysis of the firm in determining UNO's high repayment rates. Though the accounts built by UNO are required by the state bank for the loan application, moreover, the bank does not use those accounts to make its decisions; with rare exceptions, it accepts UNO's judgments on who can borrow and what the loan amount should be. This is consistent with reports on how bank managers make decisions in other countries with respect to small and medium loans, where indicators of repayment capacity--and hence the firm's financial statements--are much less important than "the quantity and quality of collateral."[1] It is doubtful, finally, that the accounts constructed by UNO always give an accurate picture of the firm, given the intermixing of the firm's activities with those of the owner's household, the difficulty of verifying whether the loan applicant is telling the truth, and the extreme seasonality of production and sales.

Though UNO's approach to account building may be the best way to gain acceptance for its clients at the state bank, there may be less costly ways to deal with the fact that small firms

---

[1]Anderson and Khambata (1982:13). In UNO's case, the "collateral" in the bank manager's eyes would be not so much the assets of the co-signer, but the guarantee fund that backs all UNO loans.

do not write things down. Agricultural credit for small farmers is one example, where simple formulas are used for calculating credit needs--for example, estimated cost per hectare, per crop, multiplied by the number of hectares cultivated. Though the activities of most non-agricultural enterprises do not always lend themselves to this formulaic approach, some of the activities financed by UNO do. The retail firms so prominent among UNO's clients are an example, given the ease of estimating their inventory and monthly sales levels. For my sample of 90 working-capital loans to 48 retail food stores, loans averaged 66% of monthly sales, with 70% of the loans being less than 75% of these sales values. This regularity, and the experience UNO now has with such firms, might be used to devise a formula for the food-store loans, which represent 21% of the total.

Some organizations providing credit to microfirms have started to find that account-building is not necessary to make wise decisions on worthwhile clients and loan amounts (PISCES 1981). They have been able to achieve high repayment rates using formulaic calculations for loan amounts and relying mainly on such factors as peer pressure and group borrowing to assure repayment. Actually, UNO already resorts to formulas for calculating debt repayment capacity in its projections of increases in sales (15% to 25%, but usually 20%), increases in expenditures for inventory (15%), and increases in the imputed wage (10-20%). If the individualized calculation has been dispensed with for these crucial parameters of the loan application, then it would also seem dispensable for some of the others. The projections, moreover, are probably inaccurate (on the overoptimistic side), if the evidence presented in the last section of the paper is valid. Yet their use does not seem to have jeopardized repayment, again suggesting that factors unrelated to the financial analysis are more important.

Perhaps the most important aspect of the costliness of UNO's approach to the loan-application procedure is that the account-building exercise has no effect on the borrower and therefore no economic benefit. It is not part of a process whereby the firm is learning how to keep accounts. Though UNO's courses for firm owners cover this subject, and though UNO was routinely advises its borrowers to keep accounts, the majority just as routinely reject that advice and do not attend the courses; they do not have the time to keep accounts or attend a course, and they do perfectly well keeping everything in their heads. (This matter is discussed in the section on training, below.)

Finally, UNO does not need a detailed set of accounts for monitoring its loans. Though each borrower is meant to receive four monitoring visits per year, each is usually visited no more than one or two times a year; in 1981, only 5 of the 32 student workers worked on monitoring. The number of supervision visits and the breadth of the information gathered had been greater until a few years ago, when UNO's growth in credit funds put more pressure on its staff. Since the state bank does not require supervision reports, it posed no problem for UNO to cut back on the information gathered during these visits. Currently, the student worker often does not even carry the loan file on the supervision visit, and instead writes down a few key indicators from the loan application or the report of the previous visit--sales, inventory, number of employees, imputed wages to the owner, and the owner's estimate of profits. The current supervision form, moreover, does not even include a place to record these values successively, so the supervisor does not have a ready picture of the changes in these variables. Though past supervision forms allowed for this comparative juxtaposition of monitoring information, this part of the form was dropped in the name of reducing excessive paperwork. All this suggests that the account-building process is not essential for loan monitoring.

Though the account-building process contributes to UNO's high costs, in sum, it seems to have little intrinsic value. It does not benefit the borrower; only simple features of it are used for monitoring; it does not play a major role in UNO's selection or rejection of clients; and it is not used by the bank to make decisions. The building of accounts does play a role in determining the size of loan recommended by UNO, and the decision as to whether or not to give investment credit. But the information that account-building provides for these decisions may not be worth its high costs. The experience of other programs suggests that there may be less costly approaches to deciding how much to lend and to whom. The main value of the account-building, then, seems to be ritualistic: because it looks like something that a respectable business would present in support of a credit application, it legitimates the applicant in the eyes of the bank.

To conclude that the value of an activity is largely ritualistic is not to belittle it or to suggest that ritualistic behavior is unusual in development organizations. Much of the planning and project-feasibility studies undertaken by Third World governments in order to obtain development financing can also be described as ritual. These exercises, also quite costly, serve to help obtain the financing by showing the donor that the applicant is serious and competent enough to prepare a respectable plan or project document. As in the case of UNO's account-building, however, the exercises do not necessarily serve their stated goal of producing better choices and better projects. Nevertheless, the project-preparation exercise has "produced" the financing, and this is very valuable, given that financing is scarce. Likewise, UNO's account-building "produces" a loan for its client by making that client look legitimate.

Though the account-building ritual makes good sense in terms of gaining access to credit for microfirms, its costliness is self-limiting: one can reach only a small number of borrowers if one has to spend so much time with each one. What may be needed, therefore, is not an abandonment of the ritual because it is too costly--but a search for a cheaper ritual. Now that UNO is 10 years old, for example, it might be able to replace the borrower's financial statements with its own legitimacy as a judge of good borrowers. Trading on its excellent reputation and its high repayment rate, it might propose to the bank a less costly form of borrower legitimation. UNO actually has evidence from the bank that it can move in this direction. Based on its good record, UNO has been able to convince the bank in recent years to reduce the amount of documentation required of borrowers. The bank's concession on these particular documents shows that its requirements need not necessarily be taken as non-negotiable; indeed, they become more subject to negotiation the more reputable UNO becomes for selecting good borrowers.

With a little research on the characteristics of its delinquent borrowers, finally, UNO might be able to show the bank that bad borrowers were already being avoided, as a result of selection criteria and lending procedures that are independent of the account-building process--a point I return to in the section on repayment. But because the account-building process has played a ritualistic role for so long, it has probably come to be identified in people's minds, mistakenly, as having contributed to UNO's excellence at choosing well-paying borrowers. This mistaken perception is likely to exist at UNO as well, so that resistance to abandoning the process may be considerable. It is for this kind of situation that investment in research is worthwhile, since its results can play an important role in making clear a mistaken identification and in changing people's minds. Here again, in conclusion, we have seen that it was not the UNO "model" of providing credit that worked well but, rather, something about the organization itself.

Spending on selection

Until 1981, UNO's way of finding and choosing clients was quite time-consuming, and resulted in a low number of loans as a share of firms initially contacted (17%).[1] The process consisted of four stages: (1) a "census" of microfirms in a particular neighborhood; (2) a "selection" visit to the firm to see if it fit UNO's criteria and was interested in credit;

[1]See Table 8.

(3) a "diagnosis" of the firm, which constructed a complete picture of its costs and outlays, assets and debits; and (4) the account-building process for the credit application. Each step was more comprehensive than the previous one, but the field worker had to start from scratch each time, since inflation and seasonal factors would make the data collected on previous visits inconsistent with that of subsequent visits. Each of the four visits, finally, required the large investment in travel time discussed above. A round trip to the applicant's place of business could take twice as much time as the interview itself; the four-hour half shift, in turn, made it necessary for workers to return from the field location usually after only one interview. (The census is an exception, where interviews are shorter, and workers often stay out in the field for a whole work day, so that one worker can complete 10 to 15 interviews per day.)

From 1974 through 1980, UNO completed loan proposals for an average of 28% of the firms it had censused, for 50% of the firms to which it had made a "selection" visit, and for 80% of the firms for which it had completed a "diagnosis." Given the rate of attrition of applicants between loan proposal and the release of funds by the bank--during which 35% of the candidates dropped out--this meant that only 17% of the firms censused by UNO actually received loans. (This amounted to about 0.003% of the microfirms in metropolitan Recife.)

In 1981, UNO decided to collapse the last three stages of its field visits into one, so that the selection, diagnosis, and credit proposal would all be done in one visit. This represents a significant decrease in time spent per loan application, which is reflected in the data for 1981. Loan proposals as a percentage of firms surveyed jumped about 50% in 1981, from their 27% average of the 1974-1980 period to 45% in 1981 (Table 8). This change must also have contributed to the 33% jump in productivity of the field workers in 1981--from 18 loans per full-time-equivalent worker per year to 24 (Table 6). (Productivity is projected by UNO to increase by another 80% in 1982, to 40 loans per full-time worker.) The change also must have contributed to the 30% decrease in average cost per loan--from U.S.$1,160 (Cr$105,900) in 1980 to U.S.$733 (Cr$66,900) in 1981--as well as to the decrease in cost per loan as a percentage of loan value, from 78% in 1980 to 46% in 1981 (Table 2). Because average cost per loan had already decreased substantially from 1979 to 1980--from U.S.$1,930 (Cr$176,100) to U.S.$1,160 (Cr$105,900), other important factors may have also been contributing to the 1980-1981 decrease.

In the last few years, UNO's first contact with prospective clients has been more a result of word-of-mouth knowledge of the program than through its neighborhood censuses and meetings. (UNO holds a large promotional meeting in a neighborhood to announce its presence and explain its program.) This means that many prospective clients now seek out UNO's office in the center of Recife, after first having heard about the program from a friend who has already participated. Thus though UNO surveyed 50% more firms in 1981 than in 1980, the number of loan proposals prepared increased by twice as much, causing the increase to 45% cited above in the number of proposals as a percentage of firms surveyed.

It is difficult to understand why UNO waited so many years before collapsing the last three field visits into one. The origins of the four-visit approach, actually, were almost coincidental. When UNO was created, AITEC had specialized in promoting community action organizations, rather than in small-enterprise programs. UNO represented AITEC's first venture into the small business sector, and it did so without any of the specialized expertise in the subject or cumulative wisdom that it has more of today. The four-visit "model," in turn, was simply the result of the AITEC promoters' reading of the manuals on small-business credit programs in the United States. Even though the four-visit "model" had no tried-and-true history for AITEC, Brazil, or Latin America, it nevertheless took on the hallowed look of a model as the years went by--partly out of sheer habit. UNO's retention of the four visits, in sum, may be no more a mystery than the simple persistence of habits, whether good or bad, characteristic of ways that many organizations do things. In addition, the four-visit habit was compatible with the lack of concern for unit costs and the bank bottleneck, which meant that even if client selection costs were minimized, it would have been difficult to increase the number of proposals financed anyway.

UNO's four visits to its prospective clients were not only costly, but they also irritated the clients, who complained of having to "answer the same old questions over and over." Some prospective clients became exasperated at the repetitive questioning and dropped out; the individual applicant files show, moreover, that several firms started to show problems, and even to disappear, between the first visit and the last one. In this sense, the time that passed between the first and final visit gave rise to a natural attrition of applicant firms that, because of their problems or failures, were likely to have been unreliable repayers. Inadvertently, then, the delays of the four-visit system may have resulted in a better selection of firms for UNO. With respect to those who dropped out because of irritation with "too many questions," however, it is not clear whether they would have proved to be good or bad credit risks.

The value of the census. Because UNO's first contact with the microfirm has produced such a low yield in loan proposals (28%), one might consider this census to be dispensable. Also, the census becomes rapidly outdated, because of the frequent failures and changes of location in the microfirm sector, a point made by Osório (1981:36). But the census is also important to UNO's success at reaching smaller firms, and has had considerable social value as well, a point I turn to momentarily.

Until recently, little was known about the microfirm sector in Recife--the number of firms, their type of activity, where they operated, and what they were like. If UNO had sat back and waited for firms to approach it, after some advertising, it would have ended up with a self-selected group of more sophisticated, larger firms, adept at taking advantage of programs providing subsidized inputs. Clandestine firms, in particular, would not come forward without some assurance by UNO that they would be served and, more important, that the information supplied to UNO would not be reported to the authorities.

UNO's censuses were one of the first forays of any public entity in Recife into the informal sector. The census operation is almost like a military search operation, though with a happier outcome. The worker-students saturate a neighborhood, walking up and down the streets asking who makes what, listening for the sound of hammers on anvils or powersaws, and trying to convince people that they are trying to help them rather than find them out and report them. Thus the census exercise helped UNO to become familiar with its work environment, as well as make UNO familiar to microfirm owners, so that it could be trusted. By mapping the microfirm sector in various neighborhoods of metropolitan Recife, moreover, the UNO census also opened up that world for Recife's public sector to see. It showed that microfirms were a major phenomenon amounting to between 100,000 to 140,000 firms in metropolitan Recife, an area of 3 million inhabitants. When the Recife urban planning agency (FIDEM) wanted a more complete picture of the sector, therefore, it could call on an UNO to carry out part of the survey work on contract.

UNO's census work, in sum, had four important results: (1) it paved the way for UNO to reach firms with the least access to credit; (2) working as it was in virgin territory, UNO was helped by the census experience to better understand the sector it was trying to assist; (3) by generating data that mapped Recife's informal sector, the census made that sector known to public authorities; and (4) it provided an "event" by which UNO could make itself known and gain confidence in the neighborhoods where it wanted to work. The census, finally, was a one-time expenditure. Once it was made, several successive stages of lending could be made in the same neighborhood.

The diseconomies of lending to microfirms

Contributing to UNO's high costs is another factor that also underlies its achievements: UNO prides itself on being the only program to lend to very small firms. Yet economies of scale are the rule in the lending business, since the same amount of work is usually required to process a small loan as a large one. One of the easiest ways of reducing the unit costs of lending, therefore, is to make larger loans, which cause costs as a percentage of loan value to fall. Many institutions do not want to serve small borrowers for precisely this reason. Even if small borrowers repay well, as many bank managers recognize, the net return on a larger loan is still greater because costs as a percentage of loan value are lower. Even more important, banks typically earn an extra "return" from large borrowers that they cannot from the small: they require that the borrower maintain a large average balance in his checking account, often 30% of the value of the loan, or they require that the borrower buy other services of the bank that are more profitable.[1]

Because of the economies of scale in lending, as well as political pressures from larger borrowers, many credit programs for small producers typically show an upward drift in average loan size, and in the size of the borrower. Subsidized credit for small and medium firms in Brazil, as reported by the president of a state development bank, is therefore "always lent to the firms which are the largest and/or the best clients, and as such are capable of offering reciprocity to the banks."[2] Bank policies also encourage this upward drift, in that the performance of branch-bank managers is usually judged by the volume of their lending and its profits. For these two indicators, larger loans and larger borrowers will clearly give better results. Even if a bank is not concerned about its costs, it is still under pressure to meet performance targets regarding the volume of lending; in development projects, the latter indicator is often taken more seriously--in determining whether a project is performing satisfactorily--than the size of the loan and the client.

---

[1]An earlier study of small and medium firms in Brazil also noted the lack of interest by development and other government-sponsored banks in lending to small firms because of the high costs and low returns (Robalinho 1973:114).

[2]As quoted in Tyler n.d.:165 . The best clients can meet the lending criteria since the ceiling definition for medium firms is quite high, equivalent to annual sales of U.S.$5.5 million (in 1978 dollars).

Given all these pressures, it is remarkable that the real average value of UNO loans has not drifted upward over the almost 10 years of its lending. Average loan value, in fact, showed a marked decrease over the first four years, and a further slight decreasing trend thereafter (Table 2). When average loan value showed a real 8% increase in 1981, moreover, UNO staff immediately took note. They were worried that this might represent the start of a trend, and talked about whether to take measures to arrest it.

UNO is fully aware that it could reduce its costs, or lend more rapidly, by increasing average loan size and lending to a larger class of firm. Indeed, AITEC had proposed that UNO lend to at least a few larger firms as one way of reducing its average costs (DGAP 1978:51-53). But UNO sees this solution as an easy and reprehensible way out. "If we worried only about our unit costs," UNO says, "then we would simply give our credit to large clients, just like the other so-called small-business credit programs." By defining its clients as it has, then, UNO has closed off one major path toward decreasing its costs. Given the problem that upward drift in loan size has meant for other credit programs, one cannot help but admire UNO for being committed enough to its goals to not fall back on larger loans. The absence of pressure to lower its unit costs, of course, has helped to make this commitment easier. A program such as UNO is in a difficult position, in sum, because its goal of reaching the poor firm conflicts with the most significant indicators of performance for credit programs: the volume of lending, the cost per loan, and the rapidity with which available credit funds are disbursed.

UNO's consistently small loans are commendable for other reasons. To a certain extent, the small loans result from UNO's scaling down of loan requests to a size considered appropriate to the size of the firm, and from the emphasis on loans for working capital (75% of the total) as opposed to investment capital. The small loans, in other words, are just as much the result of financial conservatism as they are of commitment to the small borrower. The conservatism, in turn, has paid off in low delinquency rates. (Delinquent borrowers in small-business credit programs in the Philippines were concentrated among firms with loans that were high in relation to firm size.)[1] With respect to repayment performance, then, financial conservatism and good repayment rates have turned out to be quite compatible with the goal of lending to small firms. At the same time, financial conservatism has conflicted with performance indicators regarding volumes of lending.

[1]Anderson and Khambata (1981).

It will be interesting to watch UNO's average loan size as credit resources become more abundant in this and the next few years, and as bank delays cease to be a problem. Not only are available credit funds much greater than ever before, but UNO is now subject to volume-of-lending targets because of its incorporation into three World Bank-funded projects. Before this, UNO operated at its snail's pace, with credit resources sparse enough that they were always spent, and with no waiting lines forming. Now, UNO's good reputation will be more closely tied to the volume of lending, which means that something will have to give. It will be interesting to see whether this new performance indicator will compromise UNO's commitment to small loan sizes, or whether UNO will succeed in finding other ways of reducing its costs and increasing its volume of lending.

Discovering high costs

In its programs in other countries, AITEC has started to show some concern for lowering costs and reaching more firms. It has begun to lend to much poorer firms than UNO's clients, in smaller amounts (averaging U.S.$200 compared to UNO's U.S.$1,500), and dispensing with UNO-type selection and application procedures. Through the formation of "solidarity groups," for example, a few producers who trust each other share collective responsibility for each individual's debt.[1] These self-selected participants are often without a fixed place of business--hawkers, vendors, bicycle-transporters. Technical assistance and UNO-type managerial training are not considered relevant or essential for these types of producers. Without this particular training and selection process, costs are a fraction of UNO's. A successful program of this nature in El Salvador, for example, shows costs of U.S.$30 for the first loan, and U.S.$10 for subsequent loans. (PISCES 1981:181).

For several reasons, it is interesting that AITEC's concern for reducing costs has attracted it to group lending, and to assisting poorer beneficiaries. Usually, going lower in the income distribution and making smaller loans are associated with higher costs, at least in the area of credit. The new interest in group lending, moreover, makes AITEC's approach less objectionable to its critics who, as noted above, disapprove of working with individuals as opposed to groups. Finally, although AITEC recognizes certain cost advantages in lending through groups, it was drawn to this approach not only

---

[1]See, for example, PISCES (1981:175-176) on an El Salvador program, and Sawyer (1981) on a Dominican Republic program.

out of its search for ways to reduce costs. In addition, according to AITEC, AID's interest in exploring various approaches to small-business lending--under the PISCES research project and its contracting of AITEC to look for successful examples--led AITEC to witness outside examples of this new way of lending and to consider experimenting with the new approach itself.[1]

This tale of evolution and change in AITEC thinking is somewhat different than our image of voluntary organizations as being innovative and "low-cost" in comparison to the public sector. Borrower selection and training in the UNO style, that is, have been articles of faith in the design of AITEC and other small-business programs. They were considered indispensable for sound operation, until somebody from outside came along and showed that, for a different client group and with a different organization of lending, these "basic" ingredients could be dispensed with almost completely, and a good credit program at more reasonable cost could still be achieved. The incentive to innovate and reduce cost, in sum, came partly from outside the voluntary organization, and in part from the public sector itself.[2]

AITEC, of course, has not given up individual-loan programs for group lending--it believes group lending is appropriate only for the smallest borrowers--nor is group lending being suggested here as the only alternative to the high costs of the UNO model. (The less costly Ecuadorian variant on the UNO model, mentioned above, illustrates another alternative.) The group lending example, rather, has shown us that lending to poor firms does not have to be as costly as it was for UNO, and that less costly ways may represent radical changes in the way organizations like UNO are now doing things. Mainly for this

---

[1]PISCES is the Program for Investment in the Small Capital Enterprise Sector, which is a research project sponsored by the Office of Urban Development of AID (PISCES 1981).

[2]That this tale of innovation is not unusual is suggested by a recent study of voluntary organizations in four developed countries (Kramer 1981). In contrast to our image of voluntary organizations as innovative, the study found that such organizations were not "dynamic innovators, lighting the way." Indeed, many significant program innovations were found to have been "inspired by government." Also contrary to our image, the study found that the voluntary organizations that were innovative were among the largest, most bureaucratized, and most professionalized" (Kramer 1981:xix).

latter reason, perhaps, one could not have expected the discovery of the innovation to have come from within.

Double dependency and the interest rate

UNO's high costs and low productivity are, in a sense, not surprising. AITEC set up UNO in a way that productivity and unit-costs, whether low or high, would not have much influence on the new organization's ability to survive. Both AITEC and UNO looked to successive donations from abroad and from within Brazil--rather than charges for credit and training services--as the only way to finance the operating budget. The 2% fee charged by UNO for processing loans (now 3%) would never amount to much; 3% of UNO's lending in 1981 represented 7% of the operating budget of that year.[1] Any significantly larger fee tended to be looked upon as "greedy"--as the act of an organization out to build its own empire rather than help the poor.

Recent actors in the question of UNO's charges have been the World Bank and the Brazilian regional development authority SUDENE, which has coordinating control over the rural development projects of which UNO is a part. The Bank has been in favor of UNO's charging a higher fee, while the development authority thought the fee should stay the same, since UNO was supplying credit financed and subsidized by the government. This view is politically understandable, at least, in the sense that the government might not have a political interest in allowing a private organization to become strong by taking for itself in fees a significant part of the return on credit monies provided by the government.

Just as significant in determining the cost constraints (or lack thereof) under which UNO operates is the price at which the credit is offered to clients, and the institutional arrangement for disbursing the credit. Funds are lent at highly negative real interest rates--now about negative 80% in real terms--though they were much less negative at UNO's start (negative 10% in 1974). At these rates, UNO's credit funds have had no chance of becoming self-maintaining through repayments; they have to be constantly replenished by outside benefactors, just as UNO's operating budget is also dependent on the beneficence of donors. UNO was set up, in sum, to be doubly dependent. Its ability to survive and expand would be dependent not on its ability to operate efficiently, but on whether it could obtain donations for its credit and operating

[1]Loans were U.S.$1.6 million (Cr$147 million) and the operating budget was U.S.$735,500 (Cr$67.1 million).

budget. Inefficient operation, in turn, did not seem to influence the decisions of donors. UNO, in this sense, was no different from many other organizations used to receiving funding from donors.

The institutional arrangement by which credit was provided to UNO clients was a particularly unhappy one. As in many such programs, the credit was dispensed through the formal banking system, and at an interest rate that made the program not very desirable to the banks. In 1981, UNO interest rates were 25%, in comparison to 130-230% for commercial credit, and rates of between 40% and 80% on other subsidized lines of credit. Lending to UNO clients was also undesirable because the bank could not require its usual interest-free deposits in the form of minimum balances.[1] Since bank managers were judged on performance measures that made UNO credit a sacrifice to them, it is not surprising that the banks had little interest in facilitating credit to UNO borrowers, or in committing more of their own funds toward the UNO program. The institution with control over the credit, in sum, did not have the commitment; and the institution with the commitment, UNO, did not have the credit. As the program was set up, it was dependent on the good will and funding of an institution that could only lose from it. No wonder that the banks were not very helpful.

Could UNO have been set up any differently? Could those with the commitment have taken on more of the financing responsibility, so that those without the commitment were losing less, or not involved at all? There are some examples of institutional arrangements and credit charges in other countries that look more promising. In the Dominican Republic, AITEC's group lending is disbursed by the same private development foundation that operates the program. In Ecuador, an UNO-type program complete with student field workers is run out of the very bank that supplies the credit (Banco del Pacífico). The bank charges an interest rate that, although subsidized (9%), is higher than what the bank could otherwise earn with these funds, given that the law requires that banks invest a certain share of their deposits in loans to small firms or in government bonds, which yield an even lower rate of return (6%; PISCES 1981:219). Likewise, the loans of a successful small-business credit program in El Salvador are provided by the same

[1]The state development bank did try to get more profit out of UNO credit resources by delaying disbursement. It was to the branch bank's advantage to delay disbursement of funds as long as possible after loans were approved, because these undisbursed funds appeared on the bank's monthly financial statements as deposits, thus making the position of the bank look better.

credit federation that runs the program (FEDECCREDITO); the interest rate (15-16%) is the same as that for all commercial borrowers (PISCES 1981:177). In Honduras, a small-business credit program founded by a U.S. voluntary organization (IIDI/IHF) charges the same rates as the development bank (13-17%; Fraser 1982). Unlike UNO, the program receives all the interest income and expects to become financially self-sufficient, based on this income. In small-business credit programs financed by the World Bank in Bangladesh, Jamaica, Mexico, and Portugal, an agreement was made at the time of loan negotiation that interest rates would be adjusted in accordance with changes in commercial bank credit rates. In sum, more felicitous institutional arrangements and higher real interest rates can be found in some other programs of this nature. Whether they could have been repeated in Recife is another question as discussed below.

The interest rate question. UNO's interest-rate history is tied to that of the Brazilian public sector during the periods of rapidly increasing inflation in the 1970s. Until 1976, UNO had a reasonable interest rate, at least compared to the rest of the banking system; it was charging 24% interest for individuals and 16% for registered firms, which, though negative at the then inflation rate of 40%, was at least the same as the ceiling rate allowed for commercial credit. As part of a policy of tightening credit supply, the Brazilian monetary authorities removed the ceiling on these interest rates in 1976; the 24% rate immediately rose to 35%, then 40%, and so on to their 130% and higher levels today. With the termination of the pegged commercial interest rates, UNO withdrew its program from the two private banks, as recounted above.

As inflation increased during the 1970s, UNO's rate became lower and lower in real terms, being reduced by forces outside its control. As UNO became more a part of the CEBRAE system, moveover, it was subject to national dictates on interest rates for a new line of "microbusiness" credit--so that determination of the interest rate was now partly out of UNO's control. (UNO could have gotten around the 24% ceiling on microfirm credit in other ways, or put up a fight against its application to UNO.) Though UNO could have increased its rate to accompany the inflation, finally, this would have been much more politically difficult than maintaining the real interest rate during a period of declining or constant inflation.[1]

UNO's tolerance for a rapid decline in its real interest rate, let alone its unwillingness to charge a positive real interest rate in the first place, is very much like the behavior of the Brazilian public sector. Most of the credit lent out of the Brazilian government's subsidized lines has been at negative real rates of interest for much of the 1960s and 1970s; agricultural credit accounts for 60% of the value of these subsidies. The magnitude of this subsidy has been enormous; the difference between the nominal interest rates and a 2% or 3% real interest rate amounted to 5.5% of Brazilian GNP in 1978, and 10% in 1979.[2] In 1978, the interest-rate subsidy was estimated to be 54% of Treasury revenues. As noted above, finally, the public sector itself mandated the 24% ceiling on microbusiness credit in UNO's later years. UNO cannot be criticized, then, for going against prevailing public-sector practice in its charging of negative real interest rates. Yet it was behaving no better than the public sector--despite the rhetoric to the contrary--and was worse off than the public sector for behaving this way, because it did not have the power that the Brazilian monetary authorities had to replace the credit funds decapitalized by inflation whenever they wished.

Though UNO's interest rates were undesirably low, this did not prevent it from obtaining major funding increases in 1978 and 1982 under the two World Bank projects. In order to participate in the projects, UNO was not required to charge a positive rate, or even one that was commensurate with prevailing

---

[1]When inflation is increasing, one has to increase the nominal rate in order to simply maintain the real rate, whereas when inflation is decreasing or constant, one can simply do nothing; the decline in inflation will by itself bring about an increase in the real rate, or a constant inflation rate will by itself maintain the real rate, without anyone having to raise the nominal rate. The problem is caused by what economists call the "money illusion," whereby people react to changes in nominal prices more than they do to real prices: a high nominal interest rate is perceived as "bad," even though it may be more than cancelled out by a high rate of inflation, whereas a low nominal interest rate in a country with little inflation will be perceived as more reasonable, even though it may be higher in real terms. For this reason, the administered interest rates of credit programs in countries with high inflation tend to show a consistently lower real level than those rates in countries with less inflation.

[2]World Bank files.

subsidized rates. The negative interest rates, in other words, were in no way dysfunctional to UNO's obtaining a large increase in donor funding.

The case against UNO's rates. What was wrong with UNO's subsidized and negative interest rates, if everyone else in the public sector was doing the same thing? The answer is simple: UNO was meant to be an independent organization, and a self-sustaining credit fund could have made a substantial contribution to such independence. The negative real interest rate deprived the program of any chance of becoming less dependent on others in the future. There is considerable literature on what else is wrong with subsidized rates, starting with AID's Spring Review of Agricultural Credit in 1973; much of the literature is a result of AID- and World Bank-financed research carried out at Ohio State University.[1] There is no need to recapitulate the arguments of this literature here, but I summarize the main points briefly because of their relevance to what UNO and AITEC have tried to do.

The case against subsidized interest rates on credit programs for the poor makes the following points:

1. Because of the fungibility of money, subsidized credit often substitutes for higher cost sources of capital that borrowers would have used anyway; it thus has little impact on production decisions and represents a windfall income transfer to the borrower.

2. If the investment being financed does not yield a return as high as prevailing interest rates and other alternative investments, borrowers will use the subsidized credit, or shift the total resources available to them, so as to invest in the highest yielding activity.[2]

---

[1]The research findings and arguments of much of this literature were put together as discussion papers for a Colloquium on Rural Finance (1-3 September 1981), sponsored by the Economic Development Institute of the World Bank, the Agency for International Development, and Ohio State University.

[2]One striking example of this argument is the fact that the value of Brazilian agricultural credit as a percentage of the value of agricultural production turned out to be more than 100 percent in some years. This testified to what many had already observed--that borrowers of the subsidized credit were putting it into higher yielding investments outside agriculture, such as urban real estate.

3. If the subsidized activity does show a lower rate of return, then it does not make economic sense to subsidize it--particularly when one is speaking of private-sector activities such as small businesses.

4. The interest rates that the poor pay on the informal credit market are extremely high, and indicate their willingness to pay high rates to borrow for productive activities.

5. Subsidized interest rates are usually so much lower than prevailing market rates that they attract "unqualified" borrowers to credit programs for the poor, thus causing the trickle-up problems of these programs.

6. The latter problem contributes to the high costs of subsidized credit programs, resulting from the work involved in administering the criteria for borrowing; if interest rates were the same as market rates, the argument says, these larger borrowers would stay away of their own accord.

7. Finally, as discussed above, subsidized interest rates are said to create credit institutions that have no possibility of becoming self-sustaining.

Highly subsidized interest rates, in sum, are felt to be unnecessary in order to lend to the poor. They undermine attempts to make institutional credit available to the poor, and they encourage investment in low-yield activities. It is beyond the task of this evaluation to discuss the validity of these arguments, or to trace their implications for the UNO case. Suffice it to say that there is a strong case to be made against the kind of highly subsidized interest rates used by UNO, and that the issue should be of interest to decision-making about future projects of this nature.

A few comments are in order relating the UNO experience to the argument against subsidized rates. First, my interviews with UNO borrowers showed that they were paying very high interest rates in the informal market--directly to money-lenders, or in the form of higher prices for inputs bought on credit, or in the form of discounts they had to take when negotiating postdated checks. Also consistent with the case against subsidized interest rates is the fact that UNO clients seemed more appreciative of the terms of UNO credit than of the low interest rate. When asked what was particularly desirable about UNO's credit, firm owners laid more stress on the repayment period than on the interest rate--that is, the 12- to 15-month period allowed for repayment of working-capital loans and the

3-month period of grace on principal. When asked why they preferred to continue with UNO rather than negotiate loans directly with the bank, these firm owners said that although they could probably get working-capital credit directly from the bank, they would have to repay within three months. They felt this was impossible. Other reasons for not working directly with the bank were also mentioned more frequently, or more vehemently, than the interest rate: requirements for documentation, real property guarantees, average balances and, in some cases, clandestine legal status. Some firm owners did not even know what interest rate the bank would have charged them if they borrowed directly.[1] The uniformity of these reactions of UNO clients supports some of the arguments against subsidized interest rates presented above.

UNO, in sum, was giving away more than it needed to by charging such highly negative interest rates. The resources put into subsidizing the interest rate could have better spent at providing what UNO clients valued more: access, decreased borrower costs, and desirable repayment periods for more borrowers. It would be self-defeating, of course, for UNO to charge its borrowers the same as what they were paying on the informal credit market. But a happier medium might be found between the 25% charged by UNO and the 200-400% annual equivalent paid by UNO's client population on the informal credit market--a medium that would give UNO's credit funds a better chance to become self-sustaining.

Notwithstanding the impressive array of arguments against subsidized interest rates, there are a few powerful arguments in favor of them. First, if subsidized interest rates are so obviously undesirable, why is it that the very institutions that have financed the research and argued the case against subsidized interest rates--the World Bank and AID--have agreed to finance so many programs in which highly subsidized rates are a key feature? Why did the World Bank approve various small-industry projects with subsidized rates, for example, even though the interest rate was always a hotly contested issue, with the Bank pressing for positive real rates and the

---

[1]Similar findings were reported in a World Bank study of small-business credit in various countries, in which commercial banks noted that quick availability of funds, liberal repayment and grace periods, and less stringent demands for collateral were at least as important for small borrowers as the interest rate (World Bank files).

borrower for subsidized rates? The answer is disappointingly obvious: subsidized rates are so common a tool of credit and development policy--not only in today's third world, but in the histories of the industrialized countries--that one would have had to abstain from development assistance if one refused to finance programs using them. In this kind of policy context, it seems politically unreasonable to pick on a small program like UNO--and to expect an UNO to charge more for credit to the small borrower, in the name of economic wisdom, than is currently being charged for credit to the large. (The latter argument is the favorite of proponents of subsidized rates for the poor.)

A second and compelling new argument in favor of subsidized interest rates for small firms (and farmers) is based on the same neoclassical economic reasoning that gave rise to the critique of high rates. Anderson and Khambata (1982) argue that a "market-clearing" interest rate for small firms would be so high as to extinguish the market--because of the initial difficulties of managers in distinguishing between good borrowers and "lemons." Because of the difficulty of figuring out beforehand which borrowers are good, the risk-reflecting interest rate tends toward that which would be charged if most borrowers were lemons, rather than an average mix of good and bad.[1] The market-clearing high rates will not only be higher than if more information on borrowers were available, but they ward off the potentially low-risk borrowers with sound projects, leaving only the risk-courting borrowers, whose higher failure rates will confirm the judgment that interest rates can only be very high if they are to reflect risks. It is for these reasons that the risk-reflecting rate not only clears the market, then, but also extinguishes it. In this kind of situation where lack of information about borrower repayment potential causes excessively high interest rates, the subsidized rate allows lending at a reasonable rate for sound borrowers while at the same time permitting the accumulation of information and experience on how to distinguish a good borrower from a "lemon."

---

[1]This argument is a very interesting application of an idea developed by Akerlof, who uses the used-car market as the example of the difficulty of distinguishing between good buys and lemons, with the resulting price one receives for selling one's good used car being disappointingly low--i.e., because of the generalized perception of the buyer that he is getting a lemon and has no way of determining otherwise (Akerlof 1975).

UNO's subsidized rates might be justified, according to this argument, if one could show that the program was contributing to a lowering of the high risk perceived by bank managers in lending to small firms--and that the program was accumulating and disseminating information on how to distinguish the good borrowers from the bad. Of course, UNO is contributing precisely to this end by being the first entity to lend to microbusinesses and to achieve a high repayment rate. But the fruits of this experience are not being discovered or passed on to the banking system as subsequent sections will show. Thus the substantial "external" benefits to be had from UNO's subsidized experience are not being realized.

Given the context of UNO's subsidized interest rates, is there anything left to criticize about UNO's interest-rate policy? The critique is fourfold: (1) the rates are unnecessarily low, given that they are even lower than the subsidized rates allowed to the "rich"; (2) UNO has overestimated the value of the interest-rate subsidy to its clients in relation to its other services; (3) the rates have an undesirable effect on the ability of UNO-type organizations to achieve and maintain their highly prized goals of independence and difference from the public sector; and (4) the program does not yield the benefits for which its subsidized rates could be justified--namely, the high benefits to be had from showing bank managers how to distinguish between good borrowers and lemons.

Why Do They Pay Back?

Everyone admires UNO's high repayment rate. UNO puts the rate at about 97% of its loan portfolio, while a recent estimate at ATI, using more rigorous criteria, finds repayment to be about 92%.[1] This is a remarkable record for a program of this nature, where delinquency is often high. How did UNO do it?

---

[1]UNO data on repayment were not sufficient for me to make my own estimate of repayment, so I relied on the results of the evaluation being carried out concurrently by ATI (1982). Given the more stringent criteria for delinquency used by ATI, the rate was still very good. (Mainly, ATI considered the total value of a loan as delinquent after only some payments fell overdue, rather than the value of the overdue payments only; this criterion is based on the assumption that once a certain number of payments fall overdue, there is a good probability that the rest will also.)

The difficulty of verifying UNO's delinquency calculation is that its data are broken down by the three of four different sources of its credit funds, so that one cannot get a picture of the whole portfolio. Also, the delinquency reading is not taken at a moment in time, but is a cumulative reading on a particular line of credit since its start. Bad debts, moreover, do not seem to be written off and dropped from the data. One of the main lines of credit started in 1976 and terminated in June 1980, while the other major line started in July 1980; given the cumulative representation of delinquency, the former line naturally shows a lower rate than the latter line, because it has already terminated and some delinquent borrowers continued to pay. For the older credit line, end-October 1981 data showed that 5% of the number of loans in the Recife program were delinquent (more than 3 months overdue), as were 8% of the loans in the interior program. For the later credit line, UNO showed 8% of the number of loans delinquent in Recife, and 18% in the interior.

Another clue to the state of UNO's delinquency is provided by the guaranty fund. All UNO loans are guaranteed by a fund set aside for the purpose. The fund was originally created from donations by large firms, and invested by UNO in the open market; today, the fund is administered by CEBRAE and financed from a 2% charge to the clients of all programs of subsidized credit to small and medium firms. From the beginning, 289 UNO loans had to be repaid by the guaranty fund; out of these, 92 were ultimately repaid by the borrower, leaving 197 loans paid out of the fund. This represents about 13% of the total number of loans from the beginning through the end of 1980.

High repayment and low discipline

To someone who observes UNO operate, the low delinquency rate almost comes as a surprise. Various features of the history and operation of the program would seem to be associated with low, rather than high, repayment. This makes the high repayment more remarkable, and challenges one to look harder for its explanation.

In theory, delinquent UNO borrowers are supposed to be dealt with in the following way. After 30 days of delay on a payment due--payments are due monthly on working-capital credit--the bank mails an advice of delinquency to the borrower, whose name then appears on a monthly printout sent to UNO. UNO investigates the cause for delay in the payment, and if it judges the cause to the justified (a sickness in the family, a bad turn in the business), it recommends that the bank accept late payment. The bank routinely accepts UNO's recommendation and a late payment charge is levied, equivalent to 1% of the value of the loan per year; interest must still be paid on the overdue amounts approved for late payment. If UNO does not recommend delayed payment, the bank sends additional notices after the second and third month of delinquency, and then initiates measures to collect on the loan, notifying UNO of this step.

In practice, lateness is treated less rigorously, particularly in the past. During some periods, the bank did not advise UNO of the delinquency, nor did it send a notice to the borrower; the bank, UNO said, found it less bothersome to simply collect on the loan after 90 days of delinquency. (This problem was particularly acute when the state development bank centralized its collection operations in 1980, and stopped sending out delinquency notices. UNO says that delinquency doubled during this period, and returned to normal in July 1981, when decentralized charging was reinstituted.) During some periods, moreover, the bank did not give or mail the borrower his loan "coupon" book, which indicated the due dates and amounts of each monthly payment; thus borrowers did not know what they were to pay unless they inquired. Until recently, bank delays in disbursing credit funds ran up to three or four months after the loan contract was signed (these delays have now been reduced to from eight to ten days). Since the repayment schedule was dated from the signing of the loan contract, this meant that the delayed loans were "officially" delinquent even before the funds were disbursed, because of the interest payments due during the three-month grace period. This created confusion among borrowers and a slow response at UNO to the first signs of delinquency.

Long bank delays in releasing loan funds also contributed indirectly to the risk of delinquency. When funds were delayed, loan applicants desiring to make a particular purchase of equipment or inputs would often go ahead and make the purchase anyway, out of funds borrowed on the informal market at high interest rates. When they finally received the credit, they would use it to pay off the informal money-lender, leading to difficulties later in paying off the UNO loan. (This is a common problem in such programs.) Another problem for repayment performance was caused by one particular bank-branch officer who told UNO borrowers that they need not worry too much about repaying on time because "this is government money." This portrayal of subsidized credit programs by bank officers or politicians, together with the ensuing problem of delinquency, is also common.

The bank's computerized accounting procedures are such that UNO cannot really be sure that a borrower is delinquent until his name appears on the printout two months in succession. (Each name appearing on the monthly printout as delinquent must therefore first be verified by UNO as also delinquent on the previous month's printout, before the borrower can be determined to actually be delinquent.) UNO visits the borrower about his delinquency only after three successive months of late payments. Finally, the fine charged on delayed payments--1% per year of the value of the loan, which is standard for various lines of credit--is perceived by borrowers as low and thus does not act as a deterrent.[1]

In trying to explain delinquency problems in small-producer programs, most commentators look into behavior of the borrowers or their businesses. Yet the problems presented above are bank-related, and are not unusual in programs involving subsidized credit for the poor. Recounting these problems not only gives more reason to stand in awe of UNO's high repayment rate, but also illustrates the role of participating banks themselves in contributing to delinquency. According to UNO, variations in bank behavior regarding delays and charging were correlated with marked variations in repayment rates. When coupon books were not issued, for example, delinquency increased; the greater the delays in the release of funds, as another example, the greater the ensuing delinquency. One of the two private banks that dropped out of the UNO program in 1977, UNO says, had none of the delay or charging problems

---

[1]In a study of Brazilian assistance to small and medium industry, the same low penalty for late payment--along with political favoritism and loose control by the bank--was pointed to as contributing to low repayment rates in a credit program administered by the Bank of the Northeast (Robalinho 1973:112).

mentioned above, and there was not a single case of delinquency in the whole portfolio (244 loans).

UNO's problems with bank delays and lax charging represent major struggles in its history, and occupied considerable time on the part of its managers. Whenever any such problem was resolved, it represented an important victory for UNO, often of a political nature. As told previously, the problem of bank delay in disbursing credit funds in the interior program was resolved only with the intervention of the state governor on UNO's side. Likewise, the recent resolution of the problem of bank laxness about charging was very much influenced by the arrival of a new bank director who, having worked in public-sector programs for small-scale industry, was sympathetic to UNO's goals. Seemingly trivial problems in bank procedures, then, can be just as significant a cause of delinquency as the behavior of the borrower. Perhaps because lending to the poor is new and the banking business is old, people tend to look to the borrowers rather than the banks for the cause of the problem.

UNO's high repayment rate comes as a surprise for other reasons. UNO staff do not feel completely comfortable about their role as intermediaries between the borrower and the bank. They see themselves as facilitators and do not want their clients to look at them as "loan collectors." Monitoring visits to clients are euphemistically termed "accompaniment." The students who do the field work empathize with the clients and their problems; it is that kind of empathy, after all, that has enabled UNO to be good at reaching this otherwise inaccessible group. The borrowers, surely, must sense the discomfort of the students in their monitoring roles. As one client reported in an UNO survey, "UNO is really nice, and not mean like the banks, who'll just go and start collection procedures as soons as you're a tiny bit late." All this, it would seem, would not add up to an environment of repayment rigor. Actually, the problem of excessively supportive promoters is not uncommon, causing some evaluators of credit programs to stress the need for "a healthy separation" between the persons providing supportive technical assistance and those entrusted with monitoring of loan payments (Kilby 1981:90).

That UNO does nothing until three successive months of overdue payments seems somewhat relaxed, given that the majority of UNO loans fall due in monthly installments and must be completely paid within 9 to 12 months after the grace period. My interviews with some delinquent borrowers reinforced my impression of casualness about short-term delays among borrowers. Some who were delinquent for more than three months, for example, had not received a notice from the bank or a visit from UNO. For some of the borrowers who told me they were delinquent, the delinquency was not on record in their loan file at UNO.[1] This strange combination of a certain laxness about collection with high repayment rates was also found in a similar credit program in El Salvador (PISCES 1981:175, 180).

Though default was low, in sum, short-term delays in payment were probably higher. Perhaps a certain flexibility about short-term delays does not necessarily jeopardize longer-term repayment discipline. This is particularly likely in highly inflationary countries like Brazil, where a few months' delay in repayment causes the real value of the payment to be lower, so that good and bad borrowers alike postpone repayment for as long as they are allowed to. Even without inflation, people will repay obligations only when they are forced to, especially when their capital is scarce and other creditors are more demanding.

If the reaction of UNO and the banks to borrower delinquency has been somewhat sluggish, then perhaps one should look elsewhere for an explanation of UNO's high repayment rates. One logical assumption would be that the selection process is so rigorous that it excludes the bad repayers from the start. Once the process of analyzing a firm is started, however, few applicants are rejected by UNO. In fact, I ran into five or six cases in the 25 individual files I read in which the student worker had recommended against the loan on the grounds of the shakiness of the firm or its owner, but the loan was granted anyway. Most of the applicants who do not receive loans drop out of their own accord, as noted above, an attrition rate that UNO attributes to "bureaucratic difficulties" involved in applying for credit (UNO 1979:2-3).

Repayment discipline and where it comes from

If there is nothing stringent about UNO's repayment environment, and nothing highly deliberate about selection with respect to repayment propensities, what explains the unusually high repayment rate? The answer is still a mystery to me, but I can suggest some possible explanations. First and foremost is that Brazil has a highly developed check system for consumer credit--the SPC (Servico de Proteção do Crédito), set up by citywide retail store associations in most large Brazilian cities. All delinquencies in payment of installments on

---

[1]Also, that UNO itself does not have measures of delinquency that reflect the current state of the portfolio also seems to suggest a somewhat less than rigorous approach to delinquency. Perhaps the monthly identification of delinquency cases is more than sufficient for being vigilant.

consumer credit are reported to this system, as well as bounced checks. Consumer credit offered by retail stores increased markedly in Brazil in the 1970s, and most Brazilians in large urban areas like Recife have engaged in substantial installment buying. Of the applicants for UNO credit, only a few do not have a record in the SPC.

If the SPC record shows an incident of delinquent payment, a person will find it almost impossible to obtain bank credit, let alone further consumer credit. People of little means live in fear of getting a bad record in the SPC; the fear is similar to that of small farmers who worry that if they delay payment on their credit, their land will be taken away. The high repayment rate of UNO borrowers, then, may be an effect of the financial environment in which UNO operates, rather than a result of something that UNO is doing.[1]

A second possible contributant to repayment discipline is UNO's policy of not refinancing delinquent loans--i.e., not granting loans that include amounts for repayments of previous loans.[2] Borrowers usually cannot contract for a second loan, moreover, until they have finished repaying the first. This is in distinct contrast to the widespread refinancing characteristics of subsidized agricultural credit programs for large borrowers.[3] Refinancing is rarely available to the poorer

---

[1]I am grateful to Henry Jackelen for pointing out to me the sophistication of Brazil's credit-check system, and to Andrea Calabi for explaining the system's intricacies.

[2]The year 1975 was an exception, when there was severe flooding in Recife, which is bisected by two major rivers. Floods destroyed the premises of many businesses, including UNO borrowers, and the federal government authorized the provision of emergency loans through UNO and other entities. Of the 212 loans made by UNO in that year, 54 or 25% were refinancings of previous loans to the affected businesses.

[3]In an inflationary country like Brazil, with certain interest rates kept below market levels, the refinancing mechanism obscures the loss to the bank as well as the extent of delinquency: the longer the period of repayment is stretched out, the greater the loss to the bank because of the erosion of loan principal by the intervening inflation, together with the absence of a correction of the interest rates. Obviously, refinancing is highly desirable to the borrower under these circumstances, since the more he refinances, the less he ends up paying, as long as inflation moves more rapidly than the interest rate, and there is no correction of the value of the principal.

clients of subsidized credit lines; they have nothing to offer the bank in exchange for the refinancing, cannot maintain minimum balances or buy a bank's unsubsidized services, and do not have the political power to obtain the favorable bank decision. In this sense, the absence of refinancing in the UNO program may not be that remarkable, reflecting simply the poorness of its clientele. But it does show that, unlike many credit programs, UNO's repayment levels are not masking less impressive lower repayment rates that are hidden from view through refinancing. Since most UNO clients hope to obtain subsequent loans, the knowledge that a second loan cannot be obtained without repaying the first must contribute substantially to repayment discipline.[1]

UNO's success at excluding larger borrowers must also have contributed to repayment performance. Bankers, business leaders, government technocrats, and UNO workers are unanimous in their opinion that poor borrowers pay better than rich ones. The literature on credit programs for small farmers suggests the same.[2] The explanation usually given for this phenomenon is that the poor are afraid of the consequences of paying late, while the rich know they can get out of them. The postponement of debt payment by larger borrowers is a particular problem in public-sector programs of subsidized credit, where borrower pressures to grant loans or refinance against the better judgment of the credit officer can take political forms. As noted above, UNO has done better than many other such programs at resisting political pressures to let in unqualified larger borrowers, having been dogmatic about keeping out applicants whose business did not fit their concept of a microfirm. To some extent, then, UNO's high repayment rate must be a function of its ability to exclude applicants with questionable projects and good political connections, and to

---

[1]The prospect of obtaining subsequent loans is considered so important for repayment performance that it has been cited as an advantage of lending for working capital rather than investment--the latter loans requiring much more time to repay and being associated with only one-time needs for financing (Anderson and Khambata 1982:19). Strangely enough, highly subsidized interest rates like UNO's, together with the hopes of obtaining subsequent loans, have also been thought to contribute to repayment--since borrowers know the credit is unusually cheap and do not want to jeopardize their access to it (Bottomley 1975, as cited in Anderson and Khambata 1982:19).

[2]Chuta and Liedholm report that "there is evidence in some countries" that default is lower among smaller farmers and businessmen than among larger borrowers (1979:71).

keep out firms that are large enough to have no fear of delinquency.

Though it has no explicit policy, UNO tends to shy away from longer-term investment financing--at least for its first experience with a borrower. It feels that owners of microfirms tend to immobilize their capital in land and fixed installations, and to therefore be short of working capital (Fuenzalida 1980:15). UNO's first loan to a borrower will usually be for working capital only (up to 15 months with 3 month's grace); if investment is financed (up to 36 months with 6 months grace), this will usually take place only in a second loan. Thus 75% of the value of UNO's new loans in past years has been for working capital--and is scheduled to remain at this level in the World Bank project for the Recife metropolitan area. As would be expected, investment credit has been more significant for manufacturing firms, representing 53% of the value of that credit.

Programs such as UNO's, with their subsidized interest rates causing an artificial reduction of the cost of capital relative to labor, usually encourage the undue substitution of equipment for labor--as well as installation of equipment whose capacity is frequently greater than the firm can profitably utilize. UNO seems to have been attentive to this danger. Less than half the value of investment loans has been for equipment, most of the rest being invested in modifications of physical plant (UNO 1978:T.VI). Thus even when UNO has lent money for investment purposes, equipment purchase has not been the dominant expenditure.

UNO's emphasis on working-capital as opposed to investment credit, and its caution about equipment, stands it in good stead with recent findings about small-business credit programs. These programs have tended to overemphasize investment credit as opposed to working capital--even though 50% to 70% of the asset structure of small firms is made up of working capital, and even though such firms are often overcapitalized, with an excessive investment in equipment and raw materials.[1] The overemphasis on investment in small-enterprise programs has been attributed to the orientation of aid donors toward imported equipment, and the focus of the small-enterprise literature by economists on fixed assets to the neglect of working capital, which has also resulted in a paucity of data

---

[1]Anderson (1981:55, 61). Working capital also tends to be a larger share of total capital for smaller enterprises than for larger ones. In the United States the ratio of working to fixed capital is 2.0 for small manufacturing enterprises and 1.23 for large ones (Kilby, Liedholm, and Meyer 1981:2).

in this area (Kilby, Liedholm, and Meyer 1981:7). In addition, Marris and Somerset found a preference among credit institutions for equipment loans over working-capital loans, because the equipment can be more easily described and evaluated in terms of the enterprise's prospects, and can be recovered in case of default (1971:183). Anderson and Khambata cite various works that note the tendency of governments to understate the importance of working capital. The impact of this cumulative neglect of working capital in credit programs has been repayment problems due to investment credits that were excessive, or not complemented with credit for working capital.[1] Thus UNO's working-capital emphasis, whether deliberate or not, has avoided the pitfalls of many other programs and perhaps contributed to its high repayment rates.

UNO is also conservative in setting loan amounts, reflected in the large number of complaints I heard about this from borrowers. Aside from the ceiling on loan size, now at U.S.$3,000 (Cr$400,000),[2] UNO usually reduces the amounts requested by borrowers. Many applicants, UNO says, automatically request the ceiling amount, without relating the request to their needs or repayment capacities. The delay in bank contracting and release of funds has further reduced loan amounts arbitrarily; a three-month delay, for example, would have resulted in an automatic 25% decrease in the value of the loan, given inflation rates of 100% during the last three years.

UNO's lending criteria are also directed toward selecting viable enterprises and projects. A firm must have been in existence at least three to six months,[3] and new activities are rarely financed, even for old firms. New activities and new firms have been found to be more than proportionately represented among delinquent borrowers in other programs (Anderson and Khambata 1981). UNO's loan applicants also do not automatically receive the amount they ask for; the decision as to

---

[1]A recent example of the latter problem is cited in another AID-sponsored evaluation of a small-business credit program in Honduras (Fraser 1982:21).

[2]Exchange rate is Cr$135 to the dollar.

[3]Though data on the age of UNO firms were not available, my sample of 42 retail food stores receiving UNO credit (see Table 7) showed only 10% of the firms were less than three years old. This compares to 63% less than three years old in a survey of retail microfirms in Recife (FIDEM 1981:67, T.3.5). A study of mortality among small firms in Brazil found that more than half the failing firms were less than three years old (Rattner 1978, as cited in Tyler n.d.:157).

whether the firm can repay and what the loan amount should be is guided by two criteria--the index of current liquidity, and the index of financial independence.[1]

UNO's much criticized lending to retail firms,[2] especially small food stores (21% of total loans), may also contribute to high repayment rates. Loans to retail firms are inherently less risky than those to service and manufacturing establishments; assets and sales levels are much easier to verify, retail inventory is more easily observed and a more easily appropriated asset if the borrower defaults, sales activity is not subject to extreme seasonal swings, and long delays in credit processing are less detrimental to repayment prospects because retail firms are regularly and frequently buying inventory. Though UNO's lending to retail firms may not have been the best choice in terms of growth and employment objectives, then, the financial conservatism of this emphasis may have contributed to UNO's higher repayment rates.

At the other end of the borrower size distribution, UNO's practices clearly exclude the poorest firms. As discussed later, UNO-assisted firms are better off than the average microfirm in Recife, and UNO does not work in the poorest areas of the city, the "mocambos" or "favelas." UNO has excluded this lowest stratum, it says, because these firms do not have the "conditions" to repay. This contention finds some support in a study of IDB-supported small-business projects that found that the more successful projects were those attending the better-off microfirms.[3]

---

[1]The index of current liquidity is the ratio of cash to debts. UNO considers a ratio of 2:1 to be good, and will not accept a ratio lower than 1:1. The index of financial independence is the share of the firm's own resources as a percentage of total liabilities; UNO tries to keep that share greater than 50% except in some cases of equipment purchase, where it feels that the owner will finance the costs not covered by the UNO loan in the informal credit market at very high rates, thus jeopardizing his repayment possibilities for the UNO loan.

[2]Criticism of small business programs for lending too much to retail establishments, as opposed to service and manufacturing firms, is common. Some evaluators of small-business programs in the United States have made the same complaint. See, for example, Johnson (1979:ii-iii, 26).

[3]Inter-American Development Bank files.

Another practice that excludes the poorest firms, as well as contributing to high repayment, is UNO's requirement of a co-signer. In contrast to typical bank practice with respect to co-signers, the UNO co-signer does not have to show assets of greater value than the proposed loan--which would eliminate many of the potential co-signers. The co-signer is usually a friend or relative of the borrower, from the same neighborhood. The value of the co-signature, UNO says, is more symbolic than real; borrowers have close ties to their co-signers and do not want to cause them problems by failing to pay.

The co-signer requirement also results in the exclusion of poorer firms from UNO's clientele. Many firms reported, to me and in UNO surveys, the greater difficulty they are having in finding willing co-signers. Some of those who had already obtained one loan reported their reluctance to seek another loan through UNO, because of the unpleasantness of having to ask a friend to be a co-signer. Thus the co-signer requirement may contribute to the high repayment rate by excluding unreliable candidates, though it also discriminates against poorer candidates who may be good risks.

Several things that UNO is doing, in sum, seem to be turning out "right" in terms of repayment performance--even though the loan collection environment has not been particularly rigorous. The right things can be summarized as: (1) the exclusion of large borrowers and other applicants considered undesirable, even though they have good political recommendations; (2) the exclusion of the poorest firms; (3) the requirement of a co-signer; (4) the scaling down of loan amounts requested by the applicant; (5) the emphasis on working-capital rather than investment financing, and the caution about lending for labor-saving or over-dimensioned equipment; (6) the policy of not financing repeat loans until previous ones are paid, and the absence of refinancing; and, overlapping with some of the previous points, (7) involvement with a type of client for whom the fear of a bad credit record is high.[1] Only an analysis of the characteristics of UNO's delinquent borrowers would show whether these suggested explanations are true.

Graduation

A small firm's credit experience with UNO should give it the chance to be introduced to a commercial bank and establish a record there, after which it is hoped the bank will take on

---

[1]Peer pressure to repay is often cited as very helpful for repayment in lending to small producers or farmers. In the case of UNO, however, peer pressure was not an element of this success.

the client directly. Herein lies one of the greatest potential indirect benefits of programs like UNO--a benefit that can contribute toward justifying the high costs of lending as "initiation" costs. If UNO steadily passes on its clients to direct bank borrowing, this also makes it possible to reach more new clients, rather than limiting itself to successive financings of old clients. If the UNO borrower is not able to gain direct access to the bank, then investment in that borrower has less justification: either the client continues to borrow repeatedly from UNO, thus limiting the number of new clients UNO can reach, or the client borrows from UNO once or twice and never uses institutional credit again. In the latter case, the impact of UNO credit will be limited to the temporary income-increasing effects of one or two loans--at least with respect to UNO's loans for working capital.

For all these reasons, the issue of graduation--i.e., whether clients are able to "graduate" to normal institutional credit--is an important one in programs attempting to provide poor producers with access to bank credit. The issue is particularly important in very small programs with highly subsidized interest rates, such as UNO, which by themselves can never aspire to meet the needs of a significant portion of the client population, and need a social justification for lending at subsidized rates.

In a previous section, I described the problems inherent in UNO's dependence on an outside and not always sympathetic organization to channel its credit--the state development bank. With respect to the issue of graduation, in contrast, the location of the credit outside UNO in a formal credit institution holds a certain advantage. It places UNO, as an advocate of microfirm credit, into an ongoing relationship with the bank, and allows the bank to become familiar and comfortable with a new kind of client. Just the opposite has occurred in the seemingly more desirable arrangement of an AITEC-supported program of microfirm credit in the Dominican Republic. There, credit is "in-house," administered by the same organization that chooses the clients, the Dominican Development Foundation. The Foundation and its clients, in turn, are seen as "a social program" by the Dominican banking community, which therefore has no interest in providing credit to its graduates. In contrast to this situation, one would think that the potential for graduation in the UNO program would be greater, given the formal involvement, from the start, of the bank with the client.

UNO does not keep regular track of its "graduated" clients, so that only fragmentary evidence is available on their numbers. UNO reported in 1978 that of the 631 firms to which it had made loans during the 1973-1978 period, 49% had graduated to the banking system--an impressive number (UNO

1978:16).[1] For the 1977-1979 period, UNO reported the share of "graduates" in the total to be lower, at 37% (UNO 1979:4). After 1979, data on graduates are not available.

Indirect evidence on graduation can be found by looking at the share of loans that are repeat loans. If UNO clients do not graduate, one would expect to find a large percentage of them taking successive loans through UNO--including those who could graduate, given the attractiveness of the low interest rate. UNO says that approximately 40% of its borrowers take second loans. If borrowers were repeating instead of "graduating," there would be a distinct upward creep in the share of repeaters, through the years, given that the number of one-time borrowers, and hence potential repeaters, would be increasing each year. From 1974 to the present, however, repeat loans in the Recife program did not seem excessively high--averaging 32% of total loans, with a high of 40% in 1978 (Table 2). Repeat loans since then have shown a declining trend, if anything; in 1980 and 1981, they were 31% and 26%, respectively, of the total. Thus the repeater data also seem to suggest that a larger number of potential graduates are not staying with UNO.

For various reasons, I suspect that the share of UNO borrowers who graduate may be lower than the numbers above suggest--at least at the present time. Of the 25 UNO clients (present and past) that I interviewed, only one had graduated to formal bank credit. These borrowers seemed to fall into two categories: those who were repeating or planning to repeat their UNO loans and, less common, those who had not repeated and were not planning to do so. Among the non-repeaters, I found none who had graduated to bank credit or who were planning to do so. The non-repeaters, moreover, were mainly problem cases, rather than successes. They were not repeating because they had paid late, because they became intolerant of delays in the processing of credit, because they could not find a co-signer, or because they were not doing well in their business and were afraid to take more credit. (In addition, there were the non-repeaters whose files I found but whose establishments had disappeared.) All the firms that were doing well, in short, were obtaining subsequent UNO loans or intending to do so.[2] All this made me suspect that UNO's success stories were to be found mainly among the repeaters--and that the

---

[1]In addition, 28% were still amortizing their UNO loans, another 10% had submitted proposals for subsequent loans, and 13% had closed.

[2]An UNO student worker also reported in an incomplete evaluation of UNO clients that "the large majority intended to seek a new loan through UNO" (UNO 1980-1981:25).

non-repeaters, far from being mainly "graduates," were the failures. Though my sample of borrowers was not necessarily representative, a few other pieces of evidence reinforced these impressions.

An UNO survey of 500 borrowers receiving or amortizing credit in the period 1978-1979 showed that 28% had previously obtained credit directly from a bank before taking UNO loans (UNO 1980). These borrowers might be among the 37% of borrowers who were reported as graduating during the 1977-1979 period. The graduates may have been "false" ones, in the sense that they had already had access to bank credit previous to UNO, and were attracted to UNO simply by the subsidized interest rate. In these cases, UNO credit would have provided nothing that the borrower did not already have, except the income windfall through the subsidized interest rate.

Also contributing to my impression of a low graduation rate is the attitude toward graduation on the part of UNO itself. Aside from the fact that UNO has no interest in finding out how many of its borrowers graduate, UNO managers and staff stress the "impossibility" of graduation: the additional documents, the real guaranties, the average balances, and the fact that other lines of credit for "small firms" are offered as prizes only to the bank's best clients, not the humble ones. They portray graduation as a futile expectation, at least for the majority of their clients.[1] Indeed, as UNO has started to grow and become better known, branch bank managers have been sending UNO some of the small firms that apply directly to the bank. Given that the subsidized loans for small firms are considered by banks to be prizes, it makes sense that managers would use every opportunity they could to turn away the qualified, but less prized firms--when a program such as UNO gives them the opportunity to do so.

The redirecting by banks of qualified applicants to UNO represents a kind of "reverse graduation," whereby firms who might normally have access to direct bank credit now cannot receive it because of the new opportunity to send them

[1]The evaluators of a similar program in Upper Volta also found "a gulf" between the successful credit experience of the assisted firm and what the firm would need to obtain credit from the banking system (Goldmark et al. 1982:36).

elsewhere.[1] Though I heard of these redirection attempts from persons at UNO and the bank, the number of such reverse graduates is said by UNO to be insignificant. With the large planned increase in UNO operations in Recife in the next three years, it is possible that UNO's vulnerability to redirection will increase, given the fact that it will have to move much more money per year, and per staff worker, than it ever has in the past.[2]

The "good works" vision of UNO shared by its founding fathers may also explain the lack of interest by UNO in pursuing vigorously the issue of graduation. UNO clients, in this vision, will never be able to make themselves acceptable to the formal banking system, which will never be willing to pay the high cost of servicing them. That is why UNO is considered "a good deed," in this view, rather than a program that could be replicated by the public sector. This kind of vision on the part of Recife's influential business, banking, and political actors meant that nobody with concern or with power was going to be pressing the issue of graduation with the banks. It should be noted, of course, that UNO already had its hands full simply trying to articulate a relationship with the bank that would result in the timely contracting and disbursement of credit, let alone the smooth functioning of collection procedures. It could not reasonably be expected to expend considerable effort in another battle that was not so crucial to the immediate functioning of its program.

Whereas UNO stressed documentation, guaranties, and average balances to explain why graduation was difficult, the UNO borrowers I interviewed, though also mentioning these problems, laid primary importance on the short period over which bank credit had to be amortized (as pointed out in the section on

---

[1]A similar redirection has occurred as a result of new agricultural credit programs for small farmers in Northeast Brazil, where branch managers of the Bank of Brazil have sent regular small-farmer customers to these new lines. As in the case of UNO, this redirection leaves more direct credit available for rationing among the best clients, and also reduces the bank's lending costs because, as in the case of the UNO program, most of the loan processing work is done outside the bank--in this case, by the extension service.

[2]It would seem that UNO could cope with this problem by adopting a rule used by its "disciple" in Ecuador--the Banco del Pacífico. There, any individual who already has a checking account at a bank cannot apply for this particular program's credit (PISCES 1981:220).

repayment); whereas UNO allowed 12 to 15 months for working-capital credit, borrowers said, banks were lending out short-term credit for no more than 60 days.[1] Firms that are not registered, moreover, must borrow as individuals at higher rates than those available to firms. Though borrowers also mentioned the higher interest rates at banks as reasons for their not planning to "graduate," the amortization period seemed more significant to them. Clearly, the high differential between the UNO interest rate and the other subsidized lines of credit (40-80%)--let alone credit at market rates (130-230%)--is a real disincentive to UNO borrowers to even try to graduate.

UNO and its borrowers are right when they say that it is difficult to graduate. The subsidized lines of credit to which they might normally move are blocked by the perverse effects of their subsidized interest rates, which results in tight credit being rationed to the borrowers most prized by the banks.[2] UNO's way of defining its purpose and its client group, in turn, reduces the significance of graduation: clients are seen as simply struggling to survive, rather than as having a potential for growth. They are seen as not being able to withstand the costs of becoming registered, tax-paying firms, nor does UNO advise them to do so. Graduation to direct bank credit, of course, is part of such a transition. Hence it is not surprising that graduation, like becoming legal, is looked at by UNO as beyond the realm of possibility for a large part of its clients.

Though UNO has up to now not seemed to put much hope in graduation, there are signs that the state bank is now taking more interest in handling some small firms directly. There is no doubt that the brushing of shoulders with UNO has played an important role in providing the bank with the knowledge, the experience, and the comfort necessary to help it move in this

---

[1]There is a special line of credit for working capital (CEF) that allows repayment in up to 15 months, but real guaranties are required and interest is 7% per year plus an almost full monetary correction, which would have amounted to a total of approximately 103% in 1981, compared to UNO's 25% rate of interest.

[2]Tyler also comments on this perverse effect of the Brazilian government's subsidized credit program for small firms (Resolution 388). Commercial banks use this lending, he says, "as a bargaining instrument in their dealings with large clients. Subsidized...funds are provided to the firm...in return for the purchase of other types of banking services at non-subsidized prices" (n.d.:164).

direction. Thus though graduation has not been paid the attention it should have, perhaps it will now begin to take on more importance. Were UNO able to show a large share of graduates among its ex-borrowers, the program would have considerably greater impact and justification.

Keeping Away the Unfit

UNO is very proud of having provided credit to poor producers who never had it before. It attributes its ability to do so, and to keep away the larger firms attracted by UNO's highly subsidized interest rates, to a series of qualifying criteria that it unfailingly enforces. First, there are ceilings on number of employees, firm owner's family income, annual sales, and fixed investment. The number of employees can be no greater than 5 for retail and services, and 10 for manufacturing; annual sales can be no greater than U.S.$62,000 (Cr$8.4 million) for manufacturing firms, and U.S.$44,500 (Cr$6 million) for retail and service firms; the ceiling for fixed investment is U.S.$52,000 (Cr$7 million) for manufacturing, and U.S.$37,000 (Cr$5 million) for retail and services; family income may be no greater than U.S.$9,000 (Cr$1 million); and maximum loan size is U.S.$3,000 (Cr$400,000).[1] Though the ceilings are high, given UNO's claims to lending to the smallest of firms, they are still significantly lower than the government ceilings on credit to microfirms--a fact of which UNO is quite proud. The CEBRAE ceilings are twice those of UNO for the number of employees, annual sales, and maximum loan size. (CEBRAE's ceiling on annual sales for manufacturing firms, U.S.$414,000, is actually three-and-a-half that of UNO's.)

Probably more effective than the quantitative ceilings is a set of additional qualitative criteria used by UNO for screening out inappropriate clients. The firm owner must spend the major part of his time working in the firm, the firm must be located in a lower-class neighborhood, and the firm owner has to be a "lower-class" person. In order to assure itself that the firm meets these criteria, UNO insists that the loan-application interview be conducted on the firm's premises. In contrast to the microfirm credit of the CEBRAE system, finally, UNO lends to firms that are clandestine.

UNO has also been helped, by events somewhat beyond its control, to keep larger firms away from its highly desirable credit. Various circumstances coincided to limit the demand

---

[1] Exchange rate for dollar values in this paragraph is Cr$135.

for UNO credit by small as well as large firms. First, UNO customarily interviewed the loan applicant extensively two or three times on the firm's premises, in addition to promising to make two or three onsite supervision visits after the loan was granted. This must have turned away some potential borrowers, particularly larger ones for whom direct bank credit, though more costly, would involve neither monitoring visits to the premises nor time-consuming questioning. The long delays between UNO's first contact and the final release of credit funds would also have had the same demand-constraining effect. In addition, the low loan ceiling of U.S.$3,000 (Cr$400,000) and the effect of 100%-a-year inflation in diminishing that value further would also have discouraged larger-firm pretenders to UNO credit. It was these three factors--delay, low loan value, and the numerous and extended UNO interviews--that were often complained about by UNO borrowers in my field interviews and in a survey conducted by UNO (UNO 1980-81).

Demand for UNO credit, finally, was limited by UNO's policy of not advertising its program beyond the promotional meetings it held periodically in the neighborhoods it had canvassed. A single departure from this policy--now regretted by UNO--was a radio advertising campaign in 1977, financed by a grant from the Inter-American Foundation. As a result of the radio announcements, UNO was deluged with requests and had to turn away a large number of people, many of whom came from the interior of the state, where UNO was not even lending. UNO decided thereafter that it could not handle that kind of vigorous demand.

Until the end of 1981, then, UNO closed each year with no waiting lines for credit. Because of its smallness and the costs of borrowing, particularly to large borrowers, UNO never really had to engage in the kind of credit rationing that results from the usually heavy demand for credit that is highly subsidized. It could carefully pick and choose, in an environment free of the pressures to lend fast and large.

UNO is now moving into a period where constraints on the demand for its credit are diminishing. As discussed above, the delay bottleneck has finally been broken with the bank, and loans that took three to six months to be processed and disbursed are now being handled within 10 days. Clearly, this will attract many borrowers who previously stayed away because of the delay and the reduction in real loan size caused by the intervening inflation. As also noted above, UNO has streamlined its loan application process so that time spent by applicants answering the questions of UNO field workers will now be about one-third of what it used to be.

Signs of an end to the times of constrained demand can be seen in UNO's backlog of applications (120) for the first time at the end of 1981, four months after the resolution of the delay problem. This increased demand, of course, is a sign of UNO's growth and the greater rapidity with which loans are being processed. Yet it could also weaken UNO's strength at keeping the larger applicants away; political pressure by larger clients to get access to UNO credit is likely to increase since the indirect costs of borrowing have gone down, and UNO's attempts to attend a large number of applicants will cause it to seek ways to streamline its approval process, such as the ways described above. All this may force UNO to be less careful and less concerned about weeding out the larger cases--since these cases will allow UNO to "get rid of" large chunks of funding at relatively low cost.

Another sign of increased demand, and perhaps of UNO pulling in the direction of large borrowers, is that many applicants are now seeking out UNO for the first time at its office in central Recife--having heard about UNO credit through friends or relatives who are clients. This contrasts with the past, when most applicants were sought out by UNO in the neighborhoods where it was canvassing. In fact, UNO did not even conduct any of its neighborhood promotion meetings in 1981 for lack of funds; these meetings were one of UNO's principal ways of getting to firm owners who were too shy or fearful of legal repercussions to get involved with UNO.

The trip to UNO's headquarters involves transportation costs and time away from the firm, given that most UNO clients are located at distances of from 30 to 90 minutes away by public transportation. The trips would be less costly for firms owning their own vehicles, and for owners with partners or employees who can be left in charge for a good part of the day; the trips are also more likely to be undertaken by firm owners who feel more confident about engaging with public bureaucracies. That more and more UNO borrowers have themselves sought out UNO, then, may result in a self-selection toward the better-off firms.

UNO is also being sought out more and more by applicants at its headquarters at the suggestion of some bank managers, who sometimes redirect small-firm applicants for direct bank credit to UNO instead. This redirection, described in the previous section, has developed not only because of UNO's increased funding, but because of the decentralization of the state bank's UNO operation to three branch banks in the Recife metropolitan area, in addition to the headquarters branch through which all UNO loans were previously processed. Located closer to the neighborhoods where UNO lends, these branch managers are more accessible to neighborhood firms. For the reasons discussed above, bank managers will try to slough off some of their small clients by having them borrow through the UNO line.

The potential for "reverse graduation"--whereby firms able to work directly with banks end up with UNO instead--tends to be exacerbated by the credit-tightening policies of the Brazilian government of the past few years. Small firms that might previously have had access to abundant subsidized credit are now squeezed out, as the diminished pool of credit gets rationed off to the larger firms. The smaller firms with previous access to the bank, then, are now looking for new possibilities of cheap credit, UNO being one of the few. Recession, credit-tightening, the self-selection of the better-off firms that go to UNO headquarters, and the opening of UNO credit lines in three neighborhood banks, in sum, will all increase the pressure on UNO to lend to its better-off applicants.

UNO is well aware of the pressures toward larger loans and larger firms. It is concerned about the fact that average loan size increased in 1981 for the first time by 8% in real terms. It is aware that the increase occurred in a year when the number of loans almost doubled, when delays were resolved, when many more applicants sought out UNO at its headquarters, and when UNO held no promotional meetings in the neighborhoods. UNO hopes that the opening of offices in the neighborhoods where it works, scheduled to take place under the new World Bank project, will help to reverse this tendency. It also feels somewhat protected by the fact that it can now redirect overly large applicants to a new CEBRAE credit program for microfirms being channeled through NAI. The NAI/CEBRAE ceilings are twice those of UNO's.

The rapid expansion planned by UNO under the World Bank projects, finally, may also endanger its ability to exclude the larger firms. Under the World Bank project for the Recife metropolitan area, UNO is expected to be making 2,000 loans per year by 1985, which represents a fivefold increase over the number of loans made in 1981. This degree of change represents a major transformation for any organization, and it would not be surprising if few of UNO's current ways of doing things emerge unscathed.[1] This kind of expansion, moreover, makes

---

[1]The evaluator of a small-business credit program in Honduras, which has also just received unprecedented increases in its funding (from AID and IDB loans), sets forth very similar concerns and predictions. With the new funding, the evaluator says, "the pressures to disburse many more loans rapidly will increase dramatically." This will force the organization to learn how to make more good loans at a lower cost, he says, and hence "the old system or methodology will break down..." (Fraser 1982:18).

UNO's loan-allocation power a more desirable object for manipulation by politicians and other powerful actors than was the case when UNO was small and its lending insignificant.

There is a certain contradiction, then, between UNO's success at attracting major funding and in streamlining its lending procedures--and its ability to continue serving, with highly subsidized credit, as humble a clientele as it has served until now. This is not to say that UNO is doomed to drift upwards in the size distribution of firms. UNO's fierce commitment to its target group, its pride at being "the only one" who serves that group, and its contempt for other agencies that say they are serving microfirms but who "really" are not--all represent a strong force in the opposite direction. In determining how UNO evolves, this force may turn out to be just as strong as those of demand, political pressure, cost, and program expansion.

Business Extension

UNO gives courses to firm owners in the neighborhoods where it lends. Each course lasts two weeks, and consists of four "modules": basic management, transactions with banks, basic bookkeeping, and sales promotion. The course is attended by an average of 15 firm owners, most of whom are UNO clients or applicants, though they need not be.[1] UNO's permanent staff conducts the courses, which are assumed by UNO to use approximately 30% of the operating budget.[2] UNO considers its extension efforts to go beyond the courses to the students' visits to clients during the loan-application and monitoring

---

[1]In 1980, UNO gave the sales, banking, and bookkeeping modules four times in Recife, and the management module 12 times; 198 owners attended the management module, which represents 64% of the firms receiving loans that year; 73 attended both the banking and sales-promotion modules, and 52 attended the bookkeeping module (UNO 1981:T.4.). (I make the comparison to numbers of loan recipients only to give a rough idea of the share of recipients participating; in any one year, some course participants will have received loans in previous years, some participants may not receive a loan until the succeeding year, and some participants may never receive them.)

[2]This includes the interior program as well, and would have amounted to U.S.$220,000 (Cr$20.1 million) in 1981. In 1980, twice as many courses were given in the interior as in Recife. My budget figures for UNO do not separate out the Recife program.

periods. On these occasions, the student workers give advice to clients about how to improve various aspects of their enterprises. In Recife, UNO does not provide technical assistance regarding production processes; in the interior program, UNO has made arrangements to provide technical assistance when necessary through the state technical assistance agency ITEP, which has made one staff member available for this purpose.

It is important to evaluate the contribution of UNO's extension efforts to the assisted firms because (1) the extension is costly, as can be seen from the share of UNO's budget that extension consumes; (2) if extension advice is accepted and useful, the resulting increases in production and productivity will increase the program's benefit-cost ratio--thus providing a justification for the extension expenditures and the high unit costs of delivering credit; and (3) this type of extension is a common component of small-business credit programs, and thus any judgments about its value can help in the design of future projects.

Cost-minimizing considerations have been important in determining the standard form in which UNO and other such programs provide extension. Whereas students are considered capable of being trained to give advice regarding management and bookkeeping (what UNO calls "training"), extension involving the production process (what UNO calls "technical assistance") is considered to be beyond the capabilities of these "cheap" student workers or other paraprofessionals. This distinction between "training" and "technical assistance," and the desire to use students because they are cheap, partly explains the exclusive emphasis on management training of many programs such as UNO, as opposed to technical assistance regarding the production process. The use of students and other paraprofessionals, that is, resulted from the desire of such programs to provide business extension and, at the same time, the realization that it was very expensive to do so on an individual basis. The only way around this dilemma was to train inexpensive workers with no business experience in a simple consulting procedure, and to identify needs shared by all businesses, so that extension could be provided more cheaply to groups rather than to individuals. Because bookkeeping and management are the only skills required of all firms, extension tended to concentrate on these subjects which, it was felt, could be systematized into generally relevant routines, easily learned by workers without business experience--namely, group teaching of bookkeeping and management techniques.[1]

The difficulty of providing advice regarding the production process through inexperienced students or other paraprofessionals is less of a problem when one is lending to retail firms, as UNO does in Recife. This suggests that UNO's emphasis on retail firms, as opposed to manufacturing and services, may also reflect a wise adaptation to its limitations. The fact that only the interior program of UNO provides technical assistance to the production process, through a contract with an outside agency--and that loans to manufacturing and service firms play a larger role there--is probably a result of that program's being much more liberally funded than Recife until now.

Extension and impact

UNO's courses for microfirms and the advice given by students seem to have little impact. Of 25 UNO clients I interviewed in Recife, only one had attended the courses. An incomplete UNO evaluation of clients in 1980 and 1981 also reported low rates of attendance; out of 35 clients, only 13 or 38% had attended the courses (UNO 1980-81). The impressions reported by one of the field researchers for this evaluation were similar to my own: "Many of the interviewed [clients] never participated, hadn't been asked to, nor had even heard that UNO gave a course..." Most of those who attended the courses said that they "could not put anything they learned into practice (UNO 1980-81:15)." Many participants attended the course while their applications were being processed--assuming, incorrectly, that "this demonstration of good faith would help them get their loans (UNO 1980-81:10)." Some participants came only to the first few meetings, enjoying them for their social aspects more than anything else. Some participants, as well as UNO staff, mentioned that the courses

---

[1]The elements of this history are taken from Marris and Somerset (1971:219-221) and Harper (1975:368). Not all practitioners accept the idea that the cost constraint makes group extension more preferable to individualized assistance in the management area. John Hatch, who has worked extensively in Latin America assisting small farmers to keep books, argues that intensive individual assistance to a few small farmers has proved to have very high spillover effects in terms of imitation by neighboring farmers--when the latter see the increases in their neighbors' income that result from the improved management practices.

lumped together all kinds of firms--retail, services, and manufacturing--so that the information provided was excessively general and therefore of little value.[1]

Many small-business credit projects provide courses for firm owners, and some actually require that loan applicants attend before they can obtain credit; the AITEC-assisted program in Cali, Colombia is an example (PISCES 1981). It is not unusual, moreover, that these "training" exercises are judged ineffective. An evaluation of such a program in El Salvador found that the training was "ineffective and not well received," and that clients often participated only to qualify for credit, "but very seldom actually apply what is taught (PISCES 1981:185)." Those negative findings resulted in the termination of the training component of that program. In copying the UNO program in Ecuador, the Banco del Pacifico left out the training courses completely, to "keep costs down" (PISCES 1981:219). A small-business credit program in Upper Volta, sponsored by a U.S. private voluntary organization, also decided that management assistance was "unnecessary and inappropriate" (Goldmark et al. 1982:130). Though the sponsoring organization had originally viewed management assistance as "the most important vehicle for achieving enterprise development," their experience led them eventually to pare down that part of their program radically.

The recommendations offered by UNO's student workers during the loan-application and monitoring visits also seem to have little value or impact. Of the 25 client files that I read, the recommendations recorded by the student workers were quite formulaic, and almost always the same, particularly in the case of retail establishments: (1) keep written records of receipts and expenditures; (2) keep written track of inventory; (3) diversify the inventory; and (4) improve the visual or hygienic aspect of the store. Just as routinely, monitoring reports told how clients rejected the recommendations or did not put them into practice. With respect to keeping records, firm owners usually said that they did not have the time, or that it was "a waste of time." As one student researcher reported in the above-cited evaluation:

> Fifty percent of the clients [9 out of 18] said the supervision visits were understandable, yet they did not put the recommendations into practice--either for lack of time, or because they thought them to be

---

[1]The "excessive generality" of UNO's training programs was also criticized by Osório (1981:31), who recommended that firms engaged in similar activities should be grouped.

> inappropriate in light of their long experience in business. Some expressed the hope that UNO might send a more experienced person with more specific advice. The other 50% thought that supervision visits were simply a check to see if the funds were being properly used.... The recommendations given during the visit were of no interest to them, since they said they had more experience than those who were advising them (UNO 1980-81:12).

These firm owners looked at the monitoring visits as "something to put up with stoically, given that they had obtained what they wanted" (UNO 1980-81:38).

Though UNO's clients saw the pre-loan interviews and the monitoring visits as a necessary evil, this did not mean that they disliked the students. To the contrary, they saw the students as extremely nice people who worked hard to help them get credit. An amusing illustration of this sympathy for the students combined with disinterest in their advice, is the comment of a firm owner as reported by one of the interviewers in the above-cited evaluation. Though the recordkeeping recommended by the UNO student worker was really "unnecessary," the firm owner said, he nevertheless bought a notebook to write things down--"due to the insistence" of the worker. Now, when he thinks that he is about to receive a monitoring visit from UNO, "he takes note of some numbers, pulled out of his cap and wrong at that, [so that] the [UNO] girl can do her job." Though this recordkeeping has been "just one more extra piece of work required by UNO," he said, he really "didn't mind because the UNO workers are such good people, and they are trying very hard to help (UNO 1980-81:34)." The recommendation to keep records was adopted by this client only to please UNO--and in a form that served only that purpose, rather than its real purpose of helping the firm to become more efficient.

In sum, UNO performed well at bringing formal credit to microfirms and at gaining enough trust that they would take credit. At the same time, it performed unimpressively in the area of extension, a not unusual outcome.[1] UNO's clients were also of this opinion, as indicated in the quotations above; they saw their new access to credit, and the invaluable intermediation of UNO, as worth so much that they were willing to put up with the occasions on which advice was profferred.

In describing these perceptions of UNO clients, one of the interviewers noted that many clients "have no real understanding of what UNO is," and think that it is "just a bank." They have no concept of "the difference between a selection visit and a monitoring visit," the interviewer noted, "for everything is the same in their eyes" (UNO 1980-81:22). My impression of UNO's contribution is closer to that of the clients than of the UNO researcher, who attributes the vision to a lack of understanding. Being "just a bank," I would say, was not only a fairly accurate description of UNO, but also represented an accomplishment. But it is difficult for UNO to accept this self-image for reasons discussed below.

UNO's extension efforts could have perhaps benefited by some participation by its clients in program design. With the clients having a say in the content of the training, the ineffectiveness of UNO's extension might have been traced to the inadequacy of the program itself. The clients, moreover, would probably have unabashedly endorsed the idea of UNO as "just a bank"--uninfluenced as they would have been by the accepted wisdom of what a "respectable" small-business program should look like. A little participation in this instance, in sum, might have helped UNO to respond better to this particular shortcoming.[2]

---

[1]The quotations in the previous paragraph are remarkably similar to reports on the above-cited project in Upper Volta. "Some clients proved able to learn these management techniques, but...almost none used the information they so painstakingly recorded to analyze what was happening in their business" (Goldmark et al. 1982:50, citing the sponsoring organization's final report). It was also observed that "clients often kept careful accounts until their last loan repayment, and then immediately ceased keeping such records. Books were kept, explained several clients, not as a management tool, but to please the assisting organization's staff and visitors..." (Ibid., p. 50).

[2]AITEC reports that, currently, the most successful management training courses are the most participatory ones. A sign of the success is that in at least one of these programs (in Bogota, Colombia), clients pay tuition. In the Upper Volta program mentioned above, clients are sometimes used quite effectively as business extension agents (Goldmark et al. 1982:51).

Extension and organizational respectability

Why would UNO continue committed to its training program, given its costs and the negative reports coming in through its own evaluation research? It should be noted, first, that the evaluation cited above was never completed, because of a shortage of funds; the quoted observations are taken from the written reports of seven student workers at UNO, each of whom interviewed between 10 and 20 UNO clients. Thus UNO does not really have a completed evaluation telling it that its training is ineffective, though the field reports certainly provide enough material to raise questions.

UNO's training costs have been singled out on various occasions for financing by foreign donors or Brazilian government entities, which wanted to attach their contribution to a specific activity.[1] The attraction of donors to training, then, may have been more significant in determining its continued attractiveness to UNO than any evidence of its value. Training also continues unquestioned at UNO probably because it is part of the accepted wisdom about how to go about doing a small-business credit program. As discussed above, UNO-type extension courses evolved in response to the desire to provide business extension in a way that was not as prohibitively costly as firm-specific assistance. But once one divorced the extension from the problems of any particular enterprise, the resulting courses were too general to be of use, as the comments of UNO clients indicate. Management courses nevertheless became "respectable" parts of small-business programs because they satisfied the desire to provide "low-cost" business extension, rather than because they were shown to be effective. If you were a "good" organization, then you did management training.

The unswerving commitment of small-business credit programs to training also follows from their analysis of "the microfirm problem." It is not only that microfirms have no access to credit, according to this view, but that they do not know how to do things properly and need to learn how to run their firms more effectively. Though there is some truth in this judgment, the emphasis on it represents a "comfortable" analysis of the problem. It is politically and organizationally easier for a government to be in favor of business training than to open up to small firms the system of government credit, government procurement, import preferences, and

---

[1]The Inter-American Foundation, PACT, and the Brazilian Ministry of Labor have attached their donation to UNO's training program.

other subsidies. Training, in addition, represents what a small project organization can do, whereas the coverage provided by government programs and policies is often beyond its control. The "need for training," then, is a more "functional" explanation of the problems of the small-firm sector than its exclusion from a system of incentives. Management training courses are popular, in sum, because they are easier to do, politically and organizationally, and because this analysis of what is needed leads to support for the organizations wanting to work in the small-business sector.[1] This gives strength to the diagnosis of management inefficiency as a source of the small-firm's problems. All this does not mean, however, that training is necessarily effective. But the "functionality" of training causes it to be assumed to be effective.[2]

I do not question the judgment that microfirms could improve their management. Indeed, various studies have suggested that many small firms have an adequate supply of cash and that additional credit without improvements in management,

---

[1]A similar argument can be made for the "functionality" of the myth of the ignorant peasant farmer with respect to the considerable financial support provided for agricultural extension--despite various reports on the inappropriateness and ineffectiveness of many extension recommendations. See Tendler (1982b:70).

[2]In commenting on the Recife urban development project of which UNO is a part, Osório also expresses "some doubts with respect to the effectiveness of...training programmes at both managerial and worker levels" (1981:33). Schmitz also criticizes the emphasis in Brazil on management training as "the favorite recipe" for small-enterprise problems (1982:179). He notes that proposals to change the whole incentive structure regarding small enterprises receive little consideration at government levels, whereas support is much more likely to be forthcoming for proposals to remedy the small firms' "lack of managerial ability." Given the greater relative importance of external factors versus those internal to the firm, he argues, "managerial training hardly deserves the priority it is given" (Ibid.).

will have little impact.[1] But the idea that one thing will work (credit) only if it goes together with another (training) is questionable. Though an effective training program might have added to UNO's impact on its clients, the lack of such a program does not therefore take away from the achievement in credit. More important, an ineffective training program is certainly not better than no training program at all. Even if one admits that microfirms need training at least as much as they need credit, a perhaps more relevant view of reality is that organizations providing assistance to microfirms seem to not do as well at training as they do at providing "just" credit. This reality may be a better guide for deciding what such programs should look like, rather than an ideal vision of all the things that need doing.

---

[1]Harper (1975b:369-370) says that inefficient management often gets misinterpreted as capital shortage, given that many firms show excessive investment in inventory and underutilized equipment. Kilby (1981:28) also sees "financial and business management know-how" as the major problem, rather than "the lack of cash as such." The PISCES research on small-business credit programs (1981:222) notes that the sum of various administrative inefficiencies can cause an actual shortage of working capital, thus leading to the mistaken belief that what is needed to remedy the situation is a loan.

IV - The Borrowers

Do UNO's borrowers live up to their description? Are they beyond the formal credit system? Do they actually live and work in poor neighborhoods? Where do they lie in the income distribution? What kinds of firms are they?

Data collected in a survey of 500 borrowers provide some basis for answering these questions.[1] Of the surveyed firms, 42% are retail establishments; 24% are manufacturing enterprises (including 7% mixed service/manufacturing and 3% mixed retail/manufacturing); and the remaining 34% are service firms (including 12% that are mixed retail/service). The largest single category of firms is small retail food markets, accounting for 21% of the total.[2] Of the 500 firms, 39% operate on the owner's home premises, 46% have no employees except the owner himself, and an additional 44% have between one and three employees, in addition to the owner. Thus 90% of the firms have less than four employees. A majority of the firms (63%) had annual sales levels less than U.S.$16,300 (Cr$709,200).[3] The family income of a majority of the firm owners (73%) was less than five times the prevailing minimum wage, and the income taken out of the firm for family expenses was less than five minimum wages for most of the firms (91%).[4] A majority of firm owners (51%) did not own their homes.

Most of the firm owners surveyed by UNO (78%) reported not having other sources of income. The most common form of other

---

[1]UNO 1980. The 500 firms are not a sample, but represent all firms in Recife for which UNO prepared loan proposals between April 1978 and August 1979.

[2]Next, in decreasing order of importance, are auto repair shops (5%), small restaurants and snack shops (4%), electrical repair shops (4%), furniture manufacturing (3%), photography shops (3%), small dry goods and notions stores (2%), small clothing stores (2%), metal-working shops (2%), primary schools (2%), beauty salons (2%), and manufacturers of cement or ceramic objects (2%). Together with the food markets, these categories account for 53% of the loans.

[3]All data reported from this survey are in 1980 dollars, and were converted from cruzeiros at the rate of Cr$52.699 to the dollar.

[4]In 1980, when the survey was conducted, the monthly minimum wage was equal to U.S.$54 (Cr$2,364).

incomes was property rent (received by 14% of the total owners) and social security payments (reported by 7%). Of the salaried workers employed by UNO borrowers, 48% earned less than the minimum wage; 22% of total workers were not remunerated, most being unpaid family workers. Of the total number of paid employees, only 7% were registered and received the benefits of the labor legislation (minimum wage, paid holidays, 13th salary, severance pay, social security, and medical insurance contributions). Most of the firms (87%) did not pay the business income tax and a majority (51%) were not registered as businesses. A majority of firms, finally, had never had bank credit before UNO (71%).

A majority of UNO's clients, in sum, seemed to fall within the category of informal-sector enterprises: low annual income and sales levels, little access to formal-sector credit, few paid employees, precarious wages and working conditions, and operation outside the law in terms of taxes and city codes.

A Good Place in the Distribution

Though UNO seemed to be operating within the informal sector, it was also not lending to relatively poor microfirms or people. A survey of microfirms in metropolitan Recife (FIDEM 1981), together with Brazilian census data, provide a basis for comparison. Whereas 22% of UNO firms reported outside incomes from property rental or social security payments, only a small percentage of the microfirms surveyed by FIDEM received such payments. Whereas 38% of UNO firm owners were contributing 16% of their incomes for social security and medical insurance payments for themselves as self-employed workers, only 3% of the FIDEM firms were making such payments. Finally, the average monthly sales of UNO firms were considerably higher than those of the firms surveyed by FIDEM; whereas only 25% of UNO firms showed average monthly sales of less than U.S.$5,400 (Cr$19,700), more than 72% of the FIDEM firms showed monthly sales that were less than this amount.[1]

---

[1]These figures are all in 1980 dollars. UNO firms, however, were similar to the FIDEM firms in the number of employees, with approximately 88% of each group having four or less employees. This is not necessarily inconsistent with the large difference in the average sales of the two groups, because of the large number of retail firms among the UNO clientele, for which sales and employment levels do not vary together as much as they do for service and manufacturing firms--at least for the small size of the UNO retail firms.

Another indirect sign that UNO firms are better off than the poorest firms is the low percentage of loans going to female-headed firms. Only 15% of UNO firms are headed by women; the largest concentration is in the retail sector, where women account for 22% of the firms (most of the female-headed firms are small clothing-sales operations).[1] Female-headed firms and self-employed workers are known to be disproportionately represented in the informal sector.[2] Some other credit programs have been able to reach a significantly greater number of such firms. In a credit program to small firms in El Salvador, 86% of the clients were female (PISCES 1981:173).

Another sign that UNO firms are not among the poorest comes from data on the earnings and household incomes of the owners of UNO firms. A comparison of imputed wages and family incomes of UNO firm owners to the population of metropolitan Recife shows that UNO firm owners are, on the average, not poor in either relative or absolute terms. Whereas the imputed wage earnings of only 17% of UNO firm owners were less than one minimum wage,[3] 59% of the economically active population in metropolitan Recife fell in this category in 1970.[4] Similarly, whereas an additional 51% of UNO clients earned more than two minimum wages, only 16% of the economically active population

---

[1]Even this share may be somewhat overstated, because some male owners register their firms or their loans in the names of their current wives, so that property rights do not accrue to former wives under Brazil's common-property laws. In some other cases, retired persons, not being able to take out a loan in their own names, will register the loan in the name of a daughter (or son).

[2]Mazumdar 1976:660. The same source reports on research in urban Peru by Webb, which showed that even when female domestic laborers are excluded from the data, 61% of the self-employed in the informal sector are women.

[3]These data were collected before the client received an UNO loan. UNO constructs the imputed wage by asking firm owners to state their household expenditures for food (including the monetary value of goods taken out of client-owned food stores), light, water, education, clothing, medicine, etc. If anything, one would expect this figure to be biased downward.

[4]See Table 4. Comparable data are not yet available for 1980, though the 1980 distribution for the economically active population outside agriculture in the state of Pernambuco is available and is also presented in Table 4. The non-agricultural labor force of metropolitan Recife accounts for 61% of the state total (450,000 out of 740,000 in 1970).

of metropolitan Recife fell into that stratum (Table 4). A majority of UNO clients (83%), in other words, was earning more than the bottom 40% of the working population of Recife (actually, the bottom 59%, but I prefer to leave some room for improvement in the distribution between 1970 and 1980). Correspondingly, 51% of UNO's clients were in the top 16% of the earnings distribution.[1]

Comparing the household income of UNO firm owners to that of the poor urban population of the Northeast shows differences of a similar magnitude (though the data are also available only for 1970 and refer to the whole urban Northeast, of which Pernambuco is one of seven states). Whereas 47% of the urban population of the Northeast shows an average family income of less than one minimum wage, only 5% of the households of UNO clients are in this stratum (Table 4). Similarly, whereas 72% of Northeast urban households have an average monthly income of less than two minimum wages, only 26% of UNO households are in this situation. The majority of UNO households (74%), in other words, have incomes placing them in the top 27% of urban households in the Northeast. According to these earnings and family income data, in sum, most UNO firm owners do not seem to be poor in either relative or absolute terms.[2]

More direct evidence of the place of UNO firm owners in the income distribution comes from UNO itself. In its 500-firm evaluation, UNO reported that the owners of its client firms "generally have a better standard of living than the rest in their neighborhoods--and are even better off than many formal-sector workers (UNO 1980:119)." My own visits to UNO's clients left the same impression.

UNO does not deny that it lends to better-off microfirms, and that it does not lend in the poorest neighborhoods, the so-called "mocambos" of Recife. These poorest firms, UNO says,

---

[1]The difficulties of drawing conclusions from two such different sets of data cannot be overestimated, and make impossible any precise statement of the place of UNO clients in the income distribution. For this reason, I have presented the less desirable but more recent data for comparison in Table 4, as well as comparison of household income in the text following, both of which show results of similar magnitude.

[2]Various estimates of the absolute poverty line in Brazil range from one or two minimum wages per family, representing the bottom 15% to 47% of households, depending on how income is defined (Pfefferman and Webb 1979:99-101). I am most grateful to Ricardo Moran and Lorene Yap for helping me to locate data on Brazilian earnings and income distribution.

would in no way be able to repay a loan.[1] UNO also feels that working in the poorest neighborhoods makes it vulnerable to certain political pressures; neighborhood leaders, it says, try to use UNO and its control over scarce loans to further their own political ends. While this kind of concern is understandable, it is not clear why such pressures would be greater in the poorest neighborhoods than in the others where UNO operates. UNO is now thinking of extending its operations into some of these poorer neighborhoods, having conducted censuses of firms in some "mocambos" of Recife during 1981.

Lending to the top

That UNO's clients are in the upper 30% or 40% of the income and firm-size distribution should come as no surprise. Research on the informal sector has shown that owners of small firms similar to those borrowing from UNO are not only better off than most informal-sector workers, but also earn more than many formal-sector employees. In an analysis of data for metropolitan Recife, Souza shows that "the critical labor problem" is among the small sellers of services, the self-employed workers in subordinate relationships to others, and domestics--all of which account for 20% of the labor force and have an average income of a little more than three-fifths of a minimum wage (1980:43). Family firms, in contrast, show an average income much higher than the rest of the occupational categories in the informal sector--roughly 2.5 times the minimum wage (about 50% of UNO firm owners are above even this level, as Table 4 shows). As in the UNO evaluation cited above, Souza notes that the standard of living of small firm owners is actually higher than that of unskilled workers employed in formal-sector firms (1978:31-33). Indeed, Souza specifically mentions UNO as an example of a program that "should not be considered a policy for the informal sector" (p. 179) because it is relevant "only to the most prosperous and least problematical units" (pp. 31-33).

These findings are not unique to Brazil. Mazumdar (1976:666), for example, reports on findings from Malaysia, Peru, and Tanzania, showing "a wide diversity of earnings among the self-employed, and evidence that a substantial proportion of this group performs better than wage earners" (1976:666).

---

[1]AITEC's literature incorrectly describes UNO as lending in "favelas"--the word used in Rio de Janeiro for the "mocambos" of Recife. UNO, in contrast, is very clear that it does not work in "mocambos"; indeed, UNO workers express fear and dislike for these neighborhoods.

Squire reports on research in various countries showing that the productivity and incomes of many in the informal sector are at least as high as, if not better than, those in the formal sector (1981:141-142).

What is remarkable about the status of UNO clients is that so many businesses providing an adequate living to their owners are outside the formal system of financial intermediation, state control, and state benefits--i.e., are without access to bank credit, cannot "afford" to pay taxes, and do not observe the labor legislation. Even though the businesses are better off than the poorest firms, and their owners are well above the bottom 40%, they are in important ways not integrated into the private-sector economy, as regulated and benefited by the state.

That UNO clients are better placed than one might think in the distribution of income and of microfirms is of considerable significance for the way UNO and similar programs are justified. By helping small businesses to stay afloat, UNO loans are said to keep their owners out of the pool of urban unemployed. This contention, in turn, is based in part on the assumption that owners of UNO-type firms are engaged in "informal-sector activities" because that is their only alternative to an inadequate offering of formal-sector jobs.[1] But the position of UNO clients in the distribution of earnings and family income suggests that they are well above the stratum where the unemployment problem lies. My interviews with UNO clients, moreover, showed that most of them left formal-sector employment voluntarily to start their own firms, because they thought they could do better--which they say they are now doing. This type of occupational history--voluntary exit from

---

[1]This way of describing microfirm owners is not uncommon. The PISCES research on Latin America carried out by AITEC also describes informal-sector businesses as resulting from "the inadequacy of formal-sector employment" (PISCES 1981:196).

the formal sector to the informal sector--is common, and has been found among clients of other such programs.[1]

UNO-assisted firms, then, are not a manifestation of the inadequacy of formal-sector employment, nor do their owners stand poised at the edge of the pool of urban unemployed. There is certainly a poorer stratum of microfirms that may better fit this description--the hawkers, vendors, and small traders who are assisted with average loans that are only a fraction of the size of the UNO loans. But it does not fit the UNO firms, owned as they are by persons who had the chance for formal-sector employment, took advantage of it, rejected it, and moved on to something better.

The distinction between UNO's clients and the bottom 40% is not an academic one. If UNO clients are as well off as they are with respect to income and formal-sector employment possibilities, then employment opportunities for firm owners really cannot be offered as the justification for such programs. If one is concerned about creating employment, one would either lend to much poorer firm owners or design a program that seeks to expand the number of jobs offered by small firms. Data on new jobs created by UNO-assisted firms do not reveal strong job-creation results, as described below (see Section IV, pp. 112-116). Justifying UNO in terms of its employment benefits, in sum, would appear to be inaccurate.

---

[1]In case studies of the apparel, weaving, and hammock-making industries in Brazil, Schmitz found that small independent entrepreneurs "are not unsuccessful job seekers but relatively skilled workers who left their jobs of their own accord" (1982:5, 155-156; also 1979:31). The main reason for leaving their jobs was "the low level of wages." "It does not make sense," he says, "to view the informal sector simply as a way of making a living for those who cannot get a job in the formal sector" (1979:35). Souza found that most categoreis of self-employed workers in Brazil were better off than salaried manual workers (1978:43). The World Bank reports on research in Colombia showing that "workers improved their income more rapidly when they sacrificed the stability in employment offered by the formal sector" (1981/1982:25). Also in Colombia, Peattie found that many persons in informal-sector occupations had worked as wage laborers in the past (1980:27). Research on 578 firms in the informal sector of Nairobi showed that most firm-owners were not "frustrated job seekers from the formal sector" (Kilby 1981:40). Squire reports on various studies showing that "many of the self-employed express no desire for wage employment in the formal sector" (1981:141).

Credit and the Firm: The Question of Expansion

The majority of UNO's clients did not seem to experience marked changes in growth or productivity as a result of UNO's loans. In general, the most important effect of the loans seems to be a decrease in the costs of a roughly stationary volume of business, and hence an increase in profits. Costs fell because (1) UNO credit at 25% interest was substituted for much more expensive informal credit, and (2) UNO credit allows firms to buy supplies and inputs in larger quantities, and at lower costs. Owners of small food markets, for example, commonly reported that they could now buy more inventory; whereas before everything would be sold "almost immediately" after purchase, they said, they could now buy one or two months' supply at a time.[1]

The reduced input costs, and the facilitating of larger inventories, are typical findings in evaluations of microfirm-credit programs. What is curious about these results, however, is that the cost savings and the resulting profit increases did not lead to increases in sales levels or changes in production processes. The decreased costs, in other words, seemed to translate mainly into a higher income for reinvestment in working capital and in an improved standard of living for the owner and his family.

UNO's staff and managers agree that the majority of their client firms have not expanded, and are candid and modest about the effect their credit has on their clients' businesses. They see themselves as helping micro-businesses to survive, as noted above, rather than to expand and become something different--as preventing unemployment (of firm owners) from getting worse, rather than as facilitating increases in output and indirect employment. "We are not interested," they assert, "in creating little capitalists!" This way of thinking, UNO says, partly

---

[1]My data from a sample of 42 UNO food markets did not reflect any upward trend in the ratio of inventory to monthly sales value; the average ratio fluctuated between 0.81 to 0.94, without a trend (Table 5). That the data show no evidence of the claimed increase in inventories may be a result of the way in which the inventory figure is estimated: the field interviewer, with the client, constructs an estimate of the value of the inventory from what can be seen in the store at that moment. The result is a measure of inventory at a point in time, rather than an average over a month; thus the inventory figure would be subject to wide fluctuations depending on whether the interviewer arrived shortly before or after a new purchase of stock had been made.

reflects an accommodation to post-1974, post-Brazilian-miracle times--during which rapid growth has given way to stagnation and monetary constraint. In such times, UNO says, it is more realistic to be concerned with the sheer survival of firms than with their possibilities for expansion.

The importance that UNO attributes to the economic environment as a reason for its emphasis on sheer survival seems exaggerated. Though it is true that the high growth rates of the Brazilian miracle ended in 1974, growth was zero or negative in only one of the subsequent years, 1981. Between 1974 and 1981, growth rates ranged from 3% to 5% which, though low in comparison to the 10% to 14% rates during the miracle period, were still respectable in comparison to growth rates in some other Latin American countries during that time. My interviews with firm owners, moreover, did not seem to show any particular sensitivity to recession, perhaps because they are beyond the reach of formal-sector monetary policy and because the constraints to their growth on the supply side seemed more determining than those on the demand side, as discussed below. For various reasons, then, UNO's "sheer-survival" thinking cannot necessarily be linked to the severity of the economic environment.[1] Though UNO's modesty about what it has accomplished shows remarkable candor, its emphasis on sheer survival seems partly a rationalization for doing things the way it does--i.e., for not engaging in a selection process that singles out sectors or firms for their growth and employment potential. To select clients in this latter way, after all, could be more costly and complex than the way UNO now operates, and might also sacrifice UNO's goal of lending to firms without access to credit.

"Sheer survival," it should be noted, is not typical of the way UNO-type programs are publicly described and justified. Most descriptions of small-scale enterprise projects emphasize the impact such assistance will have on the

---

[1]UNO itself admits that an important subset of its clients does better during recession. Small food markets, accounting for 60% of UNO's retail clients and 21% of all clients, receive additional business during bad times from persons who normally buy at the supermarket. When these families experience increased unemployment and real income decreases, they often switch their purchasing from the supermarket to small neighborhood stores, because only the latter will sell to them on credit and in amounts that are smaller than those sold by supermarkets--a quarter of a cabbage, two tablespoons of cooking oil, a cigarette, a cup of sugar. These improved sales during bad times were reported to me by some food-store owners, as well as by UNO staff.

businesses--how they will grow, and the new jobs they will generate. An AITEC ad in Business Week (27 July 1981:18), for example, stresses that the UNO program created, "3,000 new jobs," with each job representing "U.S.$965 of credit extended.[1] UNO's own promotional brochure represents the testimonials of a handful of UNO clients who experienced marked expansions in their businesses. Though these cases certainly exist--I came upon two of the firm owners whose photographs appeared in the brochure--it is clear that they are the exception.

My impression of UNO's firms as non-expanding is somewhat at odds with the way UNO and other programs are described. For this reason--and because I do not have robust statistical proof of my interpretation--I would like to present the evidence carefully. My impressions of UNO firms are based on the following five sources of information: (1) the reports of UNO staff workers, as noted above, (2) my interviews with 25 UNO firms,[2] (3) data on the creation of new jobs by UNO client firms, (4) results from longitudinal data on 42 food-store clients of UNO, and (5) the literature, as cited, on small-scale enterprises. In the following two sections, I present the job-creation and food store evidence. The subsequent sections explore the reasons why the firms would not have expanded.

Expansion of new jobs

UNO reports that its lending resulted in the creation of 1,428 jobs in the 1973-1978 period--or 1.6 new jobs created per loan, at an expenditure of about U.S.$950 in credit per job.[3]

---

[1]According to UNO's annual reports, the number of jobs created from the start through 1980 was actually 2,531, not 3,000. (Data on job creation from DGAP [1978:10] are consistent with the UNO figure.)

[2]Ten interviews were with retail firms, mainly food stores and small clothing and novelty shops. Ten interviews were with manufacturing firms, and the remaining five were with service establishments.

[3]UNO (1981:15). These averages remained the same in the subsequent period. UNO calculates jobs created per loan by dividing the number of new jobs by the number of total loans. Credit value per job created is the number of new jobs divided by the total value of loans during the period. Costs per job do not include administrative costs or the value of the interest-rate subsidy. Job-creation data are not available by type of firm.

Though the credit investment per job created is impressively low, it is not clear whether many new jobs actually materialized. The question is an important one, since job-creation is a central justification for many small-business credit programs and a major indicator by which such programs are judged.

Though UNO's average of 1.6 jobs created per loan is not particularly high, it still puzzled me because of the evidence that UNO's client firms were not expanding. Therefore, I checked my own data on the increases in workers among the firms I visited against the reports on increased workers in these firms' loan files, from which UNO's job-creation numbers are compiled. In most cases, the number of employees reported to me by firm owners was about the same as before the loan--and sometimes even less--rather than the larger number reported in the loan files. I began to suspect that the discrepancy was due to my visiting the firms one or two years after their UNO loan, whereas the job-creation data had been recorded during monitoring visits a few months or so after loan disbursement. At best, then, the creation of jobs seemed to have been temporary--the result of the increased cash made available by the loan.

My suspicions about the job-creation data were reinforced by the results of a sample survey of UNO firms, also conducted after the period of loan disbursement.[1] In contrast to UNO's reported 1.6 new workers per loan, the survey found an absolute decrease of 5%, or 14 workers, among the UNO-assisted firms.[2]

---

[1]Fuenzalida and Coelho (1980:T.7). Before-loan data were taken from UNO's pre-loan analysis of the firm (in the 1976-1977 period), and post-loan data were collected in the April-to-August period of 1979, leaving 1 1/2 to 2 1/2 years after loan disbursement. The number of UNO firms sampled was 112, with an average 2.5 employees per firm.

[2]The decrease includes the loss of jobs among the 22 firms that failed (20% of the sample) during the observation period. Even when one excludes the employment losses of the failed firms from the results, the average increase in new jobs per non-failed firm is significantly less than that reported by UNO after a shorter observation period--i.e., 0.5 workers per surveyed firm, in contrast to UNO's 1.6. (Excluding the failed firms, the average number of workers per firm increased from 2.8 to 3.3. The increase for services was highest, from 4.5 to 6.7; retail was next, from 1.8 to 2.5; and manufacturing was last, surprisingly, with no increase at all from 4.2.) The survey also included a matched sample of non-assisted firms, as discussed later in the text. (The researchers excluded eight firms from the original sample, because they could not be located. If one assumes that they failed, this would make the net decrease in jobs even larger.)

That net employment among UNO-assisted firms would have appeared to decrease during a period when UNO was reporting an average of 230 new jobs created per year is a remarkable discrepancy.[1] A similar discrepancy was found by IDB evaluators of an UNO-type program in Colombia. Percentage increases in jobs among assisted firms over a four-month period (December-April 1981) were 12% for the most recent recipients of loans and a negative 23% for the older recipients.[2] Consistent with these results, the evaluators found that firms used their credit "to hire additional help, if only for a temporary period," and then dismissed those new workers as soon as they were "no longer necessary." In lieu of more substantial research on this subject, these findings raise the question as to whether the employment-creating effects of UNO-type programs are in some cases highly transitory.[3] In the future, data reported by these programs on jobs created should be more carefully collected and analyzed.

Why would credit not have led to job creation in UNO's case? Of course, if firms were not expanding for the various reasons suggested below, then jobs would also not be increasing. That many firms did not graduate to permanent institutional credit--as discussed above--may also explain the low creation of permanent, as opposed to temporary, jobs. Without permanent credit, they may have been unable to sustain the level of operation or employment achieved under the loan; hence, the crucial importance of graduation to the realization of job-creation.

Some firms use their credit to make small, productivity-increasing changes in the way they do business--buying a vehicle for transport, improving the work space, or buying inventory at better terms. These kinds of changes will not necessarily involve expansion of production or sales, and hence

---

[1]UNO did not start reporting job-creation figures until 1977, when it included an aggregate figure for the 1973-1977 period of 1,152 new jobs in its annual report (UNO 1977:T.XI).

[2]IDB files. The project was the Fundación Carvajal, another program assisted by AITEC. The most recent loan recipients had obtained their credit from four to nine months before the observations were recorded, and the oldest recipients nine months or more before.

[3]An AID evaluation of a small-business credit program in Upper Volta also found "no change in any type of employment" among 67% of the interviewed firms--including managers, unpaid family labor, salaried employees, apprentices, short-term workers" (Goldmark et al.1981:69). (Emphasis mine.)

of employment. Some of these improvements, furthermore, will require the temporary hiring of additional labor--as in the case of firms modifying their premises--and the reported increase in jobs may simply reflect this temporary event (as reported in the IDB evaluation cited above). Even if firms expand as a result of credit-financed investments, finally, such expansion will sometimes be labor-displacing, particularly where the cost of credit is so highly subsidized. As Anderson points out, many small firms invest in order to raise output and labor productivity <u>without</u> increasing employment (1981:91-92). Because they are often engaged in low-productivity, low-wage activities, improvement in their situations will often translate into activities that increase labor productivity and, hence, reduce job creation.[1]

The job-creation objective is also criticized as unrealistic by Kilby (1979:321-322). Based on a study of 11 technical-assistance projects in the small manufacturing sector of Africa, he concludes that "job-saving," rather than job-creation, is a more realistic goal for projects assisting this sector. Job creation, he says, requires projects that are too complex and ambitious. Although politically popular with donors and recipient governments alike, he argues, these projects usually cannot achieve their job-creating goals because of the difficulty of identifying the "right" firms and because the project simply does not work, due to its complexity. As a more realistic and less costly alternative, Kilby recommends devoting attention to job-saving. Job-saving, of course, is not a new idea in the area of small-business credit, at least in the United States, where it is used along with job-creation as an indication of the performance of small-business credit programs (e.g., May 1981:73-81).

Given these arguments, UNO's talk of sheer survival and its distaste for "creating mini-capitalists" can be seen in a more sympathetic light. If UNO is contributing to the sheer survival of its client firms, then it is contributing to the saving of jobs. There is some fragmentary evidence that UNO

---

[1]Anderson argues convincingly against the job-creation criterion for small-business programs on the grounds that it emphasizes the wrong problem--i.e., the number of jobs rather than their quality (i.e., wages paid). Even for those concerned about job creation, he says, profitability is a better criterion for borrower selection, since firms and projects that are not profitable will not lead to new jobs. Job-creation criteria for borrower selection--like all such criteria--may simply encourage applicants and project operators to "fudge" their project proposals, and may end up excluding economically desirable and low-risk projects.

credit may indeed have had this effect.[1] Similarly, UNO's disinterest in mini-capitalists is not inconsistent with the fact that productivity-increasing firms that expand "out of" the informal sector or become modern are usually increasing their labor productivity and hence reducing their labor intensity.

Though the evidence presented above is far from conclusive, it is sufficient to raise questions about the reliability of the current measures of job creation reported by small-business projects. It also points up the need for collection and analysis of certain kinds of data--in order to determine what it is that small-business credit actually accomplishes.

The retail food markets

A sample of the loan files of 42 small food markets that had received one or more UNO loans also revealed that this particular subset of firms was not, on the average, expanding. The firms, visited by UNO at least three times over a two- to four-year period, showed the following results. On the average, gross monthly sales did not increase and, indeed, seemed to decline over the observation period--from an average monthly sales level of U.S.$3,800 for the first observation to U.S.$3,100 for the fourth observation.[2] At the same time that monthly sales were not increasing, two other measures suggest that profit margins were increasing. As a percentage of monthly sales, gross profits increased from 22% to 26%.[3]

---

[1]The Fuenzalida and Coelho study (1980:T.7) reports that a matched sample of non-UNO-assisted firms showed a higher decrease in net employment than UNO firms over the same period of time (-37% vs. -5%). (Sample size was 91 non-assisted firms with 230 employees, and 112 assisted firms with 311 employees. The results, which include job losses of the failed firms, are statistically significant.) A further comparison of these two samples with respect to failure rates shows results in the same direction (Table 7), with UNO firms having lower failure rates than the nonassisted firms (20% vs. 31%). But these latter results were not statistically significant at the .05 level--neither for all firms nor for the subsamples of manufacturing and service firms; for retail firms, the lower failure rate (16% versus 32%) was statistically significant at the .05 level, though not at the .01 level ($z = 2.07$).

[2]See Tables 5 and 6 for the data and an explanation of the methodology.

[3]Gross profit is the difference between the cost of merchandise and its sales value.

(Though the profit margin increased, the real value of profits seemed to decline--as Table 6 shows--a point I return to below.) The imputed wage to the firm owner as a percentage of sales also increased, from 8% to 11%.[1] As in the case of profits, the real value of the imputed wage decreased somewhat even though its share of monthly sales went up.[2] As a result of UNO loans, then, these particular firm owners and their families seemed better off, although their firms stayed the same. The decreased costs facilitated by the UNO loan increased the firms' profits, which allowed owners to take more out of the firm for family expenditures and other investments.

The results of the data analysis, of course, cannot stand on their own. The sample is not random, the number of firms is not large enough to make the findings statistically robust, and the quality of the data and the price deflator are questionable. Involving only retail food stores, moreover, the results cannot be generalized to include other retail establishments lent to by UNO, or to the manufacturing and service firms. But put together with my impressions from field interviews and those of UNO staff--which relate to all types of firms--these results are at least not inconsistent with the interpretation

---

[1]Though the imputed wage should be interpreted as a cost, independent of the firm's profits, UNO's way of calculating it includes elements of profit as well--in that it represents monthly outlays of the firm owner for family expenses, including the value of goods taken out of the store, as well as other expenses for food, schooling, medical care, house rent, light, water, etc. If the firm owner spends more on the family because of increased profits, then this increase in the imputed wage represents more the increased profits invested in the household than it does an increased cost to the firm--at least for determining what we are interested in here.

[2]I am less confident of these real value figures, because of the deflation problem, than I am of the ratios and percentages, which bypass the need to convert monetary values to a constant base. I suspect that the monthly general price index, which I used as a deflator, overestimates the inflation occurring in that particular area and in those particular commodities--which would mean that the downward trend in sales, profits, and imputed wages may be spurious. (I first tried using the more specific index of food prices for Recife, but it showed an even greater increase than the general price index, resulting in even greater decline in the real value of sales.) If an accurate deflator could be constructed, I would expect the real value of sales to remain about the same rather than to decline, which would mean that the increased shares for profits and imputed wages would also reflect increased absolute values.

of events that I am suggesting here. The comments that follow are not limited to the retail food stores, nor are they based mainly on evidence from that sample.

Growth as unnatural

Why wouldn't the reduced costs and the correspondingly increased profits of UNO-financed firms lead to their expansion or to other marked changes in the way they operate? What did firm owners do with their increased profits? The following answers to these questions are based on my conversations with all firms, not just the retail food markets.

Many owners reported investing their income in household items--a car (sometimes used partly for firm business and therefore a partial reinvestment in the firm), a large appliance, an addition to the house, the purchase of a rental property, or improved education for a child. Many firm owners who were doing well, moreover, were not particularly interested in expanding their businesses, even when they could obtain favorable financing. Their businesses were doing well enough to keep their families well off, they felt; therefore, there was no need to expand. Just as important, many owners felt that expansion would bring them up against barriers that they would not be able to overcome, as discussed below, or that would require a tremendous expenditure of energy and resources to overcome. They did not see that effort as worthwhile.

Small-business credit programs seem to assume that small firms do want to expand. If the successful firm does not grow, then some particular input or condition is assumed to be missing. Thus credit programs provide finance to small businesses on the assumption that the lack of credit constrains expansion. Squire, for example, cites studies that report small entrepreneurs as identifying "the high cost of capital as the main constraint to expansion." He concludes that "the lack of access to formal credit constrains expansion in the informal sector" (1981:142-143).[1] But when the credit constraint was partly removed for the UNO firms, other constraints seemed to take its place. These other problems, as described to me by firm owners, fall into three categories: (1) family management styles, (2) being clandestine, and (3) seasonality. The latter

---

[1]At the same time, studies of small enterprises in various countries, including those that grow large, show that these firms are usually started with personal and family savings and expand out of these same sources and reinvested profits (e.g., Chuta and Liedholm 1979:68).

two factors were more significant for service and manufacturing firms than for retail.

Small firms tend to expand to the point where family management and labor are exploited to the fullest, and then stop. Almost all the firm owners I interviewed had a sad tale to tell about a partner or an employee from "outside the family" who absconded with funds, or created a problem in the business in other ways. Thus owners often talked of expansion as an imprudent move, in that it would require taking on partners and employees who were "untrustworthy" by virtue of their being from outside the family.[1] The distrust was not without good reason. A study of failure rates among small firms in Brazil found that 89% of the failed firms were partnerships, while sole proprietorships accounted for only 11% of the failures.[2]

Another reason that small firms distrust new employees--and therefore avoid expansion--is the complaint that as soon as a worker is well trained, he will leave the job and start his own workshop. Peattie reports this complaint in the shoe industry in Colombia, and cites the case of a shop owner who stopped training workers for this reason (n.d.:8). Because of this problem, she reports, ownership of a small workshop was considered "more desirable" than of a large one.

The difficulties of expansion are also revealed in the findings that small entrepreneurs will often create new firms when they are doing well, rather than expand their existing business. Kilby reports for Kenya that the small industry sector tends to expand "by replication" rather than by growth of existing firms, because easy entry creates competition and reduces profits to low levels, leaving no cushion for innovation and mistakes (1981:48). Marris and Somerset, also reporting on Kenya, find that when a businessman has spare resources to invest, he will start another small firm rather than expand his present business "beyond the critical limit of direct

---

[1]Marris and Somerset commented on the same phenomenon among African businessmen in Kenya (1971:124-125). This particular constraint to the expansion of small firms was the reason that AITEC/Rio de Janiero tried to set up a venture-capital affiliate to UNO in Bahia, MICROPAR. The effort failed, for various reasons, one of them being the reluctance of firm owners to allow an outside entity to have any part of their capital.

[2]Rattner (1978) as cited in Tyler (n.d.:159). In a study of the informal sector of the northeastern city of Salvador, Cavalcanti reports that it is rare to find partnerships except in manufacturing (1981:44).

supervision" (1971:125). The evaluators of a small-business project in Upper Volta found that entrepreneurs "are reluctant to have any one economic activity become too large," because of fears of risk and of jealousy from neighbors (Goldmark et al. 1982:Chart IV-1). There is considerable evidence, in sum, that the management difficulties of expanding may put growth beyond reach for many small firms.

For service and manufacturing firms, the extreme seasonality of demand represented another major constraint to expansion. Firms could not handle the demand during peak seasons, and had no work in between. They had difficulty smoothing out the demand, even with UNO financing to buy inputs earlier, because customers bunched their requests during the peak period, giving little time to complete the order. Christmas, Carnival, and St. John's Feast are the major peaks; the customary payment of an additional month's salary to workers in December makes the Christmas peak the highest. These seasonally affected firms saw expansion as difficult, since they would be left with even more excess capacity in between the peaks.

Another important constraint to the expansion of manufacturing firms relates to the terms on which large purchasing firms buy. Many large firms customarily pay for their purchases 30 days after delivery. Public agencies often pay with considerably more delay, and with much effort expended to collect the payment; having such agencies as customers is otherwise considered one of the benefits of becoming a registered firm. Though small firms are accustomed to receiving delayed payment from individuals and other small firms, they find it difficult to wait for payment on the large orders prepared for large-firm purchasers or the state. Whereas one such order may occupy the entire firm for several weeks, making it difficult to attend to other customers at the same time, the receipt of delayed payments from individual clients and small firms can be staggered through time. The working capital needed to carry a large order several weeks beyond delivery is probably beyond what can be provided by UNO--at least over a sustained period of such orders. As a result, not many of UNO's manufacturing and service firms produce for only a few large purchasers. (A survey of 500 UNO clients showed that only 7% sold to three or fewer purchasers.)[1] Those who did sell to only a few purchasers complained of the "dependency" of

---

[1]For retail firms, the figure was 6%, for manufacturing firms, 11%, and for service firms, 5 percent. In the case of manufacturing firms, an additional 26% sold to between 4 and 7 clients, and an additional 15% to between 8 and 11 clients (UNO 1980:59, T.25).

these relationships. The need for working capital, they said, forced them into dependent relationships whereby the client would advance payment so that the firm could buy raw materials (Ibid.:63). (I found this to be a more common arrangement in services than in manufacturing.)

Some small firms cannot sell to large firms, then, because of their inability to extend credit to them. At the same time, some firms are "dependent" on large firms because the "credit" advanced by the large firms is their only way to get working capital. Some large purchasers, in other words, are facilitating expanded microfirm sales by extending credit, and other large firms have the effect of constraining such sales because they will only pay on credit. The low level of dependency of UNO clients on a few large purchasers suggests that the extension of credit by large purchasing firms may be less prevalent than the opposite phenomenon (delayed payment for purchase), at least in manufacturing. Whichever the case, firm expansion is constrained by a structural problem: the very smallness of the microfirm means that selling to a large-firm purchaser, otherwise very desirable, creates problems for the microfirm--either of dependency, or of having to accept large amounts of delayed payment. Thus while most small manufacturing firms viewed large sales to other firms as eminently preferable to selling to individuals, at the same time they considered the problems of selling to large firms as placing this possibility beyond their reach.

A similar problem constrained the growth of some firms in the service sector. Many repair firms, particularly in furniture and shoes, felt they could do well only if they engaged in manufacture as well as repair; manufacture, they said, was where the money was. For repair work, it is customary that the client advances 50% of the cost; the advance represents a "forced" working-capital loan from the client, which allows the firm to buy raw materials and pay at least part of its labor costs. With manufacturing, in contrast, firms said they had to produce before knowing who the client would be, and even if they were producing on order, it was not so customary to require a 50% advance. In expanding from repair to manufacture, then, the need for working capital increased markedly. Some service firms, which had gone into manufacture with their one or two UNO loans, lapsed back into service-only work as soon as the financing ran out.

Another reason that successful firms do not invest their credit or their profits in expansion is that they may be interested in something else--namely, increasing their productivity, which does not necessarily lead to an increase in production or sales. Many UNO clients, for example, used credit funds to modify their premises, thereby creating more efficient working or storage space. Though it is obvious that credit funds or increased profits would be used for this purpose, the implication that this activity might achieve its purpose without leading to increased production has been neglected--or at least forgotten--in the common assumption behind small-business programs that benefits will take the form of increased production and, hence, employment.[1]

Being clandestine

The clandestine nature of many UNO clients provides another explanation why expansion of the firm does not necessarily follow an increase in profits. Many firms felt that if they operated at a higher level of business, they could no longer remain clandestine, for reasons presented momentarily. Yet to become "legal," they felt, was beyond their financial and managerial capacity--a view that is also held by UNO with respect to many of its clandestine clients.

Being clandestine also affected marketing possibilities adversely, particularly in manufacturing. Many firms told of one or another large firm expressing interest in buying their products. Being legal, however, the larger formal-sector firm required an official sales receipt ("nota fiscal"). The receipt, which the firm needs to show proof of taxes paid, can be issued only by a legalized firm, making it difficult for the clandestine firm to sell to a legalized firm requiring the receipt. Many clandestine firm owners said they had to sell to individuals rather than firms for this reason, though they considered the latter preferable. The "nota fiscal" had such significance for these clandestine firms that they used the term as a proxy for talking about the process of becoming legal; they were thinking about "taking out my 'nota fiscal'," they would say, when they were really talking about registering their firm.

Given the myriad ways that registered firms are said to evade the tax law in Brazil, the insistence of legal firms on an official receipt may look like an excuse for not buying a product not wanted for reasons other than being clandestine. But the insistence on the "nota fiscal" is not necessarily indicative of a rigorous adherence to the law; firm owners told various stories about legalized firms providing the "nota fiscal," but understating the value of the merchandise recorded there so that less tax would have to be paid. Indeed, one

---

[1]The neglect of non-expanding productivity increases in the thinking about small-enterprise programs was brought to my attention by Anderson (1981:105).

legalized UNO client spoke proudly about having obtained an order from a public agency that was a "particularly desirable client" because it allowed him to understate substantially the sales value on the "nota fiscal." Registered firms require official receipts, then, not necessarily to be honest, but to fulfill the proper appearances of honesty. Or, they may require the receipts simply because the myths about the degree of tax evasion are somewhat behind the current reality--at least for those taxes recorded on sales receipts. Whatever the case, the inability of clandestine firms to supply official sales receipts seems to be a significant constraint to their expansion.

The problem of the "nota fiscal" is not necessarily insuperable for registered firms wishing to buy from clandestine ones. If a registered firm supplies the raw materials used by a clandestine manufacturer, then the former firm pays the manufacturer only for his labor. In this case, the registered firm is contracting with the clandestine firm owner as a self-employed provider of services rather than goods--and hence sales taxes do not have to be paid. This type of exchange, of course, is what characterizes the subcontracting relationship, though subcontracting to clandestine firms is not prevalent in Recife. (Subcontracting to individual household producers is common, however, particularly in the production and finishing of hammocks and apparel.) Perhaps the clandestine producers are not willing to accept the loss of autonomy that the subcontracting relationship involves, and perhaps the formal-sector firms do not want the greater responsibility for materials and accounting. This explanation would be consistent with the outcome of an attempt by UNO to bring together medium and large firms with some of its manufacturing clients through subcontracting arrangements. The attempt failed because of a lack of interest by the formal-sector firms, according to UNO, and fears about being "exploited" by the clandestine firms.[1]

That the inability to supply an official sales receipt could represent a constraint to expansion for clandestine manufacturing firms comes as a surprise. The recent literature on the informal sector has emphasized the distinct interrelationships between formal and informal-sector producers--in

---

[1]A similar, earlier effort in Pernambuco failed in 1970 for the same reasons (Robalinho 1973:106). The small firm's fear of losing independence to the subcontracting parent firm was also cited by Watanabe for the Japanese case as a reason many such firms hesitated to be helped by the parent firm (1971:65). Subcontracting to small firms in the informal sector is generally insignificant in Latin America, except in the area of apparel (Tokman 1978:1071; and Chuta and Liedholm 1979:28).

contrast to an earlier characterization of the informal sector as a manifestation of economic dualism or "marginality." According to the more recent analyses, formal-sector firms are said not only to buy a significant share of their inputs from informal-sector producers, but also to prefer informal-sector suppliers; the tax-free prices of the clandestine firms, along with their exploitation of their own and their employees' labor, are said to result in a cheaper product for the purchasing firm. This lower-priced product is also said to result from the purchasing firm's large size in relation to the informal-sector producer, which gives the purchaser firm unequal (monopsonistic) bargaining power in setting the purchase price. Formal-sector firms, in sum, are seen as relying on, and being closely linked to, the products of an exploited informal sector.

The manufacturing firms of Recife did not fit this portrayal by the literature, as seen above. Being clandestine kept these firms down because of a lack of relationships with the formal sector, rather than because of an exploitative relationship. The formal-sector firms were also turning down "cheap buys" from clandestine firms because of their need for an official sales receipt--rather than avidly seeking cheap products from the informal sector. This does not mean that Recife's economy is more akin to the dualistic model than it is to the interdependent one portrayed in the recent literature. Rather, the evidence on these particular manufacturing firms shows that being clandestine was a strong deterrent to finding clients among formal-sector firms--and that access to these formal-sector markets, in the small firm-owners' eyes, would have helped their business to be better off. Thus being clandestine, as distinct from being small, represented a significant barrier to expansion of a certain subset of UNO clients in the manufacturing sector.

Demand-constrained markets

Informal-sector firms are sometimes said to face a limited market because of the constraint on the purchasing power of the poor. Might this be another reason why UNO firms do not expand with credit, despite increases in profits? Studies of informal-sector enterprises in the three Northeastern coastal cities of Recife, Salvador, and Fortaleza show that a significant share of the goods sold by such manufacturing and service firms goes to the elites (Cavalcanti 1978, Cavalcanti and Duarte 1980a and 1980b). For these firms, then, it would seem that the constrained purchasing power of the poor would not be determining. A purchasing-power constraint might nevertheless be relevant to UNO's retail clients who, in contrast to service and manufacturing firms, sell only to the occupants of the poor neighborhoods. The comments of various food-store owners I interviewed seemed to reflect such a constraint: none of them reported having cut prices, in real terms or to a level below that of their competitors, as a result of the cost savings they claimed that the credit had brought them; nor did they anticipate cutting prices if costs were reduced even further in the future. They assumed that selling at lower prices would involve selling at a loss, and did not view price decreases as a way to increase sales.[1]

Though the lack of price-cutting might reflect an assumption that their shoppers' purchasing power was constrained, these food-store owners were nevertheless found to be engaged in a variety of non-price methods of increasing their business--mainly, diversifying their inventories and engaging in promotional activities. (To the extent that UNO clients were interested in UNO's management courses, the sections regarding sales-promotion gimmicks were the most popular among the retail food stores.) Diversification of inventory often took the form of acquiring various brands of the same product, as well as acquiring a larger variety of products. Some store owners explained how, with their UNO credit, they acquired additional brands of merchandise that they normally could not keep because they were slow-moving. They wanted to have these brands on hand because the typical shopper, they said, goes from store to store until she finds the unusual brand, and then does her complete shopping there.[2]

In the language of economics, these non-price approaches to increasing sales amounted to "differentiation" of the product--that is, transforming the shopping experience at one's store into shopping for a different "product" than shopping at a similar store selling similar products. The interesting aspect of this non-price, product-differentiating type of competition is that it usually characterizes the behavior of

---

[1]Marris and Somerset (1971:162) reported the same attitudes toward price-cutting among African businessmen in Kenya.

[2]Building up inventories with slow-moving products, of course, is not necessarily good management. Harper notes that "unsophisticated" retailers are often tempted to stock the slower moving goods because they usually yield a higher profit than staples (1975b:370-372). The heavily stocked shelves, in turn, tend to be interpreted as a sign of success, in lieu of the information about profits that many small retailers do not have. That increased inventories may reflect managerial shortcomings rather than success is also suggested by Kilby, Liedholm, and Meyer (1981:22).

firms in oligopolistic market environments.[1] This contrasts with the typical characterization of small food markets--and small businesses in general--as being the epitome of the atomistic, competitive model. (That they are said to be this way is one of the justifications used for assisting them.) Small businesses are said to behave as if they face a perfectly elastic demand curve: with a small increase in price, they will lose all their business to the competition--and with a small decrease, all the business they want is theirs, thus more than compensating for the loss in unit profit that results from the decrease in price. It is firms in non-competitive markets, in turn, that are said to resort to non-price, product-differentiating competition because they face an inelastic demand curve: any increase in business resulting from a reduced price would be too small to compensate for the decreased return per unit sold.

Manufacturing and service firms also seemed to see themselves as having no power over price. If they charged higher prices than those prevailing, they said, they would lose business; if they charged lower prices, they would not cover their costs. For these firms, the "constrained" market was even less a concern than it was for the retail stores; the firms seemed to imagine a limitless market for their products and services, the only constraint being their inability to reach that market--because of the difficulty of meeting seasonal peaks, the lack of financing to purchase raw materials, and, another way of saying the same, the need to obtain 50% advances from clients (in the case of services). Some manufacturers, particularly of furniture, felt that the "real money" was to be made in the wealthy neighborhoods; if they had aspirations for expansion, it was in terms of moving their businesses to these neighborhoods. In this sense, they may have been reflecting the perception of a purchasing-power constraint. In general, however, the constraints of seasonality and working capital seemed to supersede any constraint that the market might pose for manufacturing and, to a lesser extent, service firms.

Expansion and social value in the retail sector

The analysis of pricing behavior has brought us back to the issue of expansion, and the reluctance of many firms to do

---

[1] Peattie also comments how the literature stresses the helplessness of small firms in face of the market, and yet she finds (among small shoemakers) that owners "use much effort and ingenuity to differentiate their products and services"--seeking out existing submarkets, "so as to operate in a context of monopolistic competition" (n.d.:10).

so. In order for a retail firm to reap the profit increase resulting from a price decrease in a highly competitive market, it might have to expand more than it feels comfortable doing. Competing through price in an atomistic retail industry requires high-volume, low-markup selling activity. This contrasts to the typical low-volume, high-markup behavior characteristic of many small retail firms, including UNO's clients--behavior that is often portrayed as traditional and conservative, and the reason for small firms being overtaken by more aggressive and "modern" competitors. Thus the combination of reduced costs, increased profits, and non-increasing sales among UNO's food-market firms may simply reflect the way this kind of firm always behaves.[1] Increased profits that do not lead to increased sales, in other words, are consistent with the high-markup, low-volume model. Other explanations of the lack of expansion--such as the severity of the economic environment, or the perception of a purchasing-power constraint among poor clientele--may also be valid. But perhaps they are less relevant in explaining the lack of growth among UNO's retail clients.

The issues raised above bear considerable importance for the economic benefits that can be claimed for an UNO-type program of subsidized credit to retail food stores. One important reason to assist small food markets in poor neighborhoods is that goods consumed by the poor may become more available at lower prices and on better terms. Because UNO-assisted firms hardly expanded their sales, and did not lower prices as a result of their reduced costs, this particular benefit did not materialize. Instead, benefits were limited to the increased incomes of the few individuals receiving credit--an outcome of limited value, given the comfortable place of these individuals in the income distribution.

A recent project in Recife's retail food sector illustrates the desirable spillover effects that are possible by working with small food markets. A government program to wholesale basic foodstuffs to food markets in Recife's poor neighborhoods, requiring them to pass on their savings to final consumers, has brought reductions in prices of 10%. This "voluntary-chain" program ("Rede Somar") is part of a Brazil-wide project of the government food-supply agency COBAL, a profit-making and self-sufficient state enterprise.[2] The Recife operation has additional financing from a government

---

[1] I am grateful to Albert Fishlow for bringing this set of issues to my attention.

[2] All information in this and the following two paragraphs is from World Bank files.

nutrition program, and is also part of a World Bank nutrition project.

Under the voluntary-chain program, COBAL provides participating retailers with a basic range of food and household items at low wholesale prices. It offers technical, commercial, operational, and credit assistance and other wholesaling services to the retailer, and guarantees delivery to the retailer at fixed intervals. The retailer must observe lower resale prices fixed by COBAL, pay cash on delivery, apply recommended practices, and purchase a minimum amount from COBAL. Wholesale and retail prices, though about 10% lower than prevailing prices, are not subsidized. At the wholesale level, COBAL achieves low prices through the economies of its large-scale operation. At the retail level, retailers are forced to earn lower profit margins, which are more than compensated for by increased sales: net profits have increased by more than 50%.[1]

The price reductions of the voluntary-chain program have occurred not only because the participating stores were required to retail their COBAL-purchased foodstuffs at reduced prices and lower profit margins. In addition, the program created competition for the two large supermarket chains operating in Recife. These markets sell a considerable amount of merchandise to the types of small food markets financed by UNO, in addition to final consumers; the food stores buy retail at the supermarket and re-sell the goods at a markup. (They can sell at higher prices than the supermarkets because they sell on credit, because they make goods available for purchase in small quantities, and because of location advantages.) With the transfer of 150 of these food-market clients of the supermarkets to COBAL, the supermarkets saw themselves as losing an important clientele. Partly as a result, they began an aggressive campaign to sell directly to final consumers in lower-class neighborhoods by opening 32 "no-frills" markets. These "mini-shops" are without air conditioning, offer only a limited range of basic food and household products, use minimal packaging, offer no brand variety, and no individual service; prices are low enough, and significantly lower than at their regular supermarkets, to meet the COBAL price challenge (one supermarket even undercut the COBAL prices).

---

[1]Prices <u>are</u> subsidized for a part of the program financed as an experiment by Brazil's Institute of Food and Nutrition (INAN). The price subsidy is 15% applies only to 11 basic food items, and is being carried out only in two particularly poor neighborhoods. Approximately 70 retailers participate, in contrast to the 80 of the non-subsidized program.

The COBAL program, then, has had a strong spillover effect in terms of increased availability to poor people of basic foodstuffs and household items at reduced prices--exactly the effect that UNO's credit to food markets did not bring about. The COBAL participant's response to assistance, moreover, was exactly opposite that of the UNO client: whereas the COBAL retailer lowered prices and expanded sales, moving from a low-turnover, high-margin operation to a high-turnover, low-margin one, the UNO firm continued its old ways, using the credit to increase profits but not to reduce prices and expand sales. Whereas the increased profits of the COBAL retailers (as well as the mini-shops) were based on increased sales of a lower-priced and restricted variety of brands, the increased profits of the UNO markets were associated with the same volume of sales and an increased variety of brands, particularly slow-moving ones. The COBAL retailer's response, in short, had much greater social value than that of the UNO client. The difference in response, in turn, was a function of the different project designs.

Most important for the question of replicability, the high social benefit of the COBAL program is being achieved almost without subsidy of prices or operating budgets, whereas the subsidy of UNO and its borrowers is very high. In comparison to the public-sector COBAL, ironically, the "private-sector" UNO has the highest subsidy and the lowest benefit. It is important to note, finally, that access to cheap credit played no role in the expansion of retailers under the COBAL program. Instead, the main cost advantages provided by COBAL took the form of reduced wholesale prices, and free and reliable delivery. Though UNO's credit indirectly conferred some of these cost advantages on retailers too, it did not translate into the high social and economic benefits of the COBAL project. With respect to food stores, then, the wisdom of UNO-type credit--as opposed to other forms of assistance--might be questioned.

Though UNO did not contribute to the COBAL success story in Recife, the UNO justification for lending to retail food markets is very much a reaction to it. As a result of the new competition by the mini-shops in poor neighborhoods, UNO says, many small food markets have gone out of business, because they were unable to meet the competition of the no-frills markets. UNO sees its loans to the neighborhood markets as keeping them from going under. Though UNO agrees that the poor are better off now that basic foodstuffs are available at lower prices from the mini-shops, it nevertheless believes that the poor will be worse off if neighborhood food stores disappear completely--because only these markets sell to the poor on credit and in small quantities.

In UNO's eyes, the social benefit of COBAL's price competition is not as relevant as the social evil caused by the closing of neighborhood stores. Loans to small food markets therefore do have an important social benefit, it says, even if sales remain constant and prices do not decrease. The benefit takes the form of the preservation of a "service" to the poor--the supply of basic goods on credit and in small amounts--that is under threat of becoming extinct. By allowing neighborhood food markets to fail, UNO feels, one also allows the supermarket chains of Recife to gradually monopolize food sales--at which point one cannot be confident that they will continue to charge the comparatively low prices they are charging today in order to meet the COBAL competition.

UNO's thinking is not completely at cross purposes to COBAL. For all its advantages, the COBAL program is suited to small retailers that are larger than UNO's clients. Average annual sales of COBAL retailers are projected at U.S.$160,000 (1980 dollars), which is several times larger than the average for UNO clients and more than three times the ceiling on annual sales allowed by UNO.[1] COBAL criteria for participation in the program, moreover, exclude many UNO clients. Participants must (1) have a store area of no less than 40 square meters (many UNO clients have less) and (2) have a registered license (38% of UNO's retail clients do not). UNO sees COBAL's exclusion of these smaller markets as one more case of the general exclusion of microfirms from the subsidies and credits provided to larger firms by the public sector. Therefore, UNO is trying to help organize some of its food-market clients, along with other non-client markets, to take advantage of the COBAL system of buying from it as a group. (This is a joint effort with NAI, which took the initiative.) Though the effort is commendable, it seems to be taking a considerable amount of time, given that the market owners must first form an association and agree on various procedures and practices.

Though UNO's argument may be correct--i.e., that small food stores provide an important service to the poor, and that they are under threat of extinction--it is not clear that UNO's loans contribute to the survival of firms that would otherwise fail. UNO refers to a survey showing that UNO-assisted retail firms failed less often than non-assisted firms (16% versus 32% over a 30-month period), though the results are questionable

---

[1]My 42-firm sample of UNO's food-market clients showed average annual sales of U.S.$40,000.

without independent supporting evidence.[1] It is difficult to determine, moreover, whether UNO's firms do better--if they actually do--because UNO has chosen the "winners" from the start. If this is the case, then the loans would not have made the difference between failure and survival. Assisting a small percentage of a neighborhood's food markets through highly subsidized loans, then, seems to be a hit-or-miss way of trying to achieve an indirect benefit like the preservation of neighborhood stores. The COBAL program and UNO's efforts to link up its excluded small clients to COBAL offer an example of a more focused and powerful approach to creating social benefits for the poor through retail food markets.

The discussion brings us back again to the criticisms of UNO by the more "reformist" thinkers in the area of small-business programs. The one-to-one credit approach, according to these critics, keeps these programs from achieving the significant impacts to be gained from organizing small producers to increase their market power and their incomes. I am saying, in addition, that UNO could aim for more certain and significant social benefits in the retail food sector not so much by helping producers to organize--which has seemed to be a slow process in this particular case, and with final results still uncertain--but by playing an advocacy role vis-a-vis the public sector.[2] Already, UNO is not only helping producers to

---

[1]Fuenzalida and Coelho 1980:T.16. The retail sample was small enough (80 assisted firms and 71 non-assisted firms) that the difference was not statistically significant at the .01 level, though it was at the .05 level (z = 2.07). (The differences in failure rates for service and manufacturing firms were not even significant at the .05 level.) Also, the sample was not completely random, because some of the selected firms were dropped from the sample because they could not be found for a re-interview (8 of the original 120 assisted firms selected, and 9 of the original 100 non-assisted firms). Finally, the non-assisted "control group" was made up of firms that had been considered for but had not received UNO loans. The researchers attempt to explain away this difference of the control group by saying that the non-assisted firms dropped out of their own accord, rather than being rejected by UNO, and therefore could still represent a "matched" control. The dropping out of these firms, however, would still seem to define them as different from the assisted firms in a way that might be significant to the analysis of failure rates.

[2]This kind of intermediary role was important in the Small Business Administration programs in the United States. There, enabling small business to participate in Federal procurement programs was more important than job-creation goals (Johnson 1979:ii).

organize to buy from COBAL, but it is speaking directly with COBAL about the possibilities of gaining access for its clients. Given UNO's growing stature, these pressures on COBAL will probably play at least as significant a role as producer organizing in determining whether the effort succeeds.

Conclusion

UNO's lending, in sum, did not involve firms that were expanding. Growth of the firm, in fact, may not be a proper standard by which to judge small-business credit programs. All along, we may have been incorrect in assuming that all that is good must be growing.[1] Though there is a small minority of impressive exceptions to the no-growth average of UNO's clients, the lack of data makes it impossible to count them, to find out if they went on to bank credit or are repeating with UNO, much less to understand whether there was a relationship between the credit and the growth. Studying these exceptions would allow us to evaluate better what constraints really exist, what makes them dissolve, and how to decide whether small-business credit programs are worth financing, and for what reason.

At our present level of knowledge, it is difficult to find a strong economic or social justification for supporting what UNO does. With respect to the income transfer to UNO clients, these individuals are much less needy in terms of income and employment than roughly half of the poor population. With respect to survival of a firm, we have no adequate evidence as to whether UNO's loans make a difference--another subject worthy of research. Without income-transfer or employment (of owners) justifications, we must fall back on the economic justification that small firms can contribute to increases in growth of output and employment (of hired workers). But if UNO is not choosing for growth potential, and if the selected firms are not growing, then what is the economic justification--given the scarcity of resources available for such projects? Even if UNO loans do make a difference with respect to firm survival, is that sufficient justification?

Perhaps the paradigm of economic and social benefits is what makes it so difficult to find a justification for devoting

[1]Or perhaps we are incorrectly applying the relationship we have seen between credit and production in agriculture, where an increase in working-capital credit to small farmers almost always leads to an increase in the area cultivated, and hence in production, if not productivity.

development-assistance funds to what UNO has been doing. Perhaps one can obtain a more coherent view of UNO by suspending for a moment this way of looking at the problem and by simply saying that UNO is doing what is "just." UNO extends the mantle of the public sector to a stratum of firms that would seem to be as deserving as the rest but that are nevertheless without public-sector protection. In order to do this, it chooses a task and a way of doing the task that are simple enough to give the effort a high probability of working well. UNO also shows the public sector that it is not really so difficult to extend public-sector protection to this kind of firm.

To justify UNO's actions and achievements as being "just"--rather than as socially and economically worthwhile--brings us back to the "good works" theme of UNO and other private voluntary organizations. The economist would have no trouble with this justification, but would say that certain ways of doing good things will buy more justice than other ways. But these better ways may not be available sometimes, or they may be organizationally difficult, or they may represent unrealistic assumptions about the ability of organizations to identify winning firms. The existence of these better ways may not be particularly relevant, then, forcing us to choose second-best solutions. Nevertheless, it is difficult to avoid asking some of these doubting questions at this point in UNO's growth--when it has the strength and stature to improve upon what it does, and is receiving considerably increased funding from the public sector.

The Half-Underground Economy

About half of UNO's clients are clandestine. They do not pay sales, payroll, or business income taxes; they do not observe the labor legislation or municipal codes; and they are not registered with the authorities as businesses. A survey of 500 UNO clients found that 50% did not pay their share of sales taxes, 87% did not pay business income tax, and 93% did not pay payroll taxes. A large minority (38%), however, voluntarily paid social security taxes for themselves as self-employed workers (16% of their earnings), giving them the right to free medical and dental service as well as pensions. Of the same group of firms, 51% were not registered as businesses with the city.[1]

---

[1]UNO 1980:76-80, T.35-39. An UNO staff member noted that many certificates of supposedly registered firms turn out to be expired.

UNO has no record of the number of clients who have legalized during or after their UNO loans, except for a 1977 check of all clandestine firms which obtained loans until then. This check showed that 43% of the client firms had legalized, and another 13% were in the process (UNO 1977:6). A random sample of 112 UNO firms taken in 1979 showed that whereas 25% were legalized before receiving UNO credit (in 1976 or 1977), 51% were legalized after receiving credit.[1] Given UNO's pessimism about the possibility of its clients becoming legal, these findings are better than one would expect.

What are the costs of becoming a registered firm? According to an informal survey now in preparation by an UNO staff member, small firms must pay between U.S.$225 and U.S.$370 (Cr$30,000 to Cr$50,000) to an expediter, plus an additional U.S.$150 (Cr$20,000) in fees, photocopying, and purchases required to bring installations up to code (fire extinguishers, etc.)[2] The up-front costs of legalization, then, are approximately U.S.$450--six monthly minimum wages, which is more than the monthly imputed wage earned by almost any of UNO's firm owners (96% earn less than five times the minimum wage). The various steps necessary for registration are complex and highly bureaucratized, requiring many days of a firm owner's time, even with the help of an expediter. Once the firm is registered, it must start to pay a 17% state value-added tax (ICM); a 10% federal value-added tax on manufacturing (IPI); a 1% federal tax on sales (PIS, which is earmarked for health and education); a 5% municipal tax on services for service firms; a business income tax (35% of net taxable profits); a municipal property tax; and payroll taxes (FGTS, INPS), which, together with other fringe benefits, increase wage costs by 30% to

---

[1]Fuenzalida and Coelho 1980:T.4. This difference is probably overstated because 22 of the 112 firms sampled could not be found and thus were excluded from the post-loan proportion but not from the pre-loan proportion. Also, the increase in legalization may not have been attributable to UNO credit since a matched sample of 91 non-assisted firms, who were analyzed by UNO but did not take credit, showed a similar increase in legalization: 31% legalized in the early period and 51% in the later period. (As in the UNO sample, the results are weakened by the fact that 28 of the 91 firms could not be found for the second observation, and thus were not included in that proportion and were not excluded from the first-observation proportion.)

[2]Exchange rate is Cr$135 to the dollar.

50%.[1] Other recurrent costs involve license-renewal fees and keeping installations and equipment up to code.

Clandestine firms feel that it is cheaper to remain unregistered and to avoid the penalties of being discovered by regularly bribing the police and other official inspectors. Bribery of this nature is so routine that microfirms talk openly about it, joking affectionately about the neighborhood inspector in their pay. An owner of a small shoe manufacturing firm, when asked how many permanent employees he had, responded that "the only permanent employee I have is the policeman at the corner!"

Given the costs of operating legally, and the possibility of avoiding these costs through bribery, why would a small firm ever want to become legal? One reason has already been discussed: clandestine firms are often unable to sell to registered firms because the former cannot supply an official sales receipt. Being clandestine, then, can limit one's market severely. Similarly, firms cannot sell to public agencies without being legal; this represents a substantial impediment in a country like Brazil, where the public sector accounts for more than 50% of domestic investment.[2] Public-sector purchases of goods and services would be particularly high in a place like Recife, a state capital and one of Brazil's large metropolitan centers, which houses the regional development authority for the whole Northeast. Several firms that manufacture furniture referred to their desire to "land" a state agency as their client.

Being clandestine also limits a firm's access to financing. The Brazilian government offers various lines of credit to firms for working capital and investment, many at favorable terms and interest rates. At best, clandestine firm owners can take bank credit only as individuals, as they do from UNO. This particular advantage of being legal is strictly theoretical for many microfirms, even when they are legalized, since

---

[1]The total amount of all these taxes is less than it might seem. Many clandestine firms already pay property taxes, to establish their squatter's rights to their property. On the 17% and 10% value-added taxes (IPM and IPI), one pays only one's contribution to total value, subtracting the tax already paid on previous stages of the production process. With respect to the business income tax, finally, small firms are allowed to pay a flat 35% on 30% of their annual sales.

[2]An UNO attempt to organize female domestics to bid for public-sector contracts failed because of requirements that the group have a legal character.

they cannot meet bank requirements for real guarantees, documentation, and average balances.

Being clandestine imposes significant constraint on a firm's access to financing because of its inability to participate in the widespread system of interfirm financing in Brazil. Short-term promissory notes ("duplicatas") are issued by firms selling to one another, and can be discounted at banks. Much interfirm business is conducted with these notes, which can be issued only by legalized firms.[1] A similar system of interfirm financing, though illegal, has developed among clandestine firms and their customers. Both firms and individuals frequently pay for purchases with postdated checks. (The bank does not recognize the future date, and will cash the check upon presentation, regardless of the date.) The postdated checks can be exchanged for cash before the due date through an informal moneylender ("agiota"). The moneylender, like the bank, discounts the check, though probably at a rate higher than that at which the "duplicata" is discounted, given the illegality of the practice. The use of postdated checks was common among UNO clients, and has also been observed in the informal-sector of other countries.[2] One food-market owner I interviewed proudly displayed various postdated checks he had received from policeman-customers as an indication of the "respectable" clientele to whom he was selling on credit--in contrast to the customers buying on credit from whom one had no more assurance of payment than the amount written down in a notebook ("caderneta").

Though postdated checks are somewhat analogous to the promissory notes exchanged by registered firms, the system is more costly and risky. The receiver of the check runs the risk that the check will bounce. The moneylender who discounts the check must charge for this risk, making the negotiation of the check more costly than in the case of the promissory

[1]The note is not actually an IOU, since it is issued by the selling firm and declares that the seller is owed a certain amount by the buyer. The seller either collects on the note from the purchaser after the time period indicated (30, 60, or 90 days) or discounts the note at the bank, in which case the bank collects later from the seller (when he is paid), or arranges to collect directly from the purchaser.

[2](PISCES 1981:196) notes that postdated checks are "the normal form of payment of supplier credit" in the informal sector of Colombia.

notes.[1] The issuer of the postdated check runs the risk that the recipient (or the moneylender) will cash it before the due date, thus causing the issuer to incur the penalties for issuing bad checks. According to the law, banks must levy a fine on each bounced check and, after two such checks, the issuer's bank account is closed and he cannot open a new account in any bank for two years; he will also have his access barred to personal and bank credit.

The decision to legalize

Clandestine firm owners, and those who were once clandestine, have a clear concept of a "break-even point" for legalization--a level of activity beyond which the costs of being clandestine become greater than the costs of legalization. These firms see legalization as marking a stage of their growth, rather than as an impediment to it. One UNO client who had recently legalized, for example, felt that he had done so "prematurely"--that is, at a level of business that was not great enough to support the costs or reap the benefits. Thus even if an UNO-type program finances the up-front costs of legalization and assists firms through the process, the decision to legalize can be an imprudent one if a firm is not growing and the break-even point has not been reached.

It is for these reasons that UNO, to the surprise of many, does not encourage firms to legalize or offer any assistance to do so; indeed, UNO even discourages some firms that want to legalize, if it judges that they have not reached their break-even point. Though UNO loans can include specified amounts for legalization costs, few of them have done so. "The day that our clandestine firms become legal," UNO says, "they'll go bankrupt!" Given the increased legalization reported by UNO and by Fuenzalida and Coelho at the beginning of this section, these perceptions are surprising.

An UNO-type program, many feel, should assist its clandestine clients to legalize or, at least, should choose clients with the potential for legalizing. If legalization (and graduation to bank credit) does not result from a firm's involvement with UNO, then the firm has gained only temporary access to

---

[1]Though I consistently questioned firms about the discount they paid to moneylenders for postdated checks, the answers varied so widely that I could not estimate the discount rate. I suspect that the wide variation reflects wider transactions and client relationships of which the postdated check is only a part.

credit--only for as long as UNO continues to lend to it.[1] At best, the clandestine clients who do not legalize during the course of their UNO assistance will obtain two or three years of working-capital finance, after which they will have to revert to their previous reliance on the informal financial market.

Legalization is an important issue for other reasons. UNO's survival and recent large expansion are due, in great part, to financial support from the public sector. It may be difficult for the government to give continually increasing support to a program that winks at the evasion of the law. For the state to finance UNO's clandestine clientele, and condone its lack of interest in legalization, is tantamount to saying that the only way to succeed as a microbusiness is to break the law and bribe its representatives. Even though this may be true, it may be politically difficult for the state to openly support such a proposition.[2] For this reason, probably, the companion issues of legalization and graduation were important ones when the Brazilian government was negotiating its large increased contribution to UNO operations under the two World Bank projects. The Bank and the agencies of the Brazilian government, as could be expected, felt that more attention should be paid to facilitating the legalization of UNO clients and their permanent access to formal credit.

UNO's resignation to clandestinity, though perhaps realistic, is somewhat disturbing for another reason. To select for assistance a group of firms that are considered viable only in a clandestine form implies that their main comparative advantage is that of not having to comply with the labor legislation or to pay taxes. The literature on small businesses, however, shows that such firms have a strong comparative advantage in some sectors--based on the technology of the product, the production processes used, and the competitive environment. When such firms succeed, in other words, they have many things going for them other than their escape from the law. If the costs of being legal are overwhelming to a particular firm, then this may be more a sign of that firm's low potential for

---

[1]Between 1977 and 1981, only 25% of firms financed by UNO during the year were on their second loan or more, and only 7% were receiving the third loan or more (UNO 1980:T.III).

[2]This point is also made by a staff member of FIDEM, one of the public agencies that contracts with UNO. "[It] is not easy for the strongly regulated public institutions," she says, "to afford any commitment to clandestine micro-enterprise" (Osório 1981:31).

survival or dynamism than of a condition facing all small firms.

When UNO talks about how legalization would send many of its client firms into bankruptcy, the main troublemaking costs it points to concern labor legislation; observing the minimum wage and paying fringe benefits to employees are said to increase wage costs by 30% to 50%.[1] For UNO to portray such compliance as beyond possibility is to tacitly assume that the viability of microfirms is dependent on their continued exploitation of labor, a position that does not seem fitting for an organization set up to help the working poor. That most firms have an idea of a break-even point after which they can afford to comply with the labor legislation, as discussed above, means that microfirms do not necessarily see themselves as being forever outside the law--at least those that have some hopes for growth.

One obvious way to avoid the problem of condoning labor exploitation would be for UNO to work with firms without employees. This would place UNO largely in the retail and service sector and, to be justifiable on income-transfer or employment grounds, would require lending to a much poorer clientele--the hawkers, the vendors, the marketers, the bicycle-transporters, etc. Various programs have experimented with loans to this poorer stratum, often carried out through borrower groups of 5 to 10 persons (PISCES 1981). But UNO has so far shown little interest in going further down in the income distribution because of its concern for repayment and because of the large change this would require in its way of operating.

The labor practices of clandestine firms

Most discussions of the underground economy emphasize how the firm can protect itself, by being clandestine, from the various costs of belonging to the formal sector. But the labor legislation and the judicial system, it turns out, have a significant effect on how clandestine firms make decisions about their labor--at least those firms that are clients of UNO.

---

[1]Some clandestine firms paying more than the minimum wage will reduce the wage to the minimum when they legalize, so that the increase in labor costs is not the full 30% to 50%. Also, most legal firms have legal and clandestine employees, so that legalization does not result in increased costs for all employees. A survey of all registered Brazilian firms in 1977 showed that 15% of total employees received less than the minimum wage (Calabi and Luque 1981:9, T.3.).

In Brazil, the labor legislation concerning the circumstances under which an employee can be fired applies to all firms, in theory, not just to legalized ones. If an employee feels he is unjustly fired, whether clandestine or not, he has recourse to a labor court to prosecute his complaint; the proceeding is one of the few in Brazil where the complainant does not have to hire a lawyer. In accordance with the legislation, the labor courts determine how much severance and back pay the firm must pay--including pro-rated retroactive pay for unpaid holidays, and 13th salaries, to which full monetary correction is applied. In practice, only a minuscule proportion of fired employees ever prosecutes its case in the court. Many settle immediately for a cash payment that is considerably less than they are entitled to receive. One UNO client, whose firm was registered, explained to me how he negotiated the severance payment of a recently-fired employee; he calculated the amount owing, and then offered approximately 35% of that amount to the employee who, after a little bargaining, settled with him for an amount representing 40% of the total. Dismissed workers accept such meager settlements, rather than going to court, because of ignorance of their rights, need for immediate cash, and, more recently, a change in the labor law that puts the largest single share of the severance amount due (in the case of registered workers) in the hands of the government (FGTS), rather than the employer.[1]

Clandestine firms live in fear of being taken to court by dismissed employees. Such cases, first of all, are almost always decided in favor of the employee. The cost of such a decision can be considerably greater to clandestine as opposed to legal firms, moreover, since the former will have to pay back payroll taxes that the legal firm has been paying all along, as well as additional back taxes and fines for evading

---

[1]As long as the employer officially recognizes the act of firing, the employee automatically receives this particular share of his indemnification from the state. Because of this guaranteed severance payment from the state, which represents past contributions to an unemployment fund made by the employer in the employee's name, an employee wishing to leave a firm will often ask the employer to "fire" him.

other aspects of the law.[1] The employee of the clandestine firm, finally, has no resort to the government severance payment, so if the employer is to settle informally, he will have to bear the whole cost of the severance payment. The rules and costs of belonging to the formal sector, in sum, place a greater burden on the clandestine firms, in this particular case, than on the legal firms themselves. In this case, then, being clandestine does not always allow the small firm to escape costs associated with formal-sector status.

Severance pay is an important institution among the Brazilian working class, as well as an important part of the history of many UNO-assisted firms. Many workers see severance pay as a rare opportunity for them to have enough capital to start a business or make another investment that will improve their income-earning potential. More than half the UNO firm owners I interviewed started their business with "severance capital." A study of microfirms in the state of Pernambuco reported a case of 30 small manufacturing firms in the town of Timbaúba, all of which were created as the result of severance payments to workers by a large-shoe manufacturing firm that had recently closed down (Robalinho 1973:106). Many formal-sector employees plan their choice of employer, the period of time they work at an establishment, and their resignations or "firings" in accordance with plans to start their own businesses. Severance pay, in short, is very much in the minds of workers in Brazil.[2]

Though most unregistered workers receive only a fraction of the severance pay legally owed them, and though the cases prosecuted in the courts represent an insignificant portion of improperly dismissed employees, the mere possibility of employee recourse to the judicial mechanism has a strong impact on the perceptions and decisionmaking of clandestine employers. As reported to me by some clandestine clients of UNO, many clandestine firms try not to keep any employee for more

---

[1]Legal firms also have their problems. They often delay the payment of their payroll taxes as long as they can, which involves a substantial saving when inflation rates are at the 100% levels of the last years in Brazil; if they are taken to court by the dismissed employee, they must pay up immediately on all their payroll taxes. Also, legal firms generally employ a mix of legal and clandestine employees; if they are taken to court by a fired clandestine employee, they will be just as liable as the clandestine firm.

[2]Peattie (n.d.:22) also reports on the importance of severance pay in providing the capital for shoemakers to start their own businesses in Colombia.

than six months, because he starts to have a right to severance pay after three months of work.[1] Firms also reported that they preferred young, unskilled workers to older skilled tradesmen, such as carpenters, welders, or shoemakers. Their reason for the preference, they said, was that the unskilled workers were "more obedient" and less "uppity." But the fact that these firms were fearful of keeping their clandestine employees for more than six months would also have contributed to making skilled employees less desirable.

Partly because of this vulnerability to the labor legislation, clandestine firms had a preference for a high turnover of their labor force, and for unskilled over skilled workers--i.e., for the lower labor-productivity choice. This preference is probably one of the reasons for the high turnover and the youth of the employees of UNO clients; an UNO survey of the 788 employees of 500 UNO clients showed that 62% had worked for the firm less than 1 year, 26% were less than 19 years old, and 50% were less than 29 years old.[2] The "perverse" preference for high turnover, it should be noted, does not apply to legal firms, which have no fear of the fired employee because the severance payment is taken care of by the state, and the conditions under which an employee can be fired are not stringent. As one recently legalized bakery owner said, "it's the employer who fears a firing when you're clandestine, but it's the employee who fears the dismissal when you're legal."[3]

---

[1]The owner of a small foundry operation proudly told how he learned this "technique" from a course on labor legislation he took at a government-sponsored training program for artisans and tradesmen (SENAI).

[2]UNO 1980:112, T.61. The total number of workers at the 500 firms was actually 1,025, but I have excluded 237, or 23%, of the employees because information on time of service was not available.

[3]Brazil's comprehensive land and rural labor legislation has had an analogous "perverse" impact. Though few cases of landowner abuse of tenant farmers have been taken to the courts, landowners have considerable fear of this possibility because of the even-handed way the courts have adjudicated their cases. The fear, as in the case of the clandestine firms, does not impel them to treat their tenants and employees properly, but to avoid hiring labor and letting out their land in ways that make them vulnerable to accusation. Thus, they prefer hiring casual labor to letting out land in tenancy, and they prefer labor-saving activities (like cattle-raising) to labor-using ones (agriculture).

That clandestine firms have a preference for the least skilled labor, of course, can be viewed in a positive light. Such firms provide employment to persons who are otherwise unemployable--adolescents, old and handicapped persons, and family members who would otherwise not gain employment outside the family. With respect to the young, moreover, small firms are considered to provide employment to unskilled workers in positions that allow workers to gain skills and, ultimately, seek better-paid skilled jobs in the formal sector. Jobs created by a program of assistance to microfirms, then, may be truly "additional"--i.e., these jobs are not likely to be filled by workers attracted from other jobs.

That labor turnover is preferred by clandestine employers is a curious twist on the literature, which reports high labor turnover as a complaint of firm owners in the informal sector--because of the time invested in training the new recruit who, as soon as he is trained, is "lured away" to better employment in the formal sector.[1] The UNO case, in contrast, shows that firm owners themselves choose this low-productivity alternative, because of the "perverse" encouragement of high turnover caused among clandestine firms by the labor legislation. Because clandestine employers are so fearful of having long-term employees, a fear which in turn contributes to low labor productivity, service to these firms may not be the best approach to increasing employment.

Conclusion

Given that legalization would "bankrupt" many of UNO's clients, UNO might better approach the problem of legalization costs by trying to get these costs reduced. UNO has indeed made efforts in this direction. It has sent memoranda to Brazil's Minister of Debureaucratization (!), in which UNO has detailed the excessive costs of legalization for microfirms, as well as the extent to which they cannot gain access to government credit and other subsidies even when they are legalized. The Minister, in turn, has made several public statements about efforts to simplify the legislation and to exempt microfirms from some of its taxes. In addition, an UNO staff member (who is also a lawyer) is trying to put together a memo for the Minister and other relevant authorities on the cost of legalization. Whether any changes will occur (the Minister of Debureaucratization is without staff and is not particularly powerful), and whether UNO will have played a significant role, is difficult to say at this time.

---

[1]Or he opens up his own shop, a complaint noted by Peattie (n.d.:8).

Table 1
UNO: Loans, loan value, and expenditures, 1973-1982[a]
(1981 constant U.S.$)

Year	Total costs[b] (U.S.$1,000)	Total loan value (U.S.$1,000)	Number of loans[c]	Average loan value (U.S.$)	Average cost per loan (U.S.$)	Cost as a % of loan value (%)
1973	154.6	127.5	32	3,985	4,830	121.2
1974	254.1	491.2	174	2,823	1,461	51.7
1975	246.1	546.9	212	2,579	1,160	45.0
1976	273.4	259.0	147	1,762	1,861	105.6
1977	225.5	307.8	150	2,052	1,503	73.3
1978	318.9	255.0	138	1,847	2,311	125.1
1979	434.2	331.9	225	1,475	1,930	130.8
1980	545.1	696.3	470	1,481	1,160	78.3
1981	735.5	1,610.7	1,004	1,604	733	45.7
1982[d]	1,216.8	3,165.4	2,070	1,530	587	38.4

Source: Based on data from UNO.

[a]Cruzeiro values were converted to 1981 constant cruzeiros using the general price index, and then converted to dollars at the 1981 average rate of Cr$91.265 to the dollar.

[b]Represents total UNO expenditures per year.

[c]Includes both Recife and Interior programs.

[d]UNO estimate.

Table 2

UNO: Total and repeat loans, Recife and interior programs, 1973-1982

Year	Number of loans			Number of repeat loans[a]			Repeat loans as percentage of total (%)		
	Recife	Interior	Total	Recife	Interior	Total	Recife	Interior	Total
1973	32	-	32	-	-	-	-	-	-
1974	174	-	174	12	-	12	6.9	-	6.9
1975	212	-	212	69	-	69	32.6	-	32.6
1976	147	-	147	43	-	43	29.3	-	29.3
1977	150	-	150	58	-	58	38.7	-	38.7
1978	99	39	138	40	-	40	40.4	-	29.0
1979	170	55	225	46	8	54	27.1	14.6	24.0
1980	309	161	470	97	19	116	31.4	11.8	24.7
1981	387	617	1,004	96	48	144	24.8	7.8	14.3
1982[b]	1,000	1,070	2,070	n.a.	n.a.	270	n.a.	n.a.	13.0
Total through 1981:	1,680	872	2,552	461	81	314	231.2	45.1	199.5

Source: Based on data from UNO.

[a]Repeat loans are to firms with previous UNO loans. The repeat loans are included in total loans.

[b]UNO estimate.

Table 3
Sources of UNO's operating budget, 1973-1982
(current U.S.$1000s)[a]

Year	Foreign donors[b]	Public sector: CEBRAE	Public sector: Ministry of Labor	Public sector: World Bank projects[d]	Public sector: Total	Miscellaneous local institutions[c]	Grand total	Percentage of total (%): Foreign donors	Percentage of total (%): Public sector	Percentage of total (%): Miscellaneous local institutions[d]
1973	50.1	25.3	-	-	25.3	2.0	77.4	64.8	32.7	2.5
1974	60.7	44.2	-	-	44.2	43.4	148.3	40.9	29.8	29.3
1975	68.3	44.3	-	-	44.3	40.0	152.6	44.8	29.0	26.2
1976	87.3	56.4	-	-	56.4	40.0	182.7	47.3	30.9	21.9
1977	42.3	74.8	-	-	74.8	45.0	162.0	26.1	46.2	27.7
1978	6.6	132.4	47.8	-	180.3	62.0	248.9	2.7	72.4	24.9
1979	-	165.4	66.2	89.9	321.5	29.0	350.6	-	91.7	8.3
1980	28.6	170.8	15.2	208.7	394.7	26.4	449.6	6.4	87.8	5.9
1981	37.6	219.1	11.4	402.7	633.2	64.7	735.5	5.1	86.1	8.8
1982	5.8	219.1	-	923.4	1,142.5	68.5	1,216.8	0.5	93.9	5.6

Source: Based on data from UNO.

[a]Cruzeiros were converted to dollars at the respective average exchange rate for each year.

[b]In order of importance: OXFAM, PACT, Catholic Relief Services, Inter-American Foundation, Canadian Embassy, AITEC, Appropriate Technology International, Merrill Trust.

[c]Includes private Brazilian donors.

[d]Includes World-Bank and Brazilian-government counterpart funds.

Table 4
Distribution of monthly earnings and household income of UNO firm owners, as compared to the general population
(Percentages)

	Monthly earnings			Monthly household income	
		Economically active population			
Number of monthly minimum wages[a]	UNO firm owners (1980)[b]	Non-agricultural workers, state of Pernambuco (1980)[c]	Metropolitan Recife (1970)[d]	UNO firm owners (1980)[b]	Urban households central-Northeast Brazil states (1970)[e]
0-1	17.2	44.3	59.2	4.8	47.0
1-2	31.8	27.1	25.0	20.8	25.0
2-5	47.2	18.5	15.8	41.8	27.0
5	3.8	9.2		32.6	
Total	100.0	100.0	100.0	100.0	100.0

[a]The minimum monthly wage from November 1981 to May 1982 was U.S.$73 (Cr$10,200). From 1970 to the present, the wage has increased in the same proportion as the general price index.

[b]Source is a 500-firm survey conducted by UNO (UNO 1980). Earnings are imputed wage to firm owners.

[c]Data not yet available for metropolitan Recife only. The nonagricultural labor force of metropolitan Recife accounts for 61 percent of the state total. Source is FIBGE (1980:vol. I, Book 2, T.52).

[d]Data for 1980 not yet available. Source is Keller (1978, p. 106, T.37).

[e]Data for Recife-only not available. Source is World Bank (1979:Annex C, 80, T.C.2).

Table 5
Sample of UNO food stores[a]: Profits, wages, and inventory as a percentage of monthly sales[b]
(Percentages)

Visit[c]	Imputed monthly wage[d] as percentage of sales		Monthly gross profits[e] as percentage of sales		Inventory[f] as percentage of sales	
	Percentage	Number of cases[g]	Percentage	Number of cases[g]	Percentage	Number of cases[g]
1st	7.5	42	21.7	42	80.5	42
2nd	7.9	42	23.6	41	93.3	42
3rd	8.5	40	25.3	35	94.4	42
4th	10.9	26	26.3	27	89.8	28

Source: Based on UNO loan files; absolute values are in Table 6.

[a]File folders were chosen that showed at least three observations of monthly sales on three separate occasions, making the sample nonrandom. Of the 42 firms, 23 had had two loans from UNO, 12 had three or four loans, and 7 had only one loan.

[b]Average values were calculated by converting all values to 1981 constant cruzeiros, using the monthly general price index of Conjuntura Econômica ("disponibilidade interna"). All the first-visit observations were then averaged, and the same was done for the subsequent three sets of observations. Observations cover a period from 1975-1981, and thus the averages do not represent a particular month or year.

[c]The first visit is always a pre-loan visit during which the data for the loan application are gathered. The three subsequent visits are either for supervision or for preparing subsequent loan proposals.

[d]Wage to the firm owner, as estimated by interviewing him about his monthly household expenses and value of items taken out of the store for family consumption.

[e]Gross profits are retail value of the merchandise sold minus wholesale value.

[f]An estimate of inventory taken at the moment the store is visited, and not averaged over the month.

[g]All percentages were recalculated using only the least number of cases. The trends were essentially the same.

Table 6
Sample of UNO food stores: Average monthly sales, imputed wages, and gross profits
(Constant 1981 U.S. dollars)[a]

	Sales		Gross profits		Imputed wage	
Visit	U.S.$	Number of cases	U.S.$	Number of cases	U.S.$	Number of cases
1st	3,754	42	974	42	228	42
2nd	3,481	42	781	41	236	42
3rd	3,605	42	825	36	209	40
4th	3,086	32	657[b]	27	195	26

Source: Based on UNO loan files.

[a]See Table 5 for explanation of how data were calculated.

[b]In this case, the data calculated with the least number of cases showed considerably less decline, if any at all. The corresponding figures were: 637, 722, 781, and 657. The share of gross profits in total sales, as reported in Table 5, did not change when only the least number of cases were used: it showed an increase from 21 percent to 26%, almost exactly the same as that using the total number of cases.

Table 7
UNO: Loans per field worker per year
in Recife program, 1973-1982

Year	Number of loans	Number of field workers[a]	Loans per field worker
1973	32	2	16
1974	174	5	34
1975	212	8	26
1976	147	12	12
1977	150	12	12
1978	99	13	10
1979	170	19	8
1980	309	18	18
1981	387	16	24
1982[b]	1,000	25	40

Source: Based on data from UNO.

[a]Full-time equivalent. Students work half-time, so that the actual number of student workers per year is double the number in the column.

[b]UNO estimate.

Table 8
UNO: Number of loans, loan proposals, and firms surveyed in Recife and interior program, 1973-1982
(percentages)

Year	As a percentage of firms surveyed: Loan proposals	As a percentage of firms surveyed: Loans	Loan proposals as a percentage of loans
1973	14	9	66
1974	23	16	71
1975	29	17	59
1976	24	12	51
1977	28	30[a]	106
1978	32	16	50
1979	24	13	52
1980	30	33	107
1981	45	48	97
1982[b]	-	-	90

Source: Based on data from UNO.

[a]The number of firms surveyed in this year was 33% less than in previous years.

[b]UNO estimate.

Table 9
Dollar-cruzeiro exchange rates, 1973-1981
(Brazilian cruzeiros per U.S. dollar)

Year	Average exchange rate
1973	6.126
1974	6.790
1975	8.126
1976	10.670
1977	14.138
1978	18.063
1979	26.870
1980	52.699
1981	91.265
1981 (December)	125.040
1982 (April)	165.000

References

Adams, Dale W., and Alfredo Antonio Pablo Romero (1981). "Group Lending to the Rural Poor in the Dominican Republic: A Stunted Innovation." Canadian Journal of Agricultural Economics 29 (July):217-224.

Akerlof, George (1970). "The Market for 'Lemons': Quality Uncertainty and the Market Mechanism." Quarterly Journal of Economics 84:488-500.

Anderson, Dennis (1981). "Small Industry in Developing Countries: A Discussion of Issues." Queen Elizabeth House, Oxford, September. A revised version of this report has been published as Small Industry in Developing Countries: Some Issues. World Bank Staff Working Paper No. 518. Washington, D.C., 1982.

Anderson, Dennis, and Farida Khambata (1981). Small Enterprises and Development Policy in the Philippines: A Case Study. World Bank Staff Working Paper No. 468. Washington, D.C., July.

________________ (1982). Financing Small-scale Industry and Agriculture in Developing Countries: The Merits and Limitations of "Commercial" Policies. World Bank Staff Working Paper No. 519. Washington, D.C.

Anderson, Dennis, and Mark W. Leiserson (1980). "Rural Non-farm Employment in Development Countries." Economic Development and Cultural Change 28 (January):227-248.

ATI (Appropriate Technology International) (1982). "Micro-enterprise Development in the Urban Informal Sector: Case Studies from Brazil and the Philippines." By Marshall Bear, Henry Jackelen, and Michael Tiller. Washington, D.C. This report contains a case study of UNO's interior program, but because it was released after completion of my report, I was not able to refer to its findings, some of which are similar to my own.

Bottomley, Anthony (1975). "Interest Rate Determination in Under-developed Rural Areas." American Journal of Agricultural Economics (May):279-291.

Calabi, Andrea Sandro, and Carlos Antonio Luque (1981). "Observações sôbre o padrão de emprêgo e remuneração nos estabelecimentos brasileiros." Preliminary notes for a discussion at a seminar on employment policy of the Ministry of Labor. May 26-28.

Cavalcanti, Clóvis (1978). Viabilidade do setor informal: a demanda de pequenos serviços no grande Recife. Série Estudos e Pesquisas, 11. Instituto Joaquim Nabuco de Pesquisas Sociais. Recife.

Cavalcanti, Clóvis (1981). "Employment, Production and Income Distribution in the Informal Urban Sector of the Northeast: The Case of Salvador, Bahia." Luso-Brazilian Review XVIII:139-154.

Cavalcanti, Clóvis, and Renato Duarte (1980a). À procura de espaço na economia urbana: o setor informal de Fortaleza. Série População e Emprêgo, vol. 1, 10 (SUDENE); Série Estudos e Pesquisas, vol. 1, 17, (FUNDAJ). Recife, Brasília (Ministério de Trabalho).

__________ (1980b). O setor informal de Salvador: dimensões, natureza, significação. SUDENE/FUNDAJ. Recife, Brasília (Ministério de Trabalho).

Chuta, Enyinna, and Carl Liedholm (1979). "Rural Non-farm Employment: A Review of the State of the Art." MSU Rural Development Paper No. 4. Department of Agricultural Economics, Michigan State University. East Lansing.

Coelho, Lielson Antonio de Almeida, and Luis Arturo Fuenzalida (1980). "An Appraisal of UNO Programs in Bahia and Recife: Preliminary Results." Master Program in Economics, Universidade Federal da Bahia. Salvador, May.

DAI (Development Alternatives, Inc.) (1979). The Development Impact of Private Voluntary Organizations: Kenya and Niger. By Barclay, A. H., Jr., Marilyn W. Hoskins, Wamburi K. Njenga, and Robert B. Tripp. Washington, D.C., February.

DGAP (Development Group for Alternative Policies) (1978). "Identification and Assessment of Local Institutions and Mechanisms Appropriate for the Implementation of World Bank Supported Employment-Generating Programs: Brazil and Cameroon. Part 1: Brazil." Washington, D.C., July.

Farbman, Michael, ed. (1981). The PISCES Studies: Assisting the Smallest Economic Activities of the Urban Poor. Office of Urban Development, Agency for International Development. Washington, D.C., September.

Faruqee, Rashid, and Ethna Johnson (1982). Health, Nutrition and Family Planning in India: A Survey of Experiments and Special Projects. World Bank Staff Working Paper No. 507. Washington, D.C., February.

FIBGE (Fundação Instituto Brasileiro de Geografia e Estatística) (1980). Tabulações avançadas do censo demográfico, IX recenseamento geral do Brasil. Rio de Janeiro.

FIDEM (Fundação de Desenvolvimento da Região Metropolitana do Recife) (1980). Sinópse de dados estatísticos, Região Metropolitana do Recife. Recife.

______________ (1981). "Região Metropolitana do Recife: pesquisa sôbre microunidades de produção na RMR." Relatório Técnica Parcial No. 2. Recife, February.

Fraser, Peter H. (1982). "Impact Evaluation: IIDI/IDH Honduras." 25 May.

Fuenzalida, Luis Arturo (1980). "Criação de emprêgo e renda, setor informal e apoio as microemprêsas." Revista Econômica do Nordeste (Fortaleza, Brazil) 11 (October/December):657-684.

Fuenzalida, Luis Arturo, and Lielson Antônio de Almeida Coelho (1980). "Renda, emprêgo, trabalhadores de baixa produtividade e microemprêsas: análise custo-benefício." Universidade Federal da Bahia. Salvador, December.

Goldmark, Susan, Timothy Mooney, and Jay Rosengard (1982). "An Evaluation of the Partnership for Productivity Project in Upper Volta." Development Alternatives, Inc. Washington, D.C.

Harper, Malcolm (1975a). "Appropriate Consultancy for Small Business." Appropriate Technology 2 (May):22-23.

______________ (1975b). "The Employment of Finance in Small Business." Journal of Development Studies 11 (July):366-75.

Johnson, Douglas (1979). "Urban Impact Analysis of the Small Business Administration 7(a) and Economic Opportunity Loan Programs." M.I.T. Urban and Community Impacts Series Paper #7. Cambridge, Massachusetts, 15 October.

Kelly, Maria do Socorro de Barros (1978). Força de trabalho e emprêgo no nordeste: 1968-1972. Série População e Emprêgo, 4. Recife: SUDENE.

Kilby, Peter (1979). "Evaluating Technical Assistance." World Development 7:309-323.

Kilby, Peter (1981). "Small Scale Industry in Kenya." Studies in Employment and Rural Development No. 69. Washington, D.C., August.

Kilby, Peter, and Paul Bangasser, Jr. (1978). "Assessing Technical Co-operation: The Case of Rural Industry." International Labour Review 117 (May/June):309-352.

Kilby, Peter, Carl Liedholm, and Richard L. Meyer (1981). "Working Capital, Rural Nonfarm Firms and Rural Financial Markets." Discussion Paper No. 5, Colloquium on Rural Finance, 1-3 September 1981, Economic Development Institute of the World Bank. Washington, D.C.

Kramer, Ralph M (1981). Voluntary Agencies in the Welfare State. Berkeley: University of California Press.

Lissner, Jørgen (1977). The Politics of Altruism: A Study of the Political Behaviour of Voluntary Development Agencies. Department of Studies, Lutheran World Federation. Geneva.

Machado da Silva, Luís Antônio (1979). "Notas sôbre os pequenos estabelecimentos comerciais." In Mudança social no nordeste: a reprodução da subordinação, pp. 179-194. Edited by Jose Sérgio Lêite Lopes. Rio de Janeiro: Paz e Terra.

Marris, Peter, and Anthony Somerset (1971). African Businessmen. London: Routledge and Kegan Paul.

May, Judith V. (1981). "Leveraging Performance of Federal Economic Development Programs." Legislative and Urban Policy Staff, Office of Community Planning and Development, U.S. Department of Housing and Urban Development. Washington, D.C., May 4.

Mazumdar, Dipak (1976). "The Urban Informal Sector." World Development 4 (August):655-679.

Meller, Patricio, and Manuel Marfán (1981). "Small and Large Industry: Employment Generation, Linkage and Key Sectors." Economic Development and Cultural Change 29 (January):263-274.

Merrick, Thomas W. (1976). "Employment and Earnings in the Informal Sector in Brazil: The Case of Belo Horizonte." The Journal of the Developing Areas 10 (April):337-353.

Meyer, Richard L. (1979). "Financing Rural Non-farm Enterprises in Low Income Countries." Financing Agriculture (July-September):5-10.

Osório, Ana Maria Tinoco (1981). "An Evaluation of a Project for Generating Employment in the Informal Sector of the Metropolitan Area of Recife, Brazil." Development Planning Unit, Bartlett School of Architecture and Planning, University College. London, England, June.

Peattie, Lisa R. (1980). "Anthropological Perspectives on the Concepts of Dualism, the Informal Sector, and Marginality in Developing Urban Economies." International Regional Science Review 5:1-31.

____________________ (n.d.). "There's No Business Like Shoe Business: Notes from Bogota."

Pfefferman, Guy, and Richard Webb (1979). The Distribution of Income in Brazil. World Bank Staff Working Paper No. 356. Washington, D.C., September.

PISCES (1981). See Farbman (1981).

Rattner, Henrique (1978). Pequena e média emprêsa no Brasil. São Paulo: Editora Símbolo.

Robalinho de Barros, Federico José, and Rui Lýrio Modenesi (1973). Pequenas e médias indústrias: análise dos problemas, incentivos e sua contribuição ao desenvolvimento. Relatório de Pesquisa No. 17. Rio de Janeiro: IPEA/INPES.

Sawyer, Susan M. (1981). "Assisting the Smallest Economic Activities of the Urban Poor: A Case Study of the Solidarity Group Program Implemented by the Fundacion Dominicana del Desarrollo in Santo Domingo, Dominican Republic." Centro de Estudios Educativos, A.C. Mexico.

Schmitz, Hubert (1979). "Factory and Domestic Employment in Brazil: A Study of the Hammock Industry and its Implications for Employment Theory and Policy." Discussion Paper No. 146. Institute of Development Studies, University of Sussex. Brighton, England, November.

____________________ (1982). Manufacturing in the Backyard: Case Studies of Accumulation and Employment in Small-Scale Brazilian Industry. London and New Jersey: Frances Pinter and Allenheld, Osmun.

Schreiber, José Gentil (1975). "Análise de custo benefício do Programa UNO." Recife.

Souza, Paulo Renato (1978). "Informe de la misión de asesoría cumplida por el consultor Señor Paulo Renato Souza, programador empleo, ante el CONDEPE, Estado de Pernambuco, Brasil." ILPES. Santiago, Chile, 1 September.

____________________ (1980). Emprêgo, sálarios e pobreza. Economia e planejamento: Série teses e pesquisas. Fundação de Desenvolvimento da UNICAMP. São Paulo: HUCITEC.

Squire, Lyn (1981). Employment Policy in Developing Countries: A Survey of Issues and Evidence. A World Bank Research Publication. New York: Oxford University Press.

SUDENE (Superintendência do Desenvolvimento do Nordeste) (1977). Estratos ocupacionais de baixa renda. Vol. II: Relatório de pesquisa de campo. Recife.

Teixeira, Amélia Rosa (1979). "Notas sôbre a carteira de trabalho e a cobertura previdenciária." In Mudança social no nordeste: a reprodução da subordinação, pp. 210-226. Edited by José Sérgio Leite Lopes. Rio de Janeiro: Paz e Terra.

Tendler, Judith (1976). Inter-country Evaluation of Small Farmer Organizations--Ecuador, Honduras. Program Evaluation Study. For the Office of Development Programs of the Latin America Bureau of the U.S. Agency for International Development. Washington, D.C., November.

____________________ (1982a). Turning Private Voluntary Organizations into Development Agencies. AID Program Evaluation Discussion Paper No. 12. Washington, D.C., April.

____________________ (1982b). Rural Projects Through Urban Eyes: An Interpretation of the World Bank's New-Style Integrated Rural Development Projects. World Bank Staff Working Paper. Washington, D.C., forthcoming.

Timberg, T. A., and V. S. Raghavan (1982). "Notes on Financing Small-scale Enterprises." In Aspects of Development Bank Management, pp. 162-180. Edited by William Diamond and V. S. Raghavan. Published for the Economic Development Institute of the World Bank. Baltimore: Johns Hopkins University Press.

Tokman, Victor E. (1978a). "An Exploration into the Nature of Informal-Sector Relationships." World Development 6 (September-October):1065-1075.

____________________ (1978a). "Competition between the Informal and Formal Sectors in Retailing: The Case of Santiago." World Development 6 (September-October):1187-1198.

Tolosa, Hamilton C. (1978). "Causes of Urban Poverty in Brazil." World Development, 6, (September-October):1087-1101.

____________________ (1976). "Subutilização e mobilidade da mao-de-obra urbana." In Política de desenvolvimento urbano: aspectos metropolitanos e locais, Monograph No. 22. Edited by Josef Barat. Rio de Janeiro: IPEA/INPES.

Tyler, William G. (n.d.). "The Development and Financing of Small-scale Industry in Brazil." Pp. 141-177. A similar version of this article is published in William G. Tyler, The Brazilian Industrial Economy. Lexington, Mass.: D.C. Heath, pp. 79-108.

UNO (União Nordestina de Assistência a Pequenas Organizações) (1977). Relatório Anual (1977). Recife.

_______________ (1978). Relatório Anual (Exercício de 1978). Recife.

_______________ (1979). Relatório Anual (Exercício de 1979). Recife, December.

_______________ (1980). "Caracterização da microemprêsa e do microempresário do Recife." Recife, August.

_______________ (1980-1981). "Pesquisa de observação e avaliação--relatórios." Recife. These are seven interview summaries for an evaluation that was never completed. The summaries were unnumbered, so I numbered them consecutively in the following order of the interviewers' names: Murilo, Souza Correia, Meneses Silva, Cruz Gouvea Neto, Miranda Pereira, Acioli, Santoro.)

_______________ (1981). Relatório Anual (Exercício de 1980). Recife, August.

_______________ (1981a). "Projeto: extensão do programa de apoio ao microempresário para a Região Metropolitana do Recife." Recife, December.

Watanabe, Susumu (1971). "Subcontracting, Industrialisation and Employment Creation." International Labour Review 104 (July-August):51-76.

WB. See World Bank.

Wilson, Middleton (1981). "Some Problems in Operating a Loan Program for Craft and Emerging Small-scale Non-farm Enterprises in Jamaica." Working Paper No. 15, MSU Rural Development Series. Department of Agricultural Economics, Michigan State University. East Lansing.

World Bank (1978). Employment and Development of Small Enterprises. Sector Policy Paper. Washington, D.C., February.

_______________ (1979). Brazil: Human Resources Special Report. A World Bank Country Study. Washington, D.C.

_______________ (1981/82). Research News, 3, (Winter):24-25.

APPENDIX A

COMMENTS OF JEFFREY ASHE OF AITEC ON THE DRAFT REPORT

(retyped from original memorandum)

ACCION INTERNATIONAL/**AITEC**

TO: Thomas McKay, Austin Hymen, George Beloz, Judith Tendler

FROM: Jeffrey Ashe, Senior Associate Director

DATE: July 7, 1982

As you may know, I studied Judith Tendler's report in detail and spent a delightful day speaking with Judith and George [illegible] 29. In general, the report is excellent and wi[illegible] benefit to the AITEC staff. The many points [illegible] t I don't discuss here I am in general agreement with. There are several points, however, that were not considered in the analysis. Judith will incorporate many of the observations I made into her final version of the report, but I would like to sum up my points here:

A. HIGH COST AND LOW PRODUCTIVITY

1. It is not accurate to charge all project costs to the costs of packaging loans and monitoring them--i.e., taking the entire budget and dividing this by the number of loans granted. There are other costs--for training, research and evaluation, educating other institutions, scrambling for next year's budget, and simply making costly errors and learning from them--that do not relate in their entirety to loan packaging and monitoring.

   A more accurate measure of productivity requires a more detailed analysis of the UNO/Recife budget.

2. It is also unfair to consider as a cost of project administration what is really a problem of the <u>low productivity of the banks UNO works with</u>. Up until 1981 about 1-3 of the loans prepared by UNO were never granted because of bank delays and red tape. Productivity would increase by at least 1-3 if those costs were considered.

A related problem that increases costs is the extensive documentation required by banks. Once again, this does not reflect so much on the "UNO model" as on the bureaucratic requirements of the banks UNO is working with.

3. It is also likely that part of the problem of "high cost and low productivity" is not the "model," but the low volume of loans granted in the program before 1981. According to the 1982 projections, total costs will be reduced to approximately 28% of the value of the loans granted. This figure is much more consistent with the costs of the AITEC-assisted programs in Bogota with the Fundacion Compartir and in Santo Domingo with the Fundacion Dominicana de Desarrollo. In both projects administrative costs are running about 25% of the value of the loans granted to reach a similar clientele. Both the Cali and the Santo Domingo programs provide considerably more technical assistance than the Recife project, so potentially the costs for the Recife project could be less than the 28% indicated in the 1982 projections.

4. Productivity has increased dramatically in 1981, not only due to increased loan volumes, but to cutting down the steps required in loan packaging from 4 steps to 1. Fine-tuning the model resulted in a great increase in productivity. It also indicates that the UNO staff is not totally unconcerned about project costs.

To sum up, if only those parts of the budget attributable to loan packaging and monitoring, and perhaps technical assistance, were charged to loan administration, if bank inefficiencies were accounted for, and if the enormous increase in productivity due to the increasing loan volume and cutting down the steps required for packaging loans were emphasized, it is likely that administrative costs would be closer to 20% than 50%. At 20%, or even 30%, UNO becomes a "model" that deserves serious consideration by other public and private institutions.

Finally, the UNO project is compared to a theoretical public-sector project that could deliver credit at a 20% administrative cost. In Brazil, the public sector institutions for small and micro businesses:

(1) do not reach the UNO level of beneficiary
(2) even when they do reach larger businesses are much less productive than UNO
(3) are subject to more political pressure.

Also, typically, public sector projects have a higher default rate than the UNO project, an additional cost which should also be considered. If reaching micro businesses is a worthwhile goal, experiments such as UNO may be necessary to help show the public (and private) sector a way to reach them more effectively.

B. IMPACT

The discussion of the cost-effectiveness of the Recife project and ACCION/AITEC's efforts to make the model more effective in other countries are academic if these projects do not:

(1) create new jobs
(2) increase income
(3) increase business survivability.

This part of the report underestimated the impact of the program.

No reference is made to the data on employment generation presented by the program since its origins in 1972, which indicates that one new job is created for roughly every $1,000 loaned to these businesses. These records have been kept quite conscientiously since the beginning of the project.

Even if the new jobs created last only a year, that impact on income for very poor people is not insubstantial. If employees make $5 a day ($1,250 a year), more new income for very poor people will be generated through new salaries than the value of the loans themselves.

Actually the record for job generation may be better. A study done on the 200 loan recipients of the AITEC-assisted Cali Caravajal project since 1977 shows an average increase in new jobs of 3 per business. A substantial proportion of these businesses have kept this high number of employees for from 3-5 years. Only in 8 businesses did the number of employees drop. Of the money loaned in the Caravajal project, 85% was for working capital, countering the argument that the impact of working capital loans is necessarily short-term.

Similar impressive results were demonstrated in the AITEC-assisted Dominican Development Foundation's enterprise program. Here, 184 new jobs have been created over the last year in loans averaging under $2,000 to 63 businesses. In this program, however, long-term employment impact is yet to be demonstrated.

Both the Cali project and the Santo Domingo project work only with manufacturing and service businesses in contrast to the Recife program, where a majority of those assisted are micro commerces. One problem with the report was that an inordinate amount of time was spent looking at small retail stores, where the impact on employment is likely to be the least. Little attention was given to manufacturing and service businesses.

I admit the data presented by the program on income and employment could be better. The report's presentation of the lack of income and employment impact, however, is not substantiated adequately and runs counter to the evidence collected in the UNO program and other similar efforts elsewhere.

Another aspect of the impact of these projects which has been indicated consistently is the increase to the business owner. Figures projected through the end of 1982 in the Fundacion Dominicana de Desarrollo project indicate that through lending $312,000 to 156 business owners there will be a total of $224,000 of new yearly income created for the owners. This is in addition to the $503,000 of yearly income from the 291 jobs that are expected to be created. New income in the first year, then, totaled $815,000. In Cali, the average income of the beneficiaries increased 40%.

C. LEVEL OF BENEFICIARIES

The finding that UNO beneficiaries are by no means the poorest of business owners in Recife is essentially correct. However, her case is overstated for two reasons:

(1) The study of 500 UNO beneficiaries she refers to shows the income level of these businesses <u>after</u> they had received a loan. If the data from Santo Domingo and Cali are correct, the income of these businesses should have increased by somewhere in the vicinity of 40%. To be accurate, the income figures as the businesses entered the program would have to be considered.

(2) The major data on income compared the UNO beneficiaries with the entire state of Pernambuco for non-agricultural laborers. This is like comparing the income levels of Nairobi with the small towns in the hinterland. Often income levels in the major city are considerably higher than in the small towns. A valid comparison would require that the micro business owners be compared with other similar non-agricultural occupations in Recife.

There is no question, however, that these loans are not reaching the poorest urban entrepreneurs. This requires a different methodology such as is being tested in the solidarity group component of the Dominican Republic Foundation's micro enterprise program. The justification for reaching "micro-businesses" is the employment they generate for poor people, the teaching they provide to those who have no access to it and the provision of needed goods and services to the poor community. Often income levels in the major city are considerably higher than in the small towns.

I agree that there are major limitations in the UNO model.

(1) I think these types of programs should manage their own credit funds. Only by handling their own credit funds will they receive enough income from the interest spread to become potentially self-sufficient. The Fundacion Dominicana de Desarrollo project manages its own credit and covers a significant part of its costs by doing so.

(2) These programs should charge a rate of interest that covers costs. I believe that the interest rates should be higher than the market rate to insure that those businesses that are relatively more needy will be beneficiaries of the program.

(3) These programs should eliminate to a large degree free technical assistance. In the Bogota/Compartir program assisted by AITEC, micro businessmen who are interested will pay for their own technical assistance courses.

(4) These programs, after working successfully with credit for 2 or 3 years, should enter into other kinds of services, such as group purchasing of raw materials.

(5) Programs should stress those firms which have the greatest possibility for creating jobs. ACCION's new programs which assist the micro enterprise sector focus entirely on manufacturing and services. Both of these areas have a much greater potential for job creation.

I feel that the kinds of changes now being tested in other ACCION/AITEC assisted efforts will increasingly show the validity of this kind of approach for larger scale replication by public institutions and perhaps, more likely, private institutions.

APPENDIX B

COMMENTS OF DR. MAURÍCIO CAMURÇA, DIRECTOR OF UNO, ON THE SUMMARY AND CONCLUSIONS TO THE EVALUATION

Comments of Dr. Maurício Camurça, Director of UNO, on the Summary & Conclusions to the Evaluation*

...As in the case of any model, the UNO model cannot be analyzed without placing it in the context of Brazilian reality and, particularly, that of the state of Pernambuco. Factors that are considered flaws in the evaluation really turn out to be strengths, when analyzed against this broader background.

UNO's high costs and low productivity must be analyzed in relative rather than absolute terms. In a country in chronic crisis, where great uncertainty surrounds everything that happens, decisions and actions are taken with enormous difficulty. Just look at the sorry state of domestic firms, and of the very institutions responsible for the country's development programs. Budgeted funds that are received only after months of delay result in uncertainties, tensions, and ...osts. Against this background--which time did ... to get to know better--UNO actually does better ...nal average in terms of costs and productivity.

The social and economic justification for choosing the stratum of enterprises we work with is clearly explained in our documents. It seems that you may have misinterpreted UNO's objectives. We have never intended to assist the lowest strata of the informal sector, nor was UNO created for that purpose. Very much to the contrary, our target group is constituted by the highest stratum of the informal sector--the microenterprise. We are interested in reaching the smaller microenterprises--which can be seen clearly by the fact that the enterprises we assist fall well below the ceiling definition of a microenterprise in Brazil.

Urban poverty (absolute and/or almost absolute) is not, and never could be, the object of our concern as an entity assisting microenterprises. In order to analyze how well off

---

*Translated from the Portuguese by Judith Tendler. The comments are contained in a letter from Camurça to Tendler. Some parts of the letter that were unrelated to the evaluation were omitted from the translation--they are indicated by a string of three periods. Camurça's letter was in response to a draft version of the evaluation in English. Unfortunately, AID funds were available for translation to the Portuguese of only the final report, so that UNO did not have the benefits of the complete draft report in Portuguese, and could comment only on its own translation to the Portuguese of the Summary & Conclusions.

small and medium firms [not to the poorer strata of the informal sector].

Many international and national institutions--and even those who have never been concerned with the amelioration of poverty--are pointing to programs of management, financial, and technical support to microenterprises as "evidence" that they are attacking the problem of urban proverty--as if this were the only valid approach to the problem. For this reason, some international entities use the words "microenterprise program" to describe social projects of assistance to the lower strata of the informal sector--i.e., itinerant vendors, independent suppliers of services, and even persons without income, such as rag-collectors, the unemployed, etc. Herein lies the source of the confusion--i.e., the [mistaken] evaluation of a program for microenterprises as if it were supposed to cover the informal sector in its entirety.

UNO's greatest shortcoming--if one wants to identify it as such...--lies in the fact that after ten years of experience in Recife, it still has not been able to work through groups of producers, organized according to type of activity--improving its training programs and offering a variety of approaches toward management assistance, lowering its costs, and raising the number of microenterprises reached. This approach is being used only in the interior program at this point--and only timidly, given its novelty. Unfortunately, you visited only Recife, where UNO has only one of its projects as opposed to the seven in the interior...

A.I.D. EVALUATION PUBLICATIONS

The following reports have been issued in the A.I.D. Evaluation Publication series. Those documents with an identification code (e.g., PN-AAG-585) may be ordered in microfiche and paper copy. Please direct inquiries regarding orders to:

Editor of ARDA, S&T/DIU/DI
Bureau for Science and Technology
Agency for International Development
Washington, D.C. 20523
U.S.A.

CROSS REFERENCE LIST BY SECTOR

AGRICULTURAL RESEARCH

Discussion Paper:
No. 13: AID Experience in Agricultural Research: A Review of Project Evaluations (May 1982) PN-AAJ-611

Impact Evaluations:
No. 2: Kitale Maize: The Limits of Success (May 1980) PN-AAH-723
No. 14: Central America: Small Farmer Cropping Systems (December 1980) PN-AAH-977
No. 27: Korean Agricultural Research: The Integration of Research and Extension (January 1982) PN-AAJ-606
No. 30: Guatemala: Development of ICTA and Its Impact on Agricultural Research and Farm Productivity (February 1982) PN-AAJ-178
No. 33: Food Grain Technology: Agricultural Research in Nepal (May 1982) PN-AAJ-614
No. 34: Agricultural Research in Northeastern Thailand (May 1982) PN-AAJ-615

EDUCATION

Impact Evaluations:
No. 19: U.S. Aid to Education in Nepal: A 20-Year Beginning (May 1981) PN-AAJ-168
No. 23: Northern Nigeria Teacher Educational Project (Sept. 1981) PN-AAJ-176
No. 25: Thailand: Rural NonFormal Education - The Mobile Trade Training Schools (October 1981) PN-AAJ-171
No. 37: Radio Correspondence Education in Kenya (August 1982) PN-AAJ-620
No. 38: A Low-Cost Alternative For Universal Primary Education In The Philippines (September 1982) PN-AAL-001

Special Study:
No. 5: Korean Elementary - Middle School Pilot Project (October 1981) PN-AAJ-169

CROSS REFERENCE LIST BY SECTOR

ENERGY [Rural Electrification]

Discussion Paper:
No. 3: Rural Electrification: Linkages and Justifications (April 1979) PN-AAG-671

Impact Evaluations:
No. 15: The Philippines: Rural Electrification (December 1980) PN-AAH-975
No. 16: Bolivia: Rural Electrification (December 1980) PN-AAH-978
No. 21: Ecuador: Rural Electrification (June 1981) PN-AAH-979
No. 22: The Product is Progress: Rural Electrification in Costa Rica (October 1981) PN-AAJ-175

[Fuelwood]

Special Study:
No. 1: The Socio-Economic Context of Fuelwood Use in Small Rural Communities (August 1980) PN-AAH-747

EVALUATION METHODOLOGY/EVALUATION ISSUES

Manager's Guide to Data Collection (November 1979) PN-AAH-434

Discussion Papers:
No. 8: Assessing the Impact of Development Projects on Women (May 1980) PN-AAH-725
No. 9: The Impact of Irrigation on Development: Issues for a Comprehensive Evaluation Study (October 1980)
No. 10: A Review of Issues in Nutrition Program Evaluation (July 1981) PN-AAJ-174
No. 12: Turning Private Voluntary Organizations Into Development Agencies; Questions for Evaluation (April 1982) PN-AAJ-612

Special Study:
No. 8: Toward A Health Project Evaluation Framework (June 1982) PN-AAJ-619

FOOD AID

Program Evaluation:
No. 6: PL 480 Title II: A Study of the Impact of A Food Assistance Program in the Philippines (August 1982) PN-AAJ-622

CROSS REFERENCE LIST BY SECTOR

FOOD AID (con't)

Discussion Paper

No. 15: Food Aid and Development: The Impact and Effectiveness of Bilateral PL 480 Title I-Type Assistance (December 1982) PN-AAL-003

Impact Evaluations:

No. 8: Morocco: Food Aid and Nutrition Education (August 1980) PN-AAH-851

No. 39: Sri Lanka: The Impact Of PL 480 Title I Food Assistance PN-AAJ-623

HEALTH/NUTRITION

Discussion Papers:

No. 1: Reaching the Rural Poor: Indigenous Health Practitioners Are There Already (March 1979) PN-AAG-685

No. 10: A Review of Issues in Nutrition Program Evaluation (July 1981) PN-AAJ-174

Impact Evaluations:

No. 8: Morrocco: Food Aid and Nutrition Education (August 1980) PN-AAH-851

No. 9: Senegal: The Sine Saloum Rural Health Care Project (October 1980) PN-AAJ-008

No. 36: Korea Health Demonstration Project (July 1982) PN-AAJ-621

Special Studies:

No. 2: Water Supply and Diarrhea: Guatemala Revisited (august 1980) PN-AAJ-007

No. 8: Toward A Health Project Evaluation Framework (June 1982) PN-AAJ-619

INSTITUTION BUILDING

Discussion Paper:

No. 11: Effective Institution Building: a Guide for Project Designers and Project Managers Based on Lessons Learned From the AID Portfolio (March 1982) PN-AAJ-611

INTEGRATED RURAL DEVELOPMENT

Impact Evaluations:

No. 28: Philippines: Bicol Integrated Area Development (January 1982) PN-AAJ-179

No. 43: Egypt: The Egyptian American Rural Improvement Service, A Point Four Project, 1952-63 (April 1983) PN-AAL-011

CROSS REFERENCE LIST BY SECTOR

INTEGRATED RURAL DEVELOPMENT (con't)

Special Study:

No. 7: The Vicos Experiment: A Study Of The Impacts Of The Cornell-Peru Project In A Highland Community (April 1982) PN-AAJ-616

IRRIGATION

Discussion Paper:

No. 9: The Impact of Irrigation on Development: Issues for a Comprehensive Evaluation Study (October 1980)

Impact Evaluations:

No. 4: Philippine Small Scale Irrigation (May 1980) PN-AAH-749

No. 12: Korean Irrigation (December 1980)

No. 29: Sederhana: Indonesia Small-Scale Irrigation (February 1982) PN-AAJ-608

No. 31: Sudan: The Rahad Irrigation Project (March 1982) PN-AAJ-610

No. 35: The On-Farm Water Management Project in Pakistan (June 1982) PN-AAJ-617

No. 42: Bangladesh Small-Scale Irrigation (April 1983) PN-AAL-010

No. 43: Egypt: The Egyptian American Rural Improvement Service, A Point Four Project, 1952-63 (April 1983) PN-AAL-011

LIVESTOCK DEVELOPMENT

Discussion Paper:

No. 6: The Sociology of Pastoralism and African Livestock Development (May 1979) PN-AAG-922

Program Evaluation:

No. 4: The Workshop on Pastoralism and African Livestock Development (June 1980) PN-AAH-238

POPULATION/FAMILY PLANNING

Discussion Paper:

No. 5: Study of Family Planning Program Effectiveness (April 1979) PN-AAG-672

Program Evaluations:

No. 1: Family Planning Program Effectiveness: Report of a Workshop (December 1979)

CROSS REFERENCE LIST BY SECTOR

POPULATION/FAMILY PLANNING (con't)

Program Evaluations:

No. 2: A.I.D.'s Role in Indonesian Family Planning: A Case Study with General Lessons for Foreign Assistance (December 1979) PN-AAH-425

No. 3: Third Evaluation of the Thailand National Family Planning Program (February 1980) PN-AAH-006

PRIVATE SECTOR

Impact Evaluation:

No. 41: Impact Evaluation of Housing Guaranty Programs In Panama (March 1983) PN-AAL-008

Discussion Papers:

No. 14: Private Sector: Ideas and Opportunities: A Review of Basic Concepts and Selected Experience (June 1982) PN-AAJ-618

No. 16: The Private Sector, The Public Sector, And Donor Assistance In Economic Development: An Interpretive Essay (March 1983) PN-AAL-007

Special Studies:

No. 4: The Social Impact of Agribusiness: A Case Study of ALCOSA in Guatemala (July 1981) PN-AAJ-172

No. 6: The Economic Development of Korea: Sui Generis or Generic? (January 1982) PN-AAJ-177

No. 9: Private Sector: Costa Rica (March 1983) PN-AAL-005

No. 10: Private Sector: The Tortoise Walk: Public Policy And Private Activity In The Economic Development of Cameroon (March 1983) PN-AAL-004

No. 11: The Private Sector And The Economic Development Of Malawi (March 1983) PN-AAL-006

No. 12: Ventures In The Informal Sector, And How They Worked Out In Brazil (March 1983) PN-AAL-009

PRIVATE VOLUNTARY ORGANIZATIONS

Discussion Paper:

No. 12: Turning Private Voluntary Organizations Into Development Agencies; Questions for Evaluation (April 1982) PN-AAJ-612

Impact Evaluations:

No. 7: Effectiveness and Impact of the CARE/Sierra Leone Rural Penetration Roads Projects (June 1980) PN-AAH-751

No. 10: Tunisia: CARE Water Projects (October 1980)

CROSS REFERENCE LIST BY SECTOR

PRIVATE VOLUNTARY ORGANIZATIONS (con't)

Impact Evaluations:
No. 24: Peru: CARE OPG Water Health Services Project (October 1981) PN-AAJ-176

Special Study:
No. 12: Ventures In the Informal Sector, And How They Worked Out In Brazil (March 1983) PN-AAL-009

ROADS

Discussion Papers:
No. 2: New Directions Rural Roads (March 1979) PN-AGG-670
No. 7: Socio-Economic and Environmental Impacts of Low-Volume Rural Roads -- A Review of the Literature (Febrauary 1980) PN-AAJ-135

Program Evaluation:
No. 5: Rural Roads Evaluation Summary Report (March 1982) PN-AAJ-607

Impact Evaluations:
No. 1: Colombia: Small Farmer Market Access (December 1979) PN-AAH-768
No. 6: Impact of Rural Roads in Liberia (June 1980) PN-AAH-750
No. 7: Effectiveness and Impact of the CARE/Sierra Leone Rural Penetration Roads Projects (June 1980) PN-AAH-751
No. 11: Jamaica Feeder Roads: An Evaluation (November 1980)
No. 13: Rural Roads in Thailand (December 1980) PN-AAH-970
No. 17: Honduras Rural Roads: Old Directions and New (January 1981) PN-AAH-971
No. 18: Philippines Rural Roads I and II (March 1981) PN-AAH-973
No. 26: Kenya: Rural Roads (January 1982) PN-AAH-972

SMALL-SCALE ENTERPRISE

Impact Evaluation:
No. 40: Assisting Small Business In Francophone Africa -- The Entente Fund African Enterprises Program (December 1982) PN-AAL-002

WATER

Discussion Paper:
No. 4: Policy Directions for Rural Water Supply in Developing Countries (April 1979) PN-AAG-691

CROSS REFERENCE LIST BY SECTOR

WATER (con't)

Program Evaluation:
No. 7: Community Water Supply in Developing Countries: Lessons from Experience (September 1982) PN-AAJ-624

Impact Evaluations:
No. 3: The Potable Water Project in Rural Thailand (May 1980) PN-AAH-850
No. 5: Kenya Rural Water Supply: Program, Progress, Prospects (June 1980) PN-AAH-724
No. 10: Tunisia: CARE Water Projects (October 1980)
No. 20: Korean Potable Water System Project: Lessons from Experience (May 1981) PN-AAJ-170
No. 24: Peru: CARE OPG Water Health Services Poject (October 1981) PN-AAJ-176
No. 32: Panama: Rural Water (May 1982) PN-AAJ-609

Special Studies:
No. 2: Water Supply and Diarrhea: Guatemala Revisited (August 1980) PN-AAH-747
No. 3: Rural Water Projects in Tanzania: Technical, Social, and Administrative Issues (Noember 1980) PN-AAH-974

WOMEN IN DEVELOPMENT

Discussion Paper:
No. 8: Assessing the Impact of Development Projects on Women (May 1980) PN-AAH-725